Climate Governance Initiative Australia

A JOINT PUBLICATION BY

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Australian Institute of Company Directors

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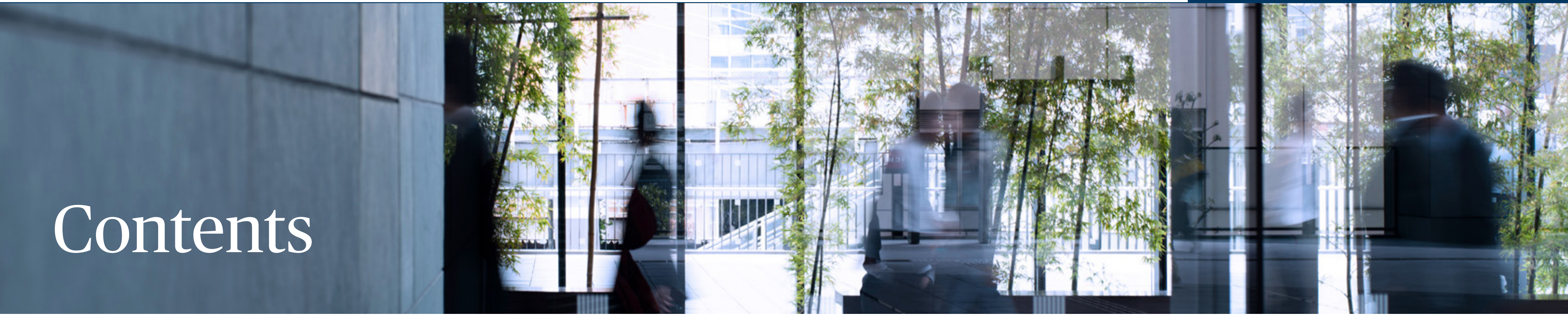
Bringing together ESG

Board structures and sustainability

NOVEMBER 2022



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Foreword

PURPOSE AND SCOPE OF THIS GUIDE

Corporate Australia's focus on environmental, social and governance (ESG) issues continues to rise at an intensifying pace. Many companies are embracing ESG matters as a strategic business imperative to ensure they are well positioned to meet the challenges of accelerating ESG risks and opportunity as well as the increasing demand for ESG action from investors and stakeholders.

These demands, combined with the prevalence of ESG risks facing various industries in Australia is motivating many companies to consider the appropriateness of current governance structures. One area of focus is the concept of establishing a dedicated Sustainability Committee, which has emerged as a tool to ensure boards have clear oversight of ESG issues, particularly relating to environmental, safety and social matters affecting the company.

ESG is a broad area of governance that spans various areas across a business. The establishment of a Sustainability Committee can be beneficial in sharpening a board's attention on important ESG matters and directing appropriate attention to ESG topics impacting the company.

However, a dedicated Sustainability Committee will not be the right governance model for every company and boards across Australia take different approaches to the oversight of ESG matters. A key part of developing a strong ESG framework and strategy is understanding whether a dedicated Sustainability Committee would assist the company with its governance, or whether ESG issues, risks and opportunities are better dealt with by existing governance structures.

The task of designing a fit for purpose, best practice ESG framework is challenging in a context where there is no uniform definition of 'ESG' and where the regulatory landscape both in Australia and worldwide is continually evolving. It is therefore not surprising that there is no uniformity in relation to board oversight of ESG issues.

This guide is intended to step directors and management through key considerations when determining whether a company would benefit from establishing a dedicated Sustainability Committee. It also explores different models for ESG governance including how a Sustainability Committee might be structured and the potential scope of its responsibilities.

