Ethical Investment Association

6 October 2005

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600
corporations.joint@aph.gov.au

Dear Secretary,

INQUIRY INTO CORPORATE RESPONSIBILITY

The Ethical Investment Association (EIA) is pleased to be able to make this submission to the Inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into Corporate Responsibility.

The EIA is Australia's peak industry body for professionals working in the area of Sustainable Responsible Investment (SRI) and Ethical Investment and also helps individuals and organisations to learn more about how they can become sustainable and responsible investors. At present almost every fund manager, superannuation fund and financial adviser working in the area of SRI is a member of the EIA as well as other professionals working toward similar goals.

The EIA was formed in 1999 to promote the concept and practice of SRI to an increasingly interested general public, to the mainstream investment community, to analysts, superannuation fund trustees, financial advisers, regulators, religious, charitable and other values-based organisations, government and non-government organisations and to the corporate sector.

The EIA Charter is as follows:

1. Business needs to be judged on environmental, social and governance performance, as well as their financial performance.
2. Business needs to continuously strive for improvement in all these areas of performance.
3. We support the growth of the SRI industry and believe it can assist business to improve performance.
4. We believe that SRI portfolios can provide competitive returns for investors within defined risk parameters.
5. We encourage transparency within the investment industry in order to empower investors.

The EIA also supports measures that seek to improve and promote corporate responsibility.

ROLE OF DIRECTORS

The EIA believes that organisational decision-makers should have regard for the interests of stakeholders other than shareholders. In this respect the EIA does not hold a view regarding reform of the *Corporations Act 2001*, but does support a strengthening and expansion of the existing ASX Principles of Good Corporate Governance and Best Practice Recommendations. It is noted that this concept has been recommended to ASIC recently by the federal government and the federal environment minister, Ian Campbell.

In particular, there is an opportunity to introduce stronger reporting and disclosure requirements of ASX listed companies in Principle 7 ("Recognise and manage risk") and Principle 10 ("Recognise the legitimate interests of stakeholders") of the ASX Principles of Good Corporate Governance.

In this respect, there are two pre-existing frameworks which are well placed to be adapted in order to augment the current ASX Guidelines:

1. The Global Reporting Initiative (GRI) which is the global standard for triple bottom-line reporting;
2. The Operating and Financial Review (OFR), a new mandatory disclosure regime introduced this year in the UK.

PROMOTION OF SUSTAINABILITY REPORTING

The EIA believes that organisational decision-makers need to adequately balance the interests of shareholders, internal stakeholders and external stakeholders. This can be done through investors taking an active interest in the companies they own.

Being able to make these decisions requires adequate disclosure. The EIA supports individuals and institutions being able to make investment decisions fully informed of the environmental, social, ethical and governance activities of the organisations they are invested in.

The EIA has strongly supported the requirement in Chapter 7 of the *Corporations Act 2001* (s1013D) that requires certain financial product issuers to disclose their approach to SRI in their Product Disclosure Statement. Such information is crucial for persons interested in making decisions on such criteria. It seems only fitting that listed companies also have obligations on them to similarly disclose to assist investors. Therefore, the EIA strongly supports the promotion of sustainability reporting for listed companies in Australia.

As noted above, in respect of ASX-listed companies, ASX Principles of Good Corporate Governance and Best Practice Recommendations already expect listed companies to "Recognise the legitimate interests of stakeholders" (Principle 10). Through the ASX Corporate Governance Council process, Australia has been able to develop a process through which the wider business and investor community can address concerns of corporate governance reporting, without imposing new or costly regulation. As well, Australia has been in the forefront of fostering sustainability reporting at home and internationally through involvement in the Global Reporting Initiative (GRI).

The EIA also notes that the Commonwealth Government has been promoting sustainability reporting through the Department of Environment and Heritage and more recently has been in dialogue with the ASX Corporate Governance Council on the matter of sustainability reporting for listed companies. The EIA would support further advancement of these initiatives with the intended outcome of widespread availability of sustainability reports by listed companies. In the event that this is done in such a fashion that avoids overly prescriptive legislation, the move toward triple bottom line or sustainability reporting is useful and also consistent within pre-existing initiatives.

IMPROVED DISCLOSURE ON SUSTAINABILITY RISKS, OPPORTUNITIES AND UNCERTAINTIES

The EIA would suggest that the Committee consider the experience in the United Kingdom of the newly legislated Operating and Financial Review (OFR) governed by the UK Accounting Standards Board (ASB). The legislation became mandatory in May 2005 and is described by the ASB as follows: "It is a principles-based standard, which in particular makes clear that the OFR shall reflect the directors' view of the business. The objective is to assist shareholders to assess the strategies adopted and the potential for those strategies to succeed. The information in the OFR will also be useful to a wide range of other users."

The OFR follows seven years of white papers prepared by the Company Law Review Steering Committee under the title "Modernising Company Law". This series of papers included recommendations around director fiduciary duty regarding corporate social responsibility, long-term reporting and disclosure time horizons, and stakeholder considerations.

Importantly, the resulting OFR provides investors with a long-term view of a company's strategic risks, opportunities and uncertainties, "The ASB believes it important that the OFR shall have a forward-looking orientation, identifying those trends and factors relevant to the investors' assessment of the current and future performance of the business and the progress towards the achievement of long-term business objectives."

Particular issues addressed include: <u>non-financial</u> information about the business and its performance relevant to the judgement of past results and future performance; resources, principal risks and uncertainties which may affect the entity's long-term value; environmental matters, including the impact of the business on the environment, on the entity's employees and on social and community issues; significant relationships with stakeholders which are likely to directly or indirectly influence the performance of the business and its value; and the impact of society and communities affected by the entity's activities.

The broad nature of the information supplied in the OFR will be of direct relevance to mainstream financial analysts in gaining a wider and deeper view of the company's true value, in the present and in the future. In particular, the lengthening of the time horizon and the broadening of issues which may affect the performance and value of a company complements the long-term investment time horizon of superannuation investors, an increasingly dominant source of world capital.

The UK OFR addresses two issues of significant importance in the quest to improve corporate environmental, social and governance performance – the ability for analysts to price non-financial or qualitative issues in this area, and the ability of the financial markets to assess corporate performance over the long-term in order to reflect the wishes of a growing number of wholesale and retail superannuation investors.

The EIA supports moves which will strengthen these two objectives as addressed in the OFR reporting structure and believes that these objectives can be incorporated into the current ASX Corporate Governance Guidelines, thereby avoiding costly and onerous changes to the Corporations Act which may provoke push-back from the corporate sector.

CONCLUSION

In conclusion, the EIA's recommendation to the Parliamentary Joint Committee on Corporations and Financial Services would be to either:

1. Incorporate GRI reporting requirements into the ASX Corporate Governance Guidelines;

or

2. Use the UK OFR as a basis from which to draw out elements which pertain to long-term reporting time horizons, the consideration of environmental, social, ethical and governance issues, and the consideration of stakeholders and to incorporate these elements into sections 7 and 10 of the ASX Corporate Governance Guidelines.

If you have any further questions or comments on this submission, please feel free to contact me on 02 8224 0314 or 0412 924 014.

Yours sincerely,

Louise O'Halloran
Executive Director

Ethical Investment Association
ABN 98 824 831 560
Level 2, 60 Castlereagh St, Sydney NSW 2000, Australia
Phone 02 8224 0314   Fax 02 8224 0333   Web www.eia.org.au