



ESG: IS IT JUST GOOD GOVERNANCE?

CPD Legal Studio
Continuing Legal Development

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Introduction and agenda

- ▶ What do we mean by 'Good Governance'?
- ▶ What is ESG?
- ▶ How can ESG be measured?
- ▶ How have ESG principles changed?
- ▶ Where do we go from here?



What do we mean by 'Good Governance?'



*“Shareholders are the corporation's
'true owners'”*

- Adolf Berle, 1932



*“Corporations have no higher purpose than
maximizing profits for their shareholders”*

- Milton Friedman, 1970



Shareholder Value Is No Longer Everything, Top C.E.O.s Say

Did the Business Roundtable Sound the Death Knell for Shareholder Primacy?



“The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large.”

Davos 2020 Manifesto: The Universal Purpose of a Company in the Fourth Industrial Revolution

“Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.”

Business Roundtable Members



Governance at Law



Corporations Act 2001

No. 50, 2001

Chapter 2D—Officers and employees

Part 2D.1—Duties and powers

Division 1 - ss 180-190

**NOTE: SIS – Super trustees act in interests of Beneficiaries – s52A(2)(c);
due care, skill and diligence – s52A(2)(b)**

Common Law Duties

Act with care and diligence

Act in good faith and for proper purpose

Not misuse information or position

Avoid conflicts of interest or duty

Not fetter discretions



What is ESG?

Environmental, Social and Governance

Environmental

E



- Carbon footprint of business, projects and products
- Supply chain
- Product stewardship
- Circular economy
- Climate Change
- Resource Management
- Risk Mitigation

Social

S



- Workplace, health and safety
- Working conditions, including child labour
- Modern Slavery
- Diversity & Inclusion
- Employee and Community Relations
- Human Rights

Governance

G



- Shareholder rights and activism
- Political activism
- Social license and Corporate Social Responsibility (CSR)
- Board diversity and structure
- Executive compensation





E

Environmental

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Environmental

- Managing carbon footprint, including supply chain and product usage (scope 3)
- Aiming to reduce carbon emissions – GHG Protocol, CDP
- Updating internal reporting standards in line with Taskforce for Climate-Related Financial Disclosures standards
- Includes forward-looking metrics and scenario testing business models targeted at maintaining warming below 2°C
- Subscribing to measures adopted by the EU Taxonomy of sustainable activities by designating and reporting the percentage of corporate assets, investments and expenditures towards sustainable finance and the green economy (so financial capital can be deployed to ‘activities’ which aid the transition to a low carbon economy)



Elements of Environmental ESG

Climate Change mitigation and adaptation



Physical

Transition

Liability



Current Trends in Environmental consideration

Why?

Fastest growing ESG Branch

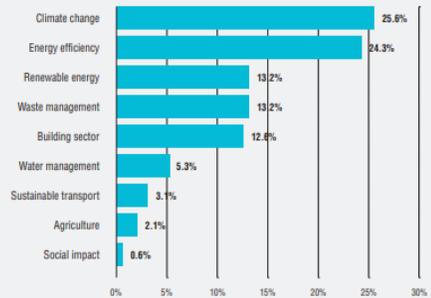
FIGURE 8: Percentage of responsible investment AUM managed on behalf of retail clients



Easier to demonstrate, monetise and achieve commercial results

Emerging public policy focus

FIGURE 19: Sustainability-themed investments by theme (AUM) (2018)



Source: Responsible Investment Benchmark Report 2019 Australia

Sustainable Swell

Assets of sustainable mutual funds and ETFs, 2013-2028

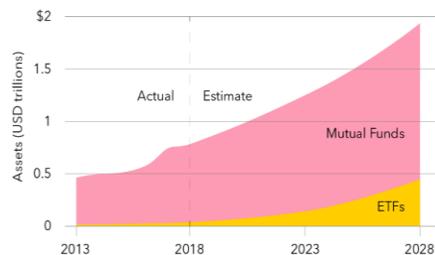


FIGURE 7: Performance of responsible investment and mainstream funds

Australian share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 17 and 34 funds sampled depending on time period)	-1.24%	5.70%	6.43%	12.39%
Morningstar: Australia Fund Equity Large Blend	-5.49%	4.87%	4.42%	7.95%
S&P/ASX 300 Total Return	-3.06%	6.65%	5.60%	8.91%