CLIMATE GOVERNANCE INITIATIVE AUSTRALIA

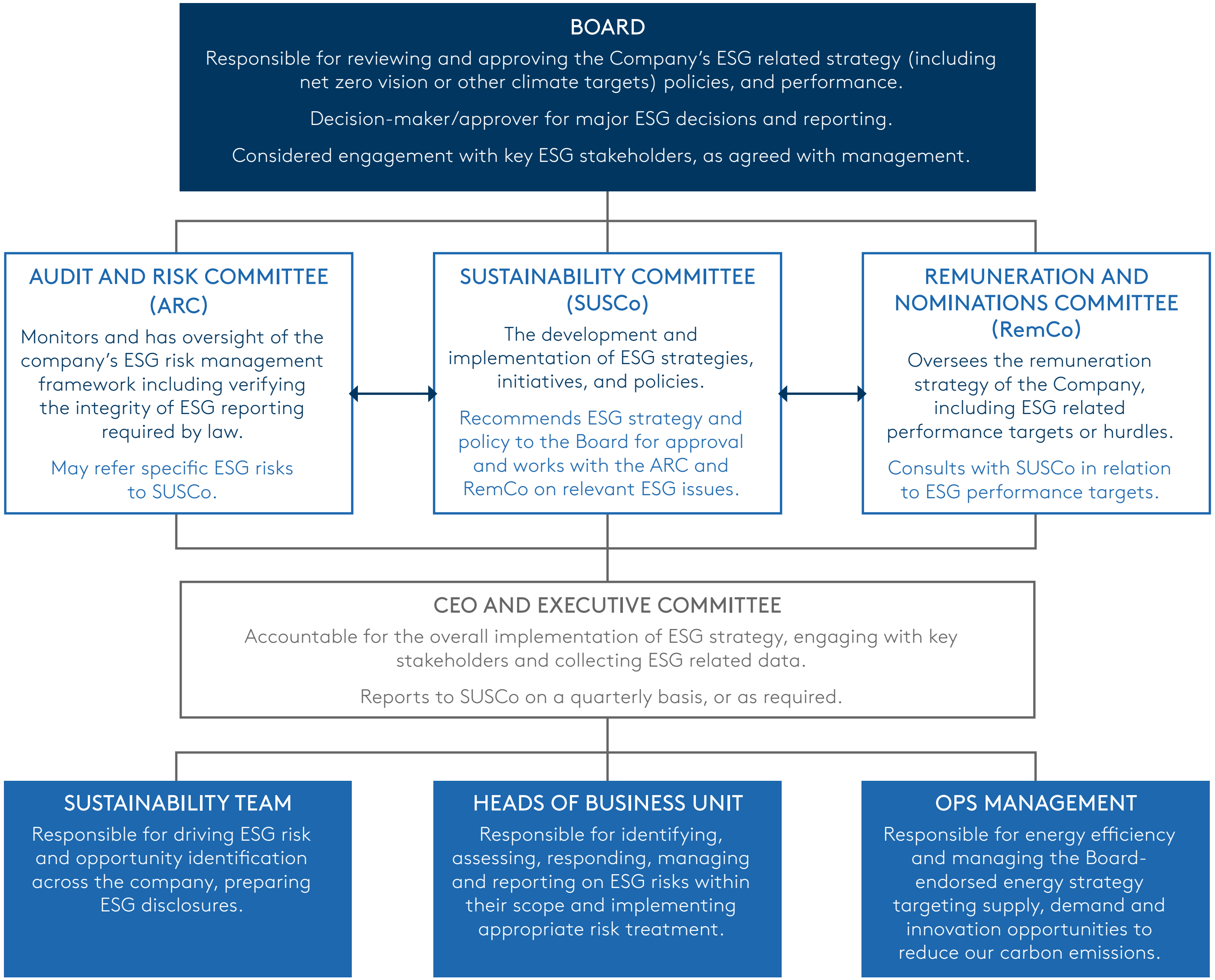
This guide has been prepared jointly by the Australian Institute of Company Directors (AICD) and Herbert Smith Freehills' ESG, Sustainability and Responsible Business practice, drawing on learnings from market practice and trends seen in overseas jurisdictions.

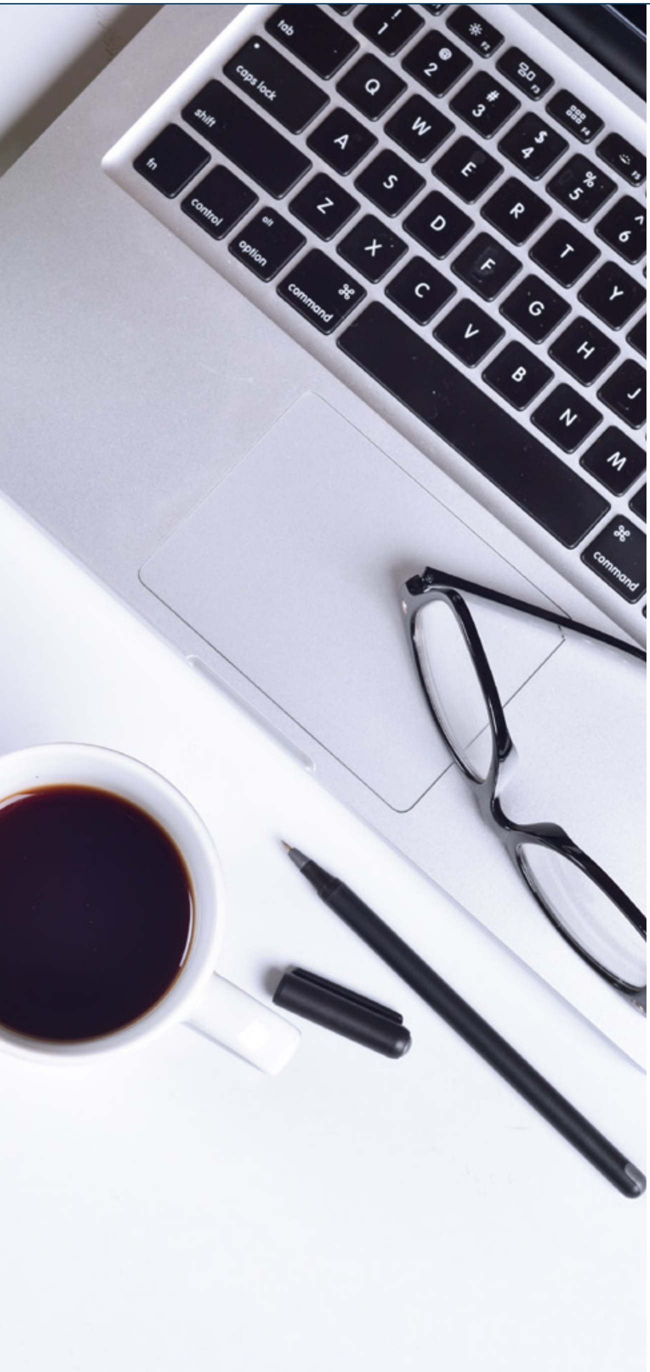
It is published as part of the work program of the Climate Governance Initiative Australia, a multi-partner collaboration aimed at supporting effective climate governance by Australian boards. Further practical resources from the Climate Governance Initiative Australia can be found **here**.

