February 12, 2016

Singapore Exchange Limited
11 North Buona Vista Drive
#06-07, The Metropolis Tower 2
Singapore 138589

(Attention: Ms. Yeo Lian Sim)

Dear Ms. Yeo,

**ACGA's Response to the SGX Consultation Paper on Sustainability Reporting: Comply or Explain ("the Consultation")**

We welcome the opportunity to respond to the Consultation, which we believe marks a significant step forward in Singapore's commitment to sustainability reporting.

The Asian Corporate Governance Association (ACGA) is a not-for-profit association chartered under the laws of Hong Kong. The association is dedicated to assisting companies and markets across Asia in their effort to improve corporate governance practices. In our educational outreach, we are guided by a practical, long-term approach. ACGA's operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as well as listed Asian companies, international accounting firms, business associations and universities. ACGA now has more than 100 organisations as members, two thirds of which are institutional investors with around US$24 trillion in assets under management globally. They are also significant investors in Singapore market.

Before we address the specific consultation questions, we would like to highlight five issues that frame ACGA's response to the Consultation:

## High Level Issues

### Fair Markets Require Material ESG Reporting

We endorse the view that environmental, social, and governance ("ESG") issues are material and that improved transparency is crucial to ensuring that investors can exercise their stewardship obligations and engage in more active price discovery related to ESG performance. As a result, ACGA strongly supports the introduction of clear mandatory obligations to shape the content of listed-company ESG disclosure and associated governance processes. This should provide much-needed structure and coherence to the growing body of ESG disclosure already found in most IPO prospectuses and material ESG event-related disclosures.



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**Board Responsibilities and Leadership**

We welcome the prominent position given to Board responsibility in the new Sustainability Reporting Guide ("the Guide") and believe this is crucial to the implementation of effective ESG management and oversight. Nevertheless, our review of the Guide does not give us full confidence that Boards will be actively engaged in playing a crucial oversight role on the selection and reporting of material ESG issues.

Specifically, we believe the language used in the consultation document (p7) is ambiguous and different in tone to the draft Guide (Practice Note 7.6, Principle 3.1). The former is mechanistic and compliance-oriented as regards the selection of material ESG issues, while the latter makes reference to the Singapore Corporate Governance Code and places more emphasis on the Board providing strategic direction and considering "sustainability issues as part of its strategic formulation". The draft Guide, however, reiterates the Board's approval role and specifically states that "senior management can lead the process".

Boards need to be informed partners with management, providing oversight for the implementation of new and focused ESG disclosure processes. It is our hope, given the much-needed focus on defining key stakeholders and more effective risk metrics, that additional steps could be taken to ensure that Boards add capacity and diligence in this area.

**Process versus Outcomes**

We recognise that the Guide's focus on process is intended to provide listed companies with a consistent structure for the reporting of ESG risks. We have concerns, however, that companies may focus too much on process and lose sight of the purpose of sustainability reporting. They might conclude, for example, that the production of long and expensively designed ESG reports is required, rather than more concise reports with a level of information commensurate with the complexity of the company, specific ESG challenges it faces, and the needs of shareholders and stakeholders.

This is an important distinction. From a corporate governance perspective, the role of a regulator is to ensure listed companies are disclosing relevant and material ESG issues. These disclosures must meet the needs of investors, who increasingly want concise reporting on material of ESG risks rather than voluminous reports containing a great deal of extraneous information.

**The Singapore CG Framework**

As ESG reporting forms part of a larger corporate reporting and governance framework, we recommend that SGX provide listed companies with greater guidance on how the revised Sustainability Reporting Guide and the CG Code will interact. With this in mind, we note also that the effectiveness of SGX's enhanced ESG reporting and disclosure initiatives will rest on coordination between the



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market's traditional governance and regulatory oversight norms. One specific concern is that the proposed amendments to the Listing Rules do not appear to reinforce the importance of including disclosure of material ESG issues on an ongoing basis. While Sustainability Reports are a valued tool, we remain focused on the ability and willingness of Boards to make timely disclosures of material ESG issues just as they would for traditional operating and financial matters. Indeed, the requirements of the two are linked and complementary.