International share funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (between 7 and 38 funds sampled depending on time period)	-0.03%	11.18%	9.48%	9.50%
Morningstar: Equity World Large Blend	-0.68%	6.37%	8.42%	8.97%
MSCI World Ex Australia NR AUD	1.52%	7.49%	9.81%	9.57%

Multi-sector growth funds	1 Year	3 Years	5 Years	10 Years
Average responsible investment fund (7 funds)	-1.13%	4.75%	5.65%	7.66%
Australia Fund Multisector Growth	-2.26%	4.39%	4.92%	7.02%

Legend: Green = Outperformed by the average RI fund; Red = Underperformed by the average RI fund

Source: Responsible Investment Benchmark Report 2019 Australia



Multitude of existing metrics and investment products



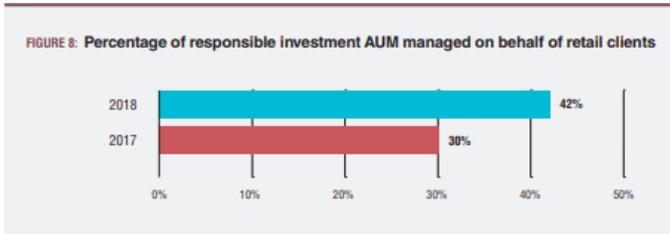
Trucost
ESG Analysis
S&P Global

MSCI ESG METRICS

Opportunities in E

Transition to widespread alignment with the E in ESG

Stakeholder Preferences



Source: Responsible Investment Benchmark Report 2019 Australia

Policy and Regulatory Changes

Norway is walking away from billions of barrels of oil and gas

'Leading the country': South Australia to ban plastic cutlery, straws and stirrers

Technological Development

Startups Target Millennials With Social-Investing Apps

Hedge funds step up ESG efforts through machine learning

Easily Understandable Tracking Metrics

There are a number of ways an individual or corporation can track their environmental impact...

Waste Reduction

CO2 per Unit of Production

Water Usage

Energy Efficiency

Green House Gas Emissions

Carbon Footprint and Emissions Targets



S

Social

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Social

- How a corporation manages its relationships with people
- Maximising Employee health and wellbeing
- Managing Staff and Executive remuneration to decrease inequality gaps
- Paying attention to issues at the heart of social consciousness (stakeholders)
- Managing exposure to high risk geopolitical situations
- Create public value and driving social impact by engaging in Social Impact Investment (such as social impact bonds) as a core business strategy
- Working with and supporting social enterprises during the course of business
- Stakeholder v shareholder primacy
- Social Enterprise business model – creation of ‘public value’ (social impact)
- National frameworks (GDP? Health & Wellbeing – NZ Treasury)



Elements of Social ESG

Developing useful metrics by which positive social engagement can be measured and encouraged

Employee Health and Wellbeing

Driving social impact via adjusting investment strategies and engaging with social enterprises



What does the S in ESG look like?

More like this...

Private Equity Firm TPG Plans to Raise Second Social Impact Fund

'The status quo is unacceptable': Walmart will stop selling some ammunition and exit the handgun market

How corporate Australia is tackling the mental health crisis

...less like this

How did CEO pay get to 500 times the wages of ordinary workers?

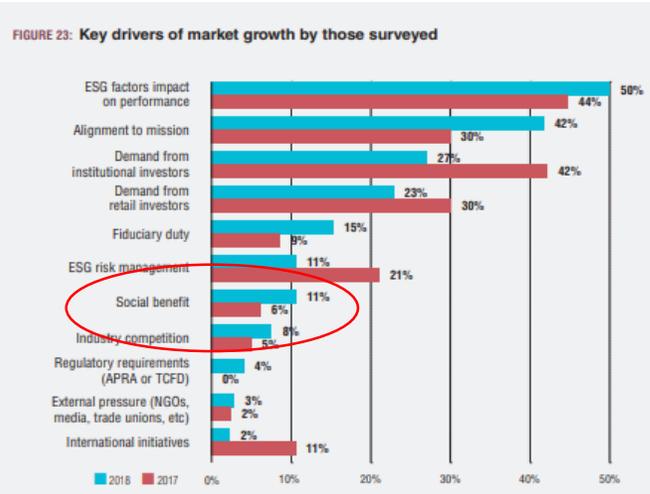
Banking royal commission: Predatory practices, exploitation of Indigenous Australians revealed