Executive summary

- An organisation's approach to ESG will depend on the entity type, sector, size and maturity of the organisation. Figure 1 provides an example of one model an organisation may adopt to address ESG governance.
- Sustainability Committees may help move the dial on 'legwork' to ensure boards are clearly addressing matters relating to climate and ESG.
- Sustainability Committees are expected to become more common as regulation and scrutiny increases and companies' climate and ESG strategies become more sophisticated.
- Ultimately, however, oversight of strategy and risk is a key board accountability – so committees are supporting structures only.

Figure 1: Flow of ESG governance (an example)





1. Directors' duties and effective stakeholder engagement

Australian directors have a duty to act in good faith in the best interests of the company, taking account of relevant facts and circumstances. To properly fulfil this duty, directors are often required to consider the long-term interests of the organisation, including its reputation and long term-sustainability, rather than adopting a narrower focus on short term shareholder return. For further information see the AICD practice statement "Directors' "best interests" duty in practice" **here**.

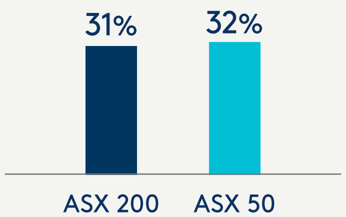
Effective stakeholder governance is crucial to securing the appropriate balance between short-term financial considerations and the long-term sustainability of an organisation. It ensures that the Board hears and engages with a range of perspectives that inform sound decision-making, especially on sustainability issues. To ensure that a company is properly equipped to manage ESG risks and opportunities, effective stakeholder engagement will be critical, with the Board and management needing to be clear on their respective roles and responsibilities.

Further information about the benefits of strong stakeholder engagement and ways to embed this process into an organisation's governance structures are explored in the AICD's Stakeholder Governance Guide, which can be accessed **here**.

2. Do you need a Sustainability Committee?

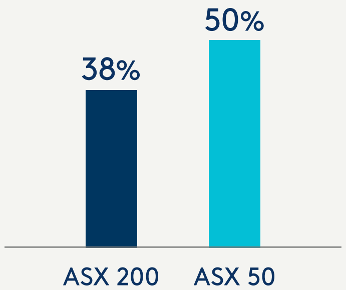
2.1 HOW COMMON ARE SUSTAINABILITY COMMITTEES?

Boards across Australia take different approaches to the oversight of ESG concerns. This diversity reflects the balancing of many factors which are outlined in this guide.



DEDICATED SUSTAINABILITY COMMITTEES

Analysis performed by Herbert Smith Freehills found that by mid-2021 approximately 31 per cent of ASX 200 companies had an ESG or sustainability-focused board committee. This was only marginally lower than the incidence amongst the ASX 50 (32 per cent).



ESG AS PART OF BOARD CHARTER

It was much more common to see sustainability-related issues featuring as part of board charters, with 50 per cent of ASX 50 companies referring to "environmental impact" or having regard to the "environment", with the number decreasing to 38 per cent for the larger ASX 200 cohort.

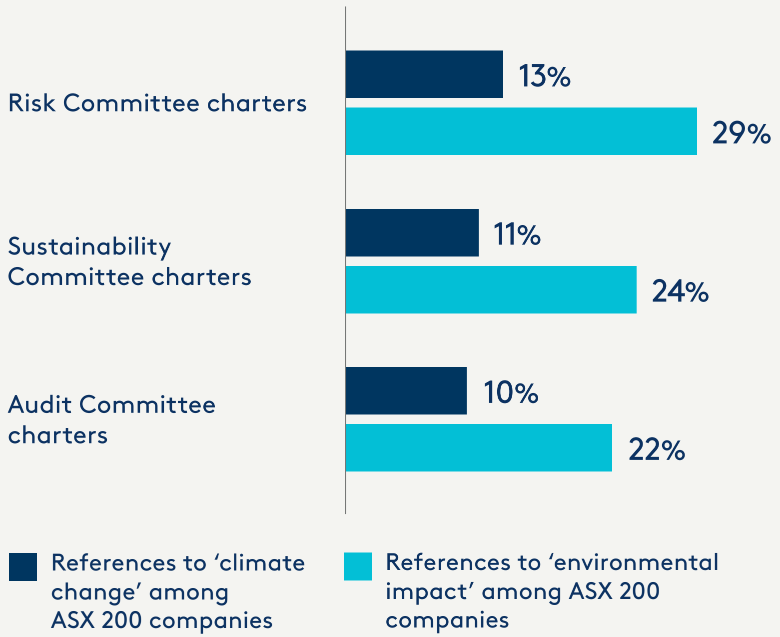
ESG AS PART OF EXISTING COMMITTEES

Many companies also address ESG risks as part of the Risk Committee, or ESG otherwise forms part of another board committee's mandate. For example, 13 per cent of the ASX 200 companies make a reference to 'climate change' in their risk committee charters.

HOW MANY COMPANIES MENTION 'CLIMATE CHANGE' AND 'ENVIRONMENTAL IMPACT' IN GOVERNANCE DOCUMENTS?

HSF research shows that references to 'climate change' appeared in 13 per cent of Risk Committee charters among ASX 200 companies. This compares to 11 per cent of Sustainability Committee charters and 10 per cent of Audit Committee charters. A similar result was found for references to 'environmental impact', which appeared in the charters of 29 per cent of Risk Committees, 24 per cent of Audit Committees and 22 per cent of Sustainability Committees.

These numbers show that it is common for environmental concerns to be addressed by existing board committees.



'ESG' OR 'SUSTAINABILITY' COMMITTEE?