**Question 1: 'Comply or explain' basis**

**Do you support sustainability reporting in the form set out in this consultation paper on a 'comply or explain' basis, giving listed issuers the opportunity to explain their individual practices and reasons for deviating from specified requirements?**

Yes.

We view the proposed comply-or-explain general disclosure obligations as a positive step for market efficiency and transparency. This aligns SGX with its global peers and ensures that the same level of diligence investors, intermediaries, and listed companies bring to other markets will have an appropriate and disciplined context in Singapore. Stewardship-focused investors have often engaged with Singapore-listed companies on issues related to operating practices and ESG. This is not a trend we expect to change. As a result, to prepare the market for the future, we recommend that SGX consider accelerated efforts to develop an outcome-focused roadmap for enhanced reporting norms on the most material operating issues and sustainability targets .

SGX's commitment to progress on ESG disclosure deserves the support of listed companies and diverse stakeholder groups, and we appreciate the need to make the case to the business community about the benefits of building ESG capacity. We have concerns, however, about language in the consultation paper suggesting that comply-or-explain provides "latitude for the reporting issuer to put its best case to investors and other stakeholders". The purpose of ESG reporting is surely to provide focused and useful disclosure on material issues that ultimately, if not managed, represent a material risk to the company. The principle of "accurate and balanced" reporting encouraged in the revised Sustainability Guide sets a helpful standard, but it should not be interpreted as an opportunity for PR, statements of aspiration, or descriptions of policies under development.

**Question 2: Frequency of sustainability reporting**

**Do you agree that the sustainability report should be issued on an annual basis, within 5 months of the end of the issuer's financial year?**



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In the short term, Yes. In the medium term, No.

We believe ESG reporting is integral to any assessment of a company's performance and that the context of ESG reporting is no different to regular annual financial reporting. SGX's goal of providing listed companies flexibility in addressing new obligations for the next phase of ESG reporting obligations has merit as a transitional strategy. Nevertheless, we would urge SGX to establish a clear goal for aligning the timing of ESG and annual reporting, or simply including sustainability reporting in the annual report, as most investors prefer for the following reasons:

- If ESG reports are published after the release of the annual report, there is a risk the annual report will lose relevance or, worse still, mislead. This is particularly true when material ESG factors have a direct financial impact.
- ESG/sustainability reports published later may not be subject to the same level of board oversight as the annual report.
- Separating the two reports could encourage companies to see them as separate disclosure projects, rather than as part of an integrated whole. If a separate unit of the company is responsible for the ESG report, it is likely it will be longer and more expensive than necessary.

As the points above note, we see this approach as equally beneficial to listed companies: it should create efficiencies in the reporting process, reduce cost and disclosure risk, and enhance the integrity of the information produced. It also reinforces collaboration within companies among cross-functional teams tasked with disclosing material sustainability information. As the Sustainability Accounting Standards Board points out, one advantage of a single report is that companies can rely on the process they already have for producing financial statements. Doing so would also force a greater understanding of how sustainability affects operational and financial performance.

**Question 3: Primary components**

**Do you agree that the 5 items listed should be required in the sustainability report? You may suggest additional items, giving reasons for your suggestions.**

- Material ESG factors
- Policies, practices and performance (includes linkage to performance incentives)
- Targets
- Sustainability reporting framework
- Board statement

Not entirely.



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While we agree that companies have a responsibility to select the sustainability reporting framework that is appropriate for their business, and should maintain continuity of approach over time, we are not convinced that all the five factors above must be in every sustainability report or chapter of the annual report. For example, static descriptions of policies and selection of risk/reporting frameworks could be explained in detail on company websites, leaving the sustainability report/chapter to focus on the most material ESG information, targets, performance incentives and Board statements. ACGA members, many of whom are experienced ESG analysts, have a strong preference for concise ESG reporting that is fundamentally aligned with the strategic goals of the company and where detail is reserved for the most material issues that have the potential to affect the long term growth of the company.