Australian CEO bonuses at near record highs despite royal commission

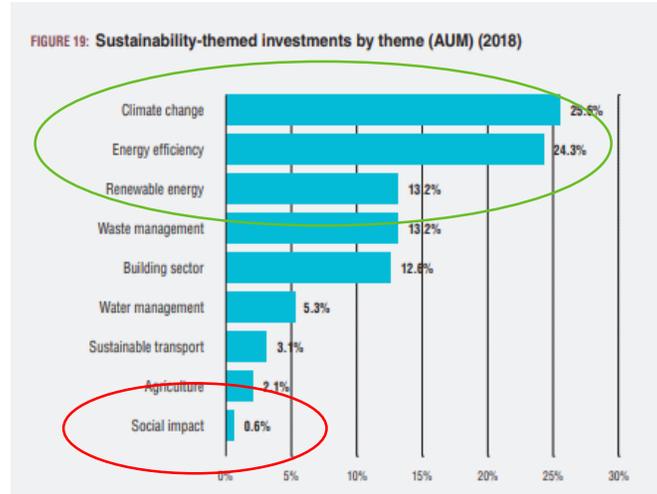
Target reveals \$9 million in staff underpayments in latest wage theft scandal at Wesfarmers

Current Trends in Social

Far slower growth than E



Source: Responsible Investment Benchmark Report 2019 Australia



Source: Responsible Investment Benchmark Report 2019 Australia

Why?

Difficult to measure

Difficult to monetise

Predominant view that governments are welfare providers

S is the next wave

Continued internal and external commercial demand for Social Inclusion

Future Cities concepts and move towards alternatives to modern day living practices

Ongoing growth in focus regarding personal health and wellbeing





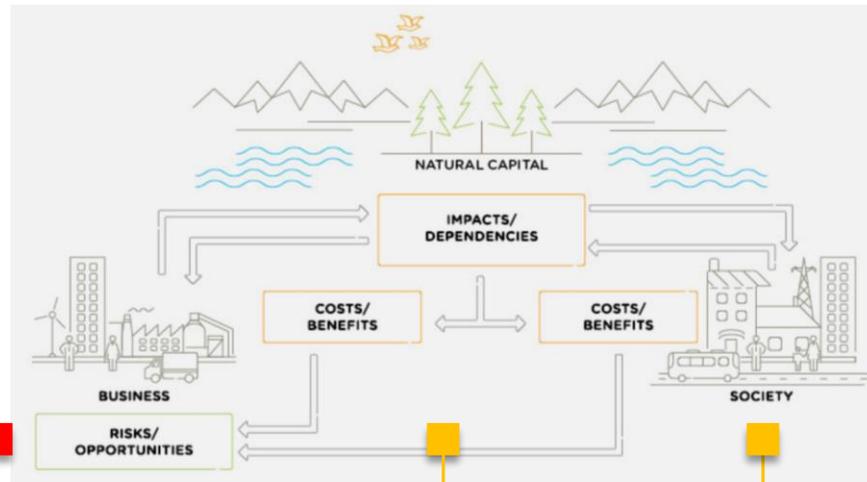
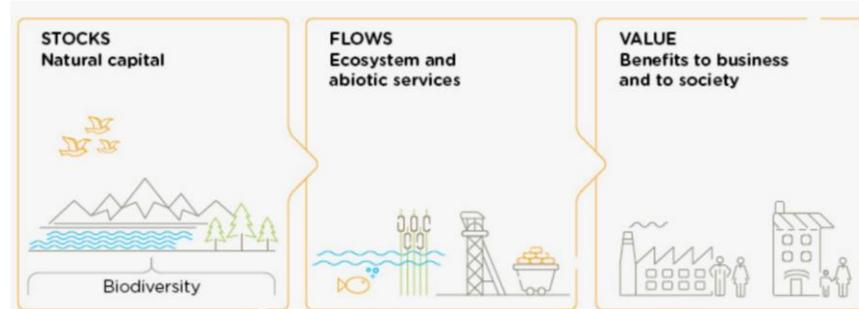
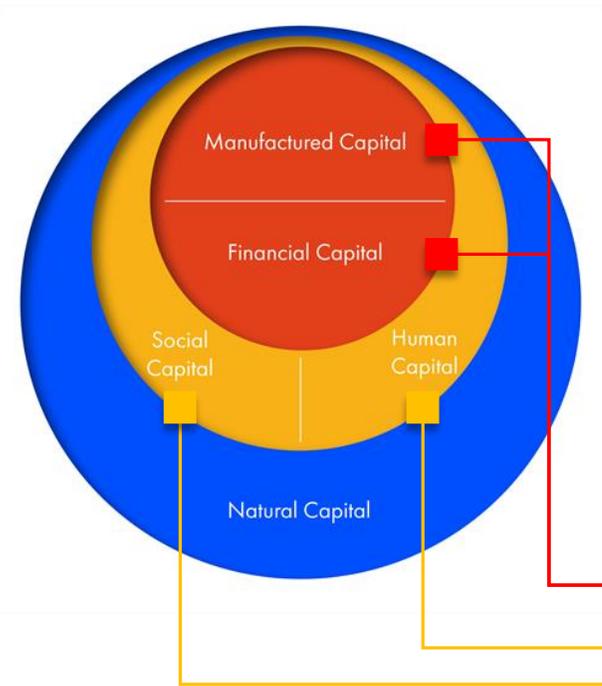
G