While the terms are often used interchangeably, 'ESG' historically derives from ESG investing which focuses on companies' environmental and social impacts, as well as broader governance processes. 'Sustainability' is used to refer more broadly to the long term sustainability of the business, including having regard to its internal and external stakeholders and impacts.

While there is considerable variability in the terminology used, what is typically more important is determining the scope of what the company means by 'ESG' – for example, in establishing a mandate for any relevant board committee, identifying the issues which are most material to the company given its particular circumstances, understanding the regulatory or stakeholder expectations placed on the company, and determining how the committee will support the Board.

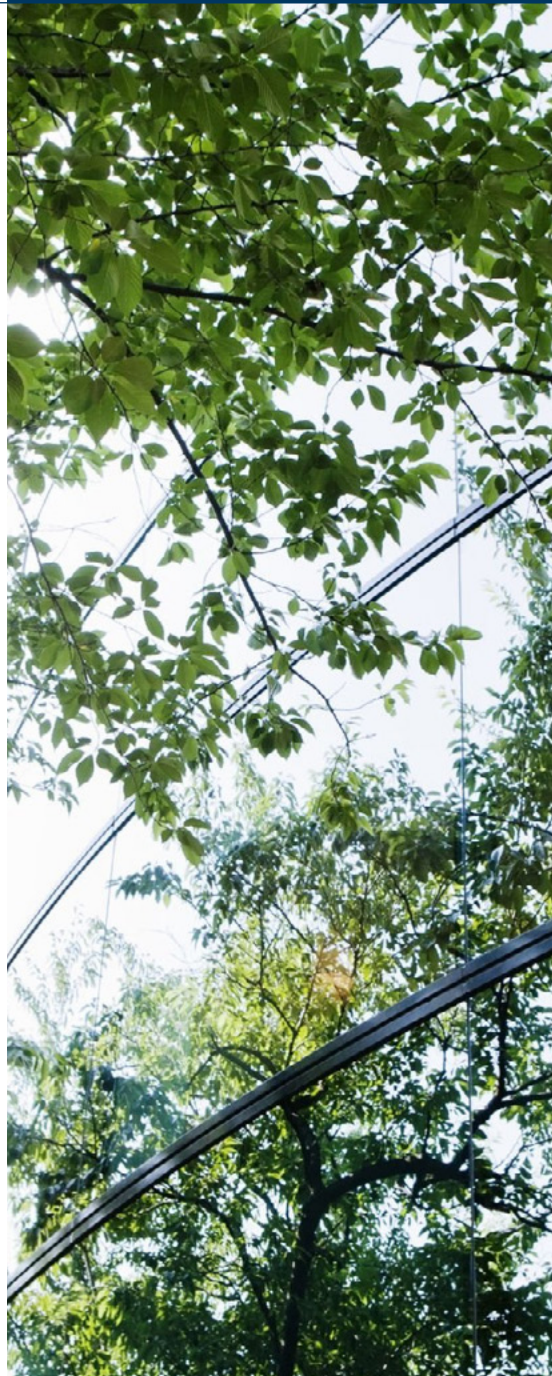
This guide uses the term 'Sustainability Committee' which is intended to capture a broad range of ESG related matters going to the creation of long-term stakeholder value. Ultimately, it will be a matter for each company to determine the most efficient and effective division of 'E' 'S' and 'G' responsibilities. This will also likely be influenced by existing management structures, risks and opportunities faced, and the maturity of current practices.

2.2 KEY CONSIDERATIONS IN ESTABLISHING A SUSTAINABILITY COMMITTEE

It is usual for boards to delegate work to committees of directors to deal with complex or specialised issues in a more efficient and effective manner.

When considering whether a standalone Sustainability Committee will add value to a company's existing corporate governance framework and committee structure, various considerations will come into play, including:

- **Size of company –** the larger the company, the more likely it is that a separate Sustainability Committee will be valuable to support the broader workload typically associated with large or complex operations. It is also more likely that larger companies will have the necessary resources to support an additional committee.
- **Industry –** while no company in Australia is immune from ESG considerations, industries such as mining, energy, and agribusiness face higher risks if ESG issues are not adequately addressed. These companies are likely to have a stronger incentive to establish a dedicated Sustainability Committee and will have more to gain by identifying and unlocking ESG opportunities.
- **Strategy & risk –** where ESG risks and opportunities impacting the company's current and expected long term strategy are material and varied in nature, it will likely warrant closer board oversight.
- **Existing Committees –** the terms of reference of existing committees may already sufficiently cover ESG concerns and ESG issues may receive adequate attention from these committees.
- **Board time –** if time is already stretched and scarce for directors, there may not be enough directors with the capacity to sit on an additional committee.
- **Stakeholder expectations –** depending on the level of stakeholder or investor expectation, a dedicated Sustainability Committee can signal to stakeholders that the company takes ESG matters seriously. This is particularly relevant for companies where investors are growing more urgent in their demands that the company address business-relevant ESG risks and opportunities, and increase their level of oversight and disclosure on ESG matters.
- **Changing laws –** the introduction of new ESG related regulations, coupled with the impending introduction of new ESG disclosures by the International Sustainability Standards Board is creating an impetus for organisations to start reviewing their current ESG governance structures.



INTERNATIONAL BASELINE FOR ESG DISCLOSURES – WATCH THIS SPACE

During 2022, the International Sustainability Standards Board (ISSB) consulted on exposure drafts for new global standards for sustainability-related disclosure. The standards will set baseline global requirements for the disclosure of material information from companies on sustainability-related risks and opportunities required for investors to adequately assess a company's value. When finalised, the standards will set a comprehensive global baseline of sustainability disclosures and will be an important reference point for companies which recognise the need to strengthen their climate governance.