Returning to our theme of "process vs outcomes", we have concerns that the list above could lead to some companies, especially SMEs, producing overly long reports. Of course, if a company is already publishing an extensive GRI-style sustainability report and feels comfortable doing so, either because of demand from shareholders or other stakeholders, or because of the complexity of its business, we are not suggesting they should refrain from doing so. The aim should be reporting that is appropriately aligned with the material disclosure needs of each company.

Arguably, it is up to company Boards and management to determine which processes will best support their disclosures. If this is accomplished and confirmed with credible Board oversight, the processes, timing, and content of the reporting stand a better chance of meeting the needs of investors and key stakeholders.

**Question 4: Stakeholder engagement**

**Do you agree that stakeholders should be engaged in determining the material ESG factors?**

**Yes.**

**Should this verification process be considered essential and therefore included as a primary component sustainability reporting?**

We agree that the mapping of stakeholder concerns and suggestions is an important way for a company to understand its wider ESG environment, how this may be changing, and public perception of the effectiveness of its actions. However, we consider the use of the word "verify" in this context to be potentially confusing. It could be read as Boards delegating their responsibility for the selection of material ESG issues to stakeholders and/or having to engage in an expensive consultant-led verification process. We think that Boards need to be the final arbiter on materiality. We suggest replacing the word "verify" with "review".



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This part of the Guide also implies that all stakeholders are equal in this process. Yet one of the tasks of any Board and management is to ascertain, with an appropriately inquiring mind, which stakeholders are most relevant to its operations. Indeed, the Singapore CG Code already states that the Board should identify a company's key stakeholders, "ensure that obligations to shareholders and other stakeholders are understood and met", and consider sustainability issues.

We expect material ESG factors to be included in regular reporting to the Board via the risk register, hence the Board should have already identified this information. For some companies, it may be sufficient therefore to simply "re-package" this information in a format appropriate for shareholders and other stakeholders.

**Question 5: Materiality**

**Do you agree with this working guideline of materiality? If there are aspects which are inappropriate, please identify, explain and suggest a better alternative.**

Yes and No.

While we agree with the paper's focus on major ESG risks underpinning any definition of materiality, we are concerned that the overall approach of the Consultation Paper and Guide could mislead company management and investors.

The emphasis on ESG "opportunities" as well as risks raises the danger that sustainability reports may become marketing documents, as some already are, or cause confusion among investors as to the substance of these opportunities. If one assumes that any significant ESG-related investment or transaction should already be reported in the MD&A section of an annual report or a continuous disclosure announcement, deferring them to a delayed ESG report would surely constitute either false disclosure and/or raise doubts as to their genuine significance.

We also have concerns about the language found in the introductory statement in Paragraph 1.2 of the Guide, which states that sustainability reporting "is separate from and does not affect the obligation of the issuer to make disclosure that would have a material effect on the price or value of its securities or to avoid the establishment of a false market pursuant to Listing Rule 703." We understand the point here—that sustainability reporting should not be seen as a substitute for material disclosure obligations generally. However, we believe the phrase "is separate from" gives the wrong impression to companies. Rather, the emphasis should be on sustainability reporting "being complementary to" or integrated within other reporting and very much part and parcel of the overall financial and ESG reporting process. The more it is seen as an entirely separate process, the more it will likely become a burden to companies and probably less relevant to investors. Here again, we believe that the market would be better served by a stronger focus



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on the ESG risk management framework actually used by the Board and related material developments.

**Question 6: Anti-corruption and diversity**

**Should anti-corruption and diversity be considered essential and therefore included as part of the primary components of sustainability reporting?**

Yes, but subject to the concerns outlined below.