Governance

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Corporate Governance



Source: Forum for the Future and the Natural Capital Coalition



Elements of Governance ESG

Abandoning shareholder primacy – governance and stakeholder and supply chain (human capital, people)

Ensuring balance between shareholder return and social responsibility (CSR)

Transparency via adherence to disclosure frameworks



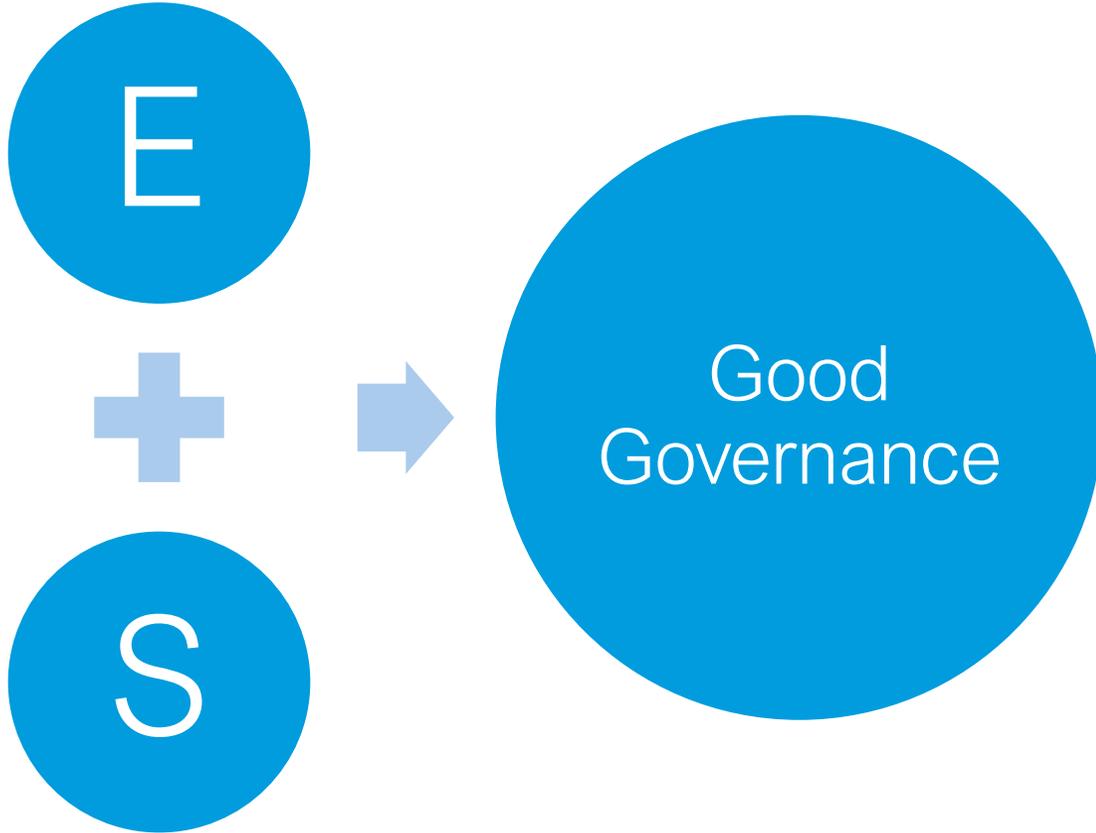
Effective disclosure in an operating and financial review