It is proposed that the new standards will be finalised by the ISSB in early 2023, with local implementation of the standards to follow. While a transition period is expected, it is likely a number of larger organisations will seek to adopt the standards early to meet investor needs for comparable sustainability data.

The Australian Government has indicated its support for the ISSB standards while indicating that it will introduce mandatory, internationally aligned, climate reporting for larger businesses.

You can read about the AICD's submission on the draft ISSB standards **here**.

ESG LEGISLATIVE FRAMEWORK

Australia does not have any overarching ESG legislation, rather a patchwork of regimes and laws which operate at both the Commonwealth and State and Territory levels.

Key pieces of legislation include:

Environment

- *Environment Protection and Biodiversity Conservation Act 1999* (Cth)
- *National Greenhouse and Energy Reporting Act 2007* (Cth)

Social

- *Native Title Act 1993* (Cth)
- *Fair Work Act 2009* (Cth)
- *Workplace Gender Equality Act 2012* (Cth)
- *The Charter of Human Rights and Responsibilities Act 2006* (Vic)
- *Human Rights Act 2019* (Qld)
- *Human Rights Act 2004* (ACT)

Governance

- *Modern Slavery Act 2018* (Cth)
- *Corporations Act 2001* (Cth)
- ASX Corporate Governance Council's Principles and Recommendations (4th edition)

CORPORATE DISCLOSURE OBLIGATIONS: REPORTING ON ESG

The *Corporations Act 2001* (Cth) requires a public company's annual report to include disclosures of information that shareholders would reasonably require to make an informed assessment of the entity's operations, financial position, business strategies and prospects for future financial years. This includes discussion of relevant ESG risks (see ASIC Regulatory Guide 247).

Further, the ASX Corporate Governance Council's Principles and Recommendations (4th edition) states that listed entities should disclose whether they have any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks.

The process of identifying and disclosing material risks relevant to each company will necessarily require consideration of its climate related-risks, including physical and transition risks. Where climate-related risks are material to a particular business, the onus will be on boards to also proactively take steps to mitigate and manage them.

Directors should also consider whether to obtain external assurance over ESG related reporting to provide themselves with comfort as to the accuracy and limitations of disclosures. This has often been practically difficult in the ESG context due to data gaps and the need for estimations but it is an evolving area.

2.3 OPTIONS FOR THE BOARD'S ESG OVERSIGHT AND ELEVATING ESG CONSIDERATIONS

There is no 'one size fits all' approach to allocating ESG oversight responsibilities among the Board and its committees, and delegation of responsibilities may change over time. A company's readiness to address ESG related issues is often dependent on where it sits in developing and implementing its own ESG strategy. There are some companies that have been considering ESG implications for many years and have an evolved and sophisticated ESG regime, whereas many other companies are just beginning to embark on their ESG journey. In either case, it is important for boards to step back and consider what ESG approach aligns best with their business structure, strategy and market dynamics.

Board oversight of ESG issues can reside with the full board, an existing board committee, or a dedicated Sustainability Committee. This oversight can also be shared by the full board and one or more committees or by multiple committees dealing with ESG issues that fall within their charter mandates and areas of expertise.

For example, the Audit Committee may have responsibility for the verification of ESG related reporting and the Remuneration Committee may be tasked with considering how ESG targets can be incorporated into performance hurdles for senior executives. Companies may also use a combination of these approaches.

WAYS EXISTING BOARD COMMITTEES CAN INCORPORATE ESG INTO THEIR FUNCTIONS

A company's ESG oversight can be strengthened by all existing board committees seeking ways to incorporate ESG into their existing responsibilities and functions. For example:

- **Governance committee –** Ensure appropriate director training on ESG issues; review corporate policies on ESG; monitor research and development on ESG issues; ensure that material environmental and social issues are integrated into the full board and committee charters and areas of expertise.
- **Audit and risk committee –** Understand risks and opportunities relating to ESG including in annual reporting on performance of the company; ensure quality and reliability of disclosures; ensure compliance with new regulations on ESG issues.
- **Remuneration committee –** Align environmental and social goals to executive pay to drive strategic progress and align executives to the long-term focus of the company; integrate sustainability executive performance evaluations and compensation; engage with investors on sustainability and remuneration.
- **Nominations committee –** Integrate ESG competencies into the director nominations process and board matrix; incorporate ESG KPIs into board performance evaluations.

2.4 ADVANTAGES AND DISADVANTAGES OF THE DIFFERENT OPTIONS FOR ESG OVERSIGHT

Each company will need to decide the approach that is the most appropriate to their circumstances. The most effective structure may change over time based on the advancement of the company's ESG journey, changes in its business and the expertise of management and directors.

High level advantages and disadvantages of the different options for ESG oversight are set out in the adjacent table.

ESG AND RISK MANAGEMENT

In Australia, the most common approach is for ESG risks to sit within the company's broader risk management framework, making ESG a natural fit for the existing Risk Committee. However, this can result in the Risk Committee placing an overly narrow 'risk' lens on ESG and may lead to ESG opportunities being overlooked.