While we fully endorse the importance of companies undertaking anti-corruption measures, and having policies to promote diversity on the Board and through their HR practices, we believe that such disclosure should in the first instance be placed in the corporate governance section of the annual report (with a particular focus on diversity in the nomination committee report). Both issues are linked to ESG policy and practice in certain ways, yet are also broader and an integral part of corporate leadership and culture more generally. Indeed, as the Singapore CG Code states, part of a Board's role is to:

- Set the company's values and standards (including ethical standards), and ensure that obligations to shareholders and other stakeholders are understood and met; (Guideline 1.1 (e))

And on composition:

- The Board and its board committees should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company. They should also provide core competencies such as accounting or finance, business or management experience, industry knowledge, strategic planning experience and customer-based experience or knowledge. (Guideline 2.6)

Because this high-level disclosure should already be in the CG statement section of annual reports, it may be redundant to repeat it in the sustainability report. (As an aside: We note that the CG Code does not mention corruption explicitly, but rather alludes to it indirectly in Guideline 1.1 (e) above. We recommend that this be addressed in an amendment to the CG Code.)

There is, however, an important place for a discussion of significant ESG-related corruption risk, and how companies are responding to such events, in the sustainability report. Moreover, to the extent that ESG matters relate to unethical behaviour with material consequences, such as in management of the supply chain, disclosure on this should also be included in a sustainability report. Investors want to know what a company is doing in terms of implementing appropriate education and training of employees, contractors and sub-contractors in the supply chain to avoid



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similar problems in future. And whether there is a whistleblowing system that is working effectively.

Lastly, as with our comment above in Question 3 on ESG policies, standardised disclosures describing anti-corruption policies and safeguards are best put on company websites, not in sustainability reports.

**Question 7: Responsibility of the board**

**Do you agree on the specific roles and responsibilities assigned to the Board with regard to sustainability reporting?**

Not entirely.

We believe that the measures outlined are necessary, but not sufficient, as we note above in our comment on page 2.

We are concerned that absent additional legal or regulatory steps, these ESG responsibilities will be little more than a new board agenda item subject to mechanistic oversight. We would urge the SGX to consider taking two additional steps to more strongly support the governance structures that are crucial to ESG management and disclosure.

First, we recommend that SGX more closely align board oversight of ESG management with existing risk management disciplines reflected in the Code of Corporate Governance and implemented by the Audit Committee or other committees tasked to oversee critical risk management functions. As a reference, we find the *Risk Governance Guidance for Listed Boards,* released in 2012 by the Corporate Governance Council, makes a number of valuable recommendations that would leverage on progress envisioned under the CG Code. Specifically, Section 5 makes common sense recommendations concerning the development of risk registers, management disciplines, and oversight obligations of boards that relate equally to ESG risks.

Second, we believe that Board engagement in these issues would be more likely if the SGX were to make clear how it intends to enforce non-disclosure of material ESG issues.

**Question 8: Independent assurance**

**Do you agree that assurance should be voluntary? If you disagree, please give reasons.**

Yes.



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We see assurance as a tool that is suitable in instances where the ESG issues involved are highly complex (such as long supply chains or where companies operate in markets rife with bribery and corruption), where correct interpretation relies on services and data provided by third parties, or where the Board itself is not comfortable with the information provided by management. Listed companies with such ESG issues may benefit from assurance, but only if it is needed to validate data and underlying processes.

**Question 9: Phased approach**

**Do you agree that sustainability reporting should be implemented by way of a phased approach?**

Yes, but subject to the concerns outlined below.

We believe that listed companies in Singapore would benefit from a phased implementation of these new guidelines, but only if the process is reframed to build on the principles of good governance in the Singapore CG Code and to reflect existing risk management and disclosure norms. Companies should be encouraged to see this process as an extension of what they are already required to do under the CG Code, which explicitly refers to sustainability issues as a key area for board oversight (Guideline 1.1(f) ).

By referencing the five primary components, and by providing quite prescriptive suggestions of how companies might phase in this reporting ("Year 1, Year 2, Year 3") as well as processes for how to identify material ESG issues, there is a danger that companies will over-complicate the process. We believe that a simpler approach would lead to more efficient reporting, better informed investors, and better governed listed companies.

We would be pleased to answer any questions you may have regarding our comments above.

Yours truly,



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Secretary General

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