Modern Slavery Act 2018



$$\underline{E + S = G}$$



- ESG Principles are inherently long-term and holistic
- Recognising ESG factors as examples of prudent governance under the business judgement rule
- Long Term Value Creation via focus on customer centricity, employees and fair returns to financial capital
- Good Governance requires strategic consideration of value chain drivers over short and longer term horizons
- Who is to say that ESG factors are not material to the fiduciary duty to act with due care and diligence?
- Businesses are well served being ahead of the curve as governments move increasingly towards climate and ESG oriented action

Labor commits to net-zero emissions by 2050

The Greens Are Germany's Leading Political Party. Wait, What?





How can we measure ESG?

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Benchmarking ESG

Despite the lack of a standardised body, private actors, independent bodies and government organisations have taken it upon themselves to benchmark ESG

MSCI ESG Reporting Service

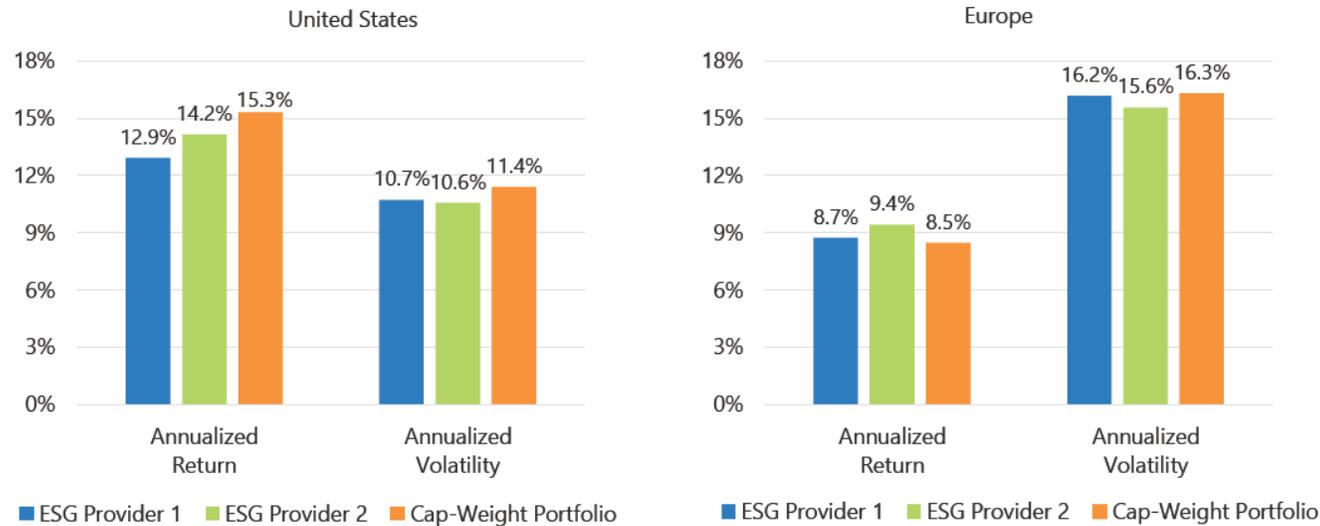


Traditional measures are also useful – Credit Rating Agencies are joining the fray



ESG data and metrics are still an emerging field

Performance of a Simple ESG Portfolio Using Different Ratings Providers, Jul 2010–Jun 2018



Source: Li and Polychronopoulos, *What a difference an ESG Ratings Provider Makes!*, (January 2020, Research Affiliates)

- Market-wide standards yet to be implemented
- Different models and approaches will produce different results
- Quantitative v Qualitative: What's providing the most accurate view?
- Only 20 or so years of data to draw on... as data develops, outcomes will be refined and improved
- Emerging technologies, including Artificial Intelligence and Machine Learning, will speed up the data optimisation process
- EU Taxonomy
- TCFD

Conflicting ESG Ratings Are Confusing Sustainable Investors





“With the impact of sustainability on investment returns increasing, we believe that sustainable investing is the strongest foundation for client portfolios going forward”

Larry Fink, CEO, BlackRock



“The results show that the business case for ESG investing is empirically very well-founded. Roughly 90% of studies find a non-negative ESG-Corporate Financial Performance relation. More importantly, the large majority of studies report positive findings.”