Option	Advantages	Disadvantages
Split between board and existing Committees	• Allows the full board to focus on the most significant ESG matters, with specific issues delegated to committees as appropriate • Reduces administration burden as there is no need to establish a new committee where existing structures and processes are leveraged • Ensures that ESG strategy is aligned with a company's broader strategic plan • Reduces the burden of responsibilities on any one committee • Cross-pollination of ESG related issues between committees	• Risk of duplication of work between the Board and committees • ESG issues may not receive adequate attention (particularly with increasing regulation and reporting) • Reluctance for any one body to take ownership of issues • Relies on strong reporting and accountability mechanisms between the bodies • There may be 'gaps' in ESG matters that are addressed • Lack of transparency between split bodies may lead to differences in approach and views on the company's ESG strategy
Dedicated Sustainability Committee	• Provides a forum for regular and in-depth discussion of ESG issues, ensuring thorough oversight • Development of specialist knowledge over time • More likely to identify key risks and opportunities • Unified approach to ESG across the business due to centralised responsibility • Ability to issue standing invitation for whole Board to attend meetings which enables all directors to contribute to important discussions	• Risk of separating the discussion of ESG from the broader business, finance, and strategy discussions • Administrative burden of establishing a new committee, director availability to partake, and putting in place appropriate governance documents

2.5 OVERLAP AND COOPERATION BETWEEN DIFFERENT COMMITTEES

ESG is relevant to the work of all Board committees (even where there is a Sustainability Committee) and the integrity of ESG oversight is strengthened when each committee considers relevant ESG matters within its remit. When ESG responsibilities are split between more than one body, it is important that there are clear lines of accountability and reporting between the various committees and the Board. The following tools can be used to ensure clear divisions of responsibility, accountability and collaboration:

- a referral process between two committees in relation to specific ESG issues;
- reviewing and updating as necessary relevant Board and committee charters;
- a collaborative arrangement between two committees on an ad hoc basis (e.g. in relation to a specific project);
- ESG issues are elevated to the Board as they arise and the Board is then responsible for delegating responsibility back down to a selected committee;
- allocation of clear accountability within management for ESG matters;
- one committee regularly reports to another committee specifically on ESG; and
- joint sessions between multiple committees to consider ESG issues.

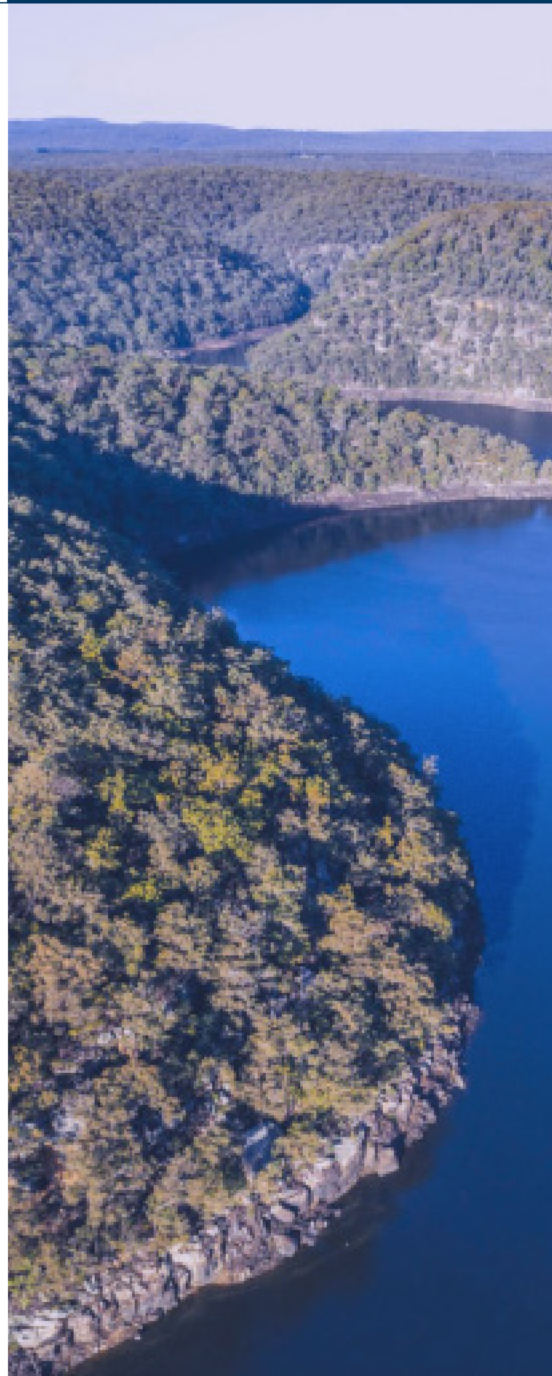
2.6 ELEVATING ESG MATTERS TO THE BOARD

It is important that the Board is aware of ESG issues, and that information is not siloed within committees (including a Sustainability Committee). In addition to regular reporting on ESG matters by committees, the Board should ensure it is upskilled in ESG matters impacting the company. ESG matters should regularly be elevated to the Board and there should be regular reporting by committees to the Board. ESG can be elevated to the Board by:

- regular management reporting to the Board – this can be achieved by including ESG as a standing agenda item at each Board meeting;
- the Board undertaking a review of ESG related responsibilities in existing committee charters to ensure there are no 'gaps';
- inviting NGOs, peers, and other experts to present to the Board; and
- conducting board training.

The AICD's **resource**, *Elevating stakeholder voices to the Board*, provides a broader governance framework for boards to consider. The guide explores:

- the Board's role in stakeholder governance;
- directors' legal duties in relation to stakeholders;
- principles boards should apply to ensure effective stakeholder governance;
- how boards can balance the interests of stakeholders when making decisions; and
- the hallmarks of good stakeholder governance.