Friede, Busch, Bassen,, 'ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies' *Journal of Sustainable Finance and Investment* (2015)





How have ESG Principles
manifested themselves?

Capital for purpose – Responsible investment

Unilever CEO Alan Jope: 'We'll dispose of brands that don't stand for something'

FIGURE 6 Responsible investment by approach

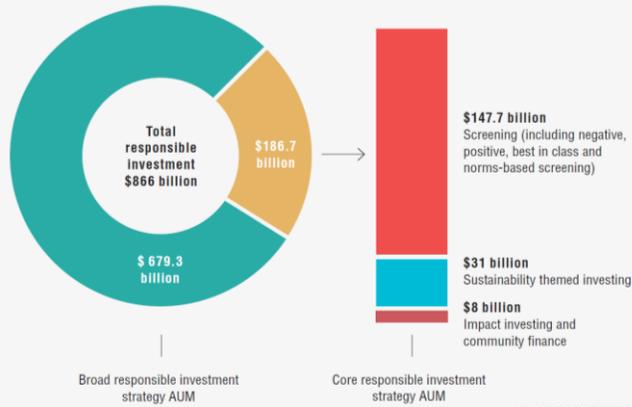


FIGURE 4 RIAA's Responsible and Ethical Investment Spectrum

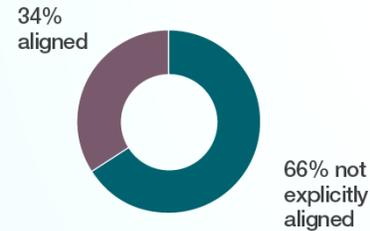
TRADITIONAL INVESTMENT	RESPONSIBLE & ETHICAL INVESTMENT						PHILANTHROPY	
	ESG INTEGRATION (including shareholder engagement & voting)	NEGATIVE SCREENING (\$ norms based)	POSITIVE OR BEST-IN-CLASS SCREENING (\$ norms based)	THEMATIC/ SUSTAINABILITY THEMED INVESTMENTS	IMPACT INVESTING MARKET RATE	CONCESSIONARY RATE		
FOCUS	Limited or no regard for environmental, social and governance factors	Consideration & analysis of environmental, social and governance (ESG) factors as part of investment decision making	Industry sectors or companies excluded/ diverted from to avoid risk or better align with values	Investments that target companies or industries with better ESG performance	Investments that specifically target sustainability themes eg clean energy, green property	Investments that target social and environmental impact and deliver market rate financial returns	Investments that target social and environmental impact and deliver below market rate returns	Grants that target positive social and environmental impact with no financial return
IMPACT INTENTION	Agnostic	Avoids harm	Benefits stakeholders				Contributes to solutions	
FEATURES	Delivers competitive financial returns			Manages ESG risks		Pursues ESG opportunities	Intentionally delivery of impact in central to underlying investment/transaction. Impact of investment is measured & reported	

* This spectrum has been adapted from frameworks developed by Bridges Fund Management, Sison Capital and the Impact Management Project

Source: Responsible Investment Association Australia 2018 report

Sustainable Bonds Insight

The green, social and sustainability bonds aligned with the Sustainable Development Goals amounted to \$70,238.6 M in 2018. 34% of green, social and sustainability issuances explicitly align with the Sustainable Development Goals. The three most covered SDGs are SDG11 (Sustainable cities and communities), SDG7 (Affordable and clean energy) and SDG13 (Climate action).



Methodology: Bonds that have been included in this Infographic are those that have indicated that they contribute to one or more of the Sustainable Development Goals (SDGs) in their framework or external review. The figures represent the combined value of the bonds that align with each SDG. Several bonds have indicated that they align with more than one SDG.

Sustainable Development Goals across the three markets combined



Source: Environmental Finance: Sustainable Bonds Insight 2019



Capital for purpose

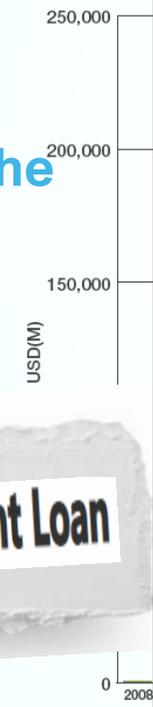
Sustainable finance global / Australian market



Cumulative
social an

The share of
increased s

Green bor



SUSTAINALYTICS | Sustainable Finance Solutions

Sustainability Linked Loan

Sustainable finance and green lending are on the rise as more borrowers and lenders recognize the potential benefits of green and sustainability-linked loan products for their businesses. Loan terms tied to metrics such as Sustainalytics' ESG risk ratings, impact borrowers' overall cost of capital. Lenders can strengthen their position as sustainable finance leaders when they offer ESG loans to companies committed to sustainability.

Sustainability Linked Loan (ESG Linked Loan)

A dynamic product that enables lenders to incentivize improvements in the borrower's sustainability profile by aligning loan terms to the borrower's performance against pre-determined sustainability performance targets.

Sustainability Linked Loan Principles

Developed by the top 3 global syndicated lending industry associations, The **Sustainability Linked Loan Principles** consist of voluntary recommended guidelines providing a framework for sustainability linked loan products.

ESG Rating

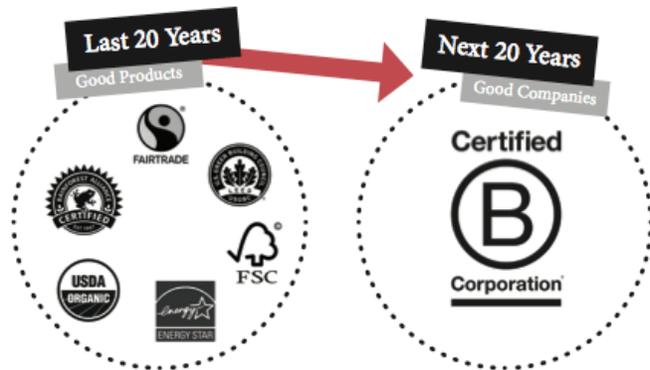
Sustainalytics' ESG Risk Ratings are recommended as a key metric to measure an organizations' sustainability performance. ESG Ratings, when obtained, is a good indicator of whether a company is meeting its sustainability performance targets.



B Corps and Social Enterprise

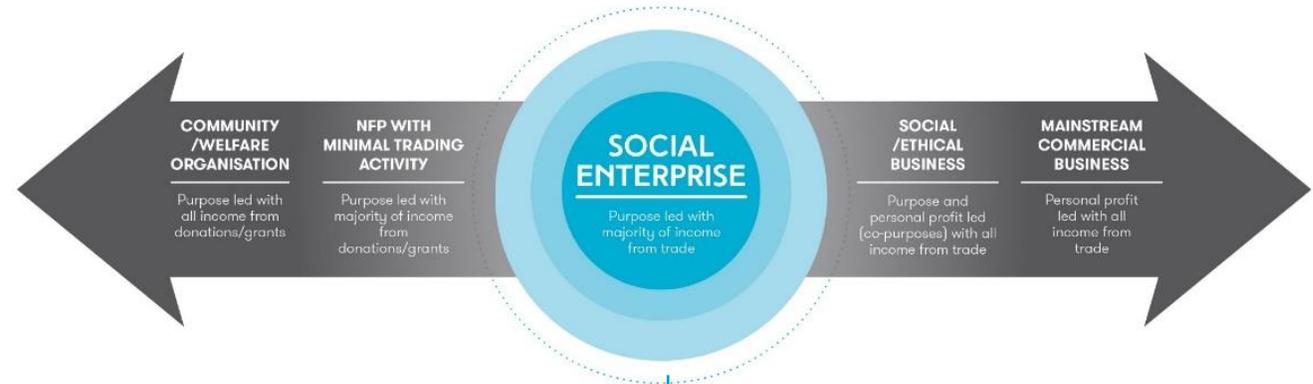
“ B Corp is to business what Fair Trade certification is to coffee or USDA Organic certification is to milk. B Corps are for-profit companies certified by the nonprofit B Lab to meet rigorous standards of social and environmental performance, accountability, and transparency. ”

www.bcorporation.net



THE SPECTRUM

Where Social Enterprise Fits



TWO GOOD CO.