3. The role and structure of Sustainability Committees

3.1 SHOULD SUSTAINABILITY COMMITTEES HAVE DECISION MAKING AUTHORITY?

Sustainability Committees (like most board committees) are generally established as an advisory body that reports and makes recommendations to the Board and is only delegated decision-making authority for specific functions from time to time. This is particularly the case for Sustainability Committees given that ESG issues impact various functions across a company's business and risk functions and typically require the full board's oversight. It is important that ESG matters are elevated to the Board's attention for board discussion and sign off on decisions impacting the company. This is especially important for ASX listed companies, who must ensure adequate consideration of ESG matters are being taken into account to satisfy stakeholder and regulator expectations. This helps to ensure that ESG related actions are not made in a vacuum without properly considering the broader context of the company's strategy.

ADVISORY COMMITTEE OR BOARD COMMITTEE?

In Australia, the predominant model is for a Sustainability Committee to be established as a sub-committee of the Board. In some jurisdictions however, there is a greater use of advisory committees outside of the formal board structure. For example, an advisory committee may be established to receive feedback from internal and external stakeholders as well as external experts without any formal line of accountability to the Board. This type of committee may be more appropriately characterised as an 'advisory committee'.

While advisory committees can be helpful mechanisms for accessing external viewpoints on a company's approach to ESG issues, the Board will still need to synthesise and integrate the information received for use in their deliberations and this may lead to increased or duplicated workloads. Additionally, given that directors' duties do not typically apply to advisory committee members, there will also be a need for careful consideration to be given to the ways in which information is shared with advisory committee members, what their formal role is (in a legal sense), whether they will be indemnified for their actions by the company, and whether the company's insurance arrangements will extend to them.

3.2 WHO SHOULD SIT ON A SUSTAINABILITY COMMITTEE?

There is no legal requirement regulating the composition of a Sustainability Committee. Most commonly a Sustainability Committee will comprise of at least 3 directors appointed by the Board and will include:

a. directors with ESG experience or expertise; and
b. representatives of other board committees with ESG related responsibilities.

Generally, all directors on the Board will have a standing invitation to attend Sustainability Committee meetings.

In addition, companies will typically have relevant executives or business managers present at Sustainability Committee meetings who can provide insight into how ESG considerations interact with the operational matters of the business, and ensure 'fit for purpose' ESG outcomes.

3.3 EXTERNAL ADVISERS OR COMMITTEE MEMBERS

As with the makeup of any board or board committee, it is prudent to consider the gender-related and broader diversity of the directors selected to sit on a Sustainability Committee. Ensuring that there is a diverse range of perspectives can be crucial to overseeing and stress-testing the company's ESG strategy. Ultimately, it will also be important that this diversity is reflected at the board-level given that overall responsibility for ESG rests with the board.

Some boards do not have directors with the necessary skills and experience to form a Sustainability Committee and choose to appoint external experts to support the committee, either as advisers or formal committee members. These individuals bring specific expertise and may fill 'gaps' in the knowledge of committee members. This notwithstanding, bringing in external expertise in this way cannot be a substitute for director and executives upskilling themselves. The organisation should ensure it has the necessary human capital to effectively navigate the evolving ESG landscape without undue reliance on external support.

In most cases these advisers would be paid compensation for their involvement in the Sustainability Committee and would need to sign a confidentiality undertaking in respect of any information obtained while performing their role.

Inviting external independent advisers who are not directors can pose a risk for those individuals, as they are likely not covered by directors' indemnities and insurance and therefore some ESG experts prefer to be an external adviser to the committee, rather than a formal committee member.

To gain exposure to different and emerging perspectives ideas and insights, a Sustainability Committee can also benefit from inviting external guests (such as employee groups, subject matter experts or community groups) to attend meeting sessions and share insights on ESG topics.

3.4 ESG FOCUS IN BOARD COMPOSITION AND EDUCATION

The board should consider whether collectively it has the right mix of skills and experience to grapple with current and emerging ESG issues, while recognising that non-traditional backgrounds may add particular value.

It is important that boards turn their mind to ESG capabilities in their succession planning and look to add directors with specific expertise in certain ESG areas where needed. This is particularly the case if an ESG topic is a transformational issue to the company (e.g. renewable energy, artificial intelligence, electric vehicles, or industry transformation).

It is common for the composition of a Board Committee to be reviewed by the Nomination Committee (or similar) to ensure the composition and mix remain appropriate to fulfil the Sustainability Committee's role and responsibilities.

Some companies may also consider recruiting ESG skilled individuals into management and operations of the company to assist the Board in delivering on their ESG related actions. For example, the role of Chief Sustainability Officer has been introduced in several large Australian companies, and that person may often have a reporting line to the Sustainability Committee.

More broadly as part of periodic Board evaluation and renewal processes, there should be a critical assessment of whether the current skills mix of directors remains appropriate to fulfil its core oversight role.

ESG WORKING GROUPS

In recognition of the cross-functional impact of ESG on an organisation, there is an increasing use of working groups to support the Board and senior executives in relation to sustainability issues. These working groups are established in management teams for the purpose of appropriately assessing ESG risks and opportunities across the business, including by considering input from operational divisions as well as functional expertise from a legal, risk, finance and stakeholder engagement perspective. These working groups can often play a helpful role in supporting the Board and any dedicated Sustainability Committee by driving forward ESG projects and thinking in a holistic manner that is sometimes not possible for a standalone sustainability function to achieve.