CHARCOAL LANE | A social enterprise of **MISSION AUSTRALIA**



Vanguard
LAUNDRY SERVICES

“Findings continue to indicate that many staff experience physical and mental health improvements, and increased levels of social engagement and financial independence. These effects are particularly apparent in the first 12 months. The changes appear to stabilise after the first year, as staff prepare to transition into the open jobs market with support from our Careers Team.”

Source: Social Traders

Public Institutional Involvement



Source: TriplePundit



ESG – is it just good governance?

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Where do we go from here?

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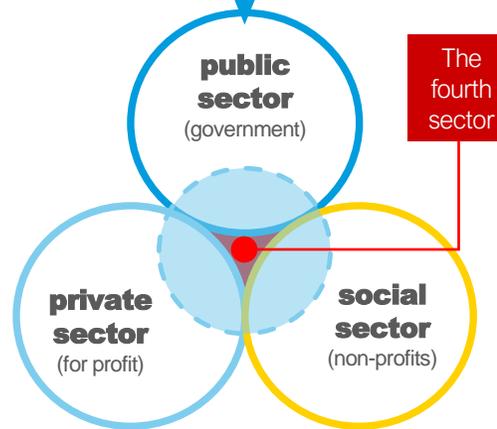
Next Steps...

Australian socio-economic system



SIZE
 Approximately
\$1.25 trillion (2017)

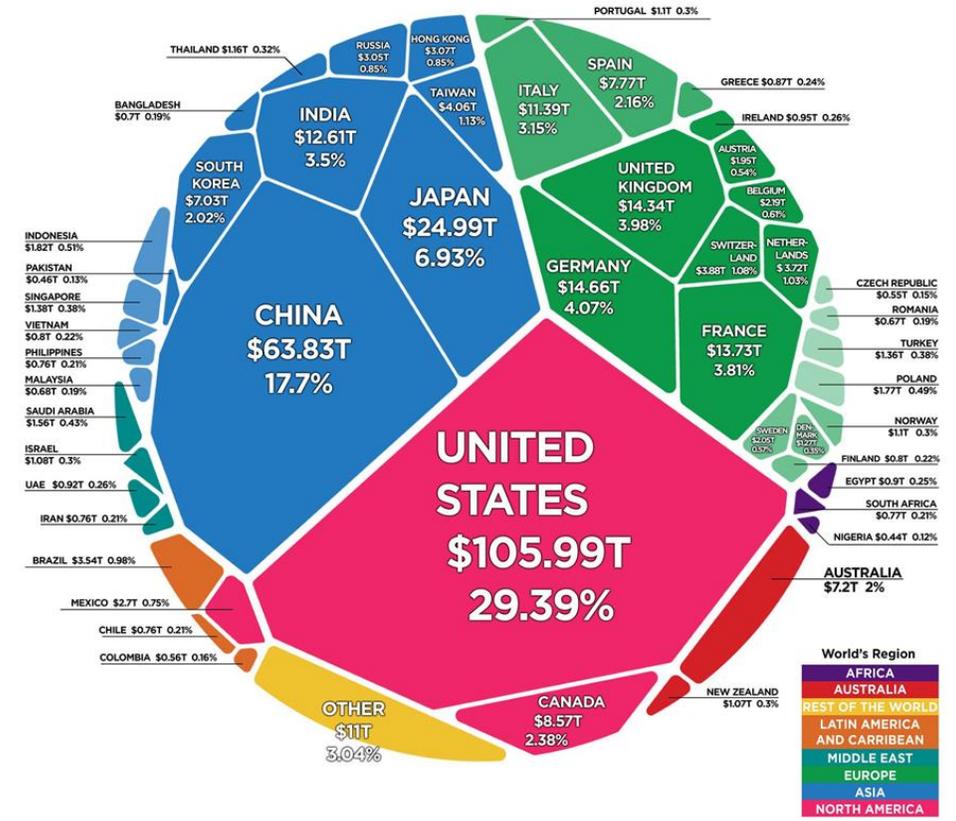
PEOPLE ENGAGED
2,240,000
 Australian Businesses employing
9,400,000 employees



SIZE
GPD
\$142.8 billion
 in annual spend (2016)

PEOPLE ENGAGED
1.3 million employees (2016)
2.3 million volunteers (2016)

The Distribution of the World's Wealth Total Wealth by Country in 2019



'We are on the edge of a fundamental reshaping of finance'





Questions?

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Contact



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Thank you