GREENWASHING RISKS

One of the key roles of any Sustainability Committee is to ensure that all company reports on its ESG related strategy that involve making forward-looking statements are based on reasonable grounds. This is particularly the case if the company is setting ESG targets (e.g. net zero emissions by a certain year). Unlike in some jurisdictions, there is no 'safe harbour' in respect of those statements in Australia. That means that unless the statements are supported by reasonable grounds, they will be deemed misleading by law if they later turn out to be incorrect. This is the case even where they were genuinely believed at the time they were made. Accordingly, ESG reporting must be done cautiously to ensure any aspirational statements are based on reasonable grounds, with appropriate due diligence undertaken in advance of public announcements. Failure to do this may expose directors and the company to claims of misleading and deceptive conduct.

ASIC's guidance on greenwashing can be found **here**.

3.5 DANGERS WITH THE 'DESIGNATED EXPERT' MODEL

In some overseas jurisdictions there is a trend for boards to appoint a particular director as the "designated expert" on ESG issues. This model has not been widely adopted in Australia, as that director may carry additional legal risks. There is also more broadly a risk that the Board may rely inappropriately on that director (i.e. in respect of matters that the courts deem to be non-delegable duties of each and every director).

For these reasons, it is preferable for Australian companies to focus on ensuring that the Board, and its committees, collectively have the appropriate skills and experience to discharge their functions. While some individual directors may bring particular expertise, such as in energy transition or other ESG topics, they should not be 'designated' as responsible for those areas, rather they would offer their insights in decision-making as part of the broader collective of directors. This may require broader upskilling on ESG matters to be a specific priority area for board education.

ESG RATING SYSTEMS

When considering a company's ESG and broader sustainability targets, the starting point for a Sustainability Committee is to try to understand shareholder and broader stakeholder expectations. ESG rating systems (such as offered by MSCI, ISS and Sustainalytics) can lend insight into stakeholder expectations. These systems use varying methodologies to rate companies based on their management of ESG issues, targets and disclosures.

Many institutional investors will also have their own stewardship and ESG related policies which set out their expectations for the companies in which they invest. This approach is demonstrated by BlackRock, the Australian Council of Superannuation Investors and key proxy adviser firms, among others.

3.6 FREQUENCY OF MANAGEMENT REPORTING TO THE BOARD ON ESG ISSUES

Adequate reporting on ESG issues to the Board and relevant committees by management is of vital importance to any ESG governance framework. As with other governance matters, day-to-day implementation of the ESG strategy usually rests with senior management, and companies employ different approaches in delineating internal reporting lines and determining whether any formal procedures are used for such management-level ESG governance.

The appropriate frequency of management reporting to the Board on ESG issues will vary based on individual company circumstances, including board oversight structure; management structure and staffing; company size, type, and industry; regulatory developments and trends; the significance of each respective ESG issue to the company; investor and other stakeholder pressures and priorities; and the company's strategies with respect to these issues. Different issues generally warrant different reporting approaches.

A well-functioning reporting strategy between management and the Board is critical for the success of any company's ESG strategy.

CASE STUDY: Lessons on clear lines of responsibility from the Hayne Royal Commission

In the final report, Commissioner Hayne identified culture, governance and remuneration as key to preventing corporate misconduct. In relation to governance, he stated that "notions of accountability lie at the heart of governance." There is a danger that without clear lines of accountability, outstanding issues can be left unresolved. Further, it is crucial that the Board has the right information so that they may test and challenge that information. It is the quality, not the quantity, of information that is important here.

In the context of this guide, lessons learnt from the Royal Commission can be applied in the following ways:

- determining and clearly stating where the responsibility for the different aspects of ESG lies, which is particularly important where this responsibility is divided between different committees;
- clearly stating what information should be reported to the Board regarding ESG; and
- ensuring any committees dealing with ESG have adequate resources to fulfil their role.

THE FLOW OF ESG GOVERNANCE

It can be useful to map out ESG responsibilities and the reporting between the Board, committees and management. This will be particularly helpful during the early stages of integrating ESG into an existing governance framework as it gives directors and management a central point of reference. This might involve extracting each ESG-related responsibility for a committee and any associated reporting or referral obligations. Preparing a flow chart (i.e. refer to **Figure 1 on Page 4**) can also assist with clarifying how responsibilities may be most efficiently divided between committees.

4. Sustainability Committee Charter

A Sustainability Committee must have clear terms of reference put in place which sets out its purpose and the scope of its role and responsibilities. In most cases this will require the preparation of a committee charter.

A template charter is provided as an example in the **Appendix** to this guide.

4.1 SPECIFIC RESPONSIBILITIES OF A SUSTAINABILITY COMMITTEE

The most integral aspect of any Committee Charter is the designation of its specific responsibilities. For Sustainability Committees, it is useful to consider these responsibilities as falling into two broad buckets, one reporting responsibilities and the other, strategic responsibilities. These different functions as well as the common responsibilities that may be given to a Sustainability Committee are set out in the table below.

Reporting	Strategy
Responsibilities concerned with reporting on ESG issues and risks, include gathering information from internal stakeholders, as well as keeping informed about emerging market and industry trends and then providing detailed reports to the designated body (i.e. other committees and/or the Board).	Responsibilities focused on formulating an ESG strategy include identifying priorities or risks within the business as well as opportunities to develop pro-active strategies and assuming responsibility for the implementation of that strategy. Importantly, this will include considering and engaging with key stakeholders.

Common responsibilities that may be given to a Sustainability Committee include:

- Monitoring external ESG trends, considering risks and opportunities and preparing plans to respond accordingly
- Seeking out and recording internal and external stakeholder feedback in relation to ESG matters
- Collecting data and reports from the business and reporting on ESG targets
- Monitoring and ensuring compliance with relevant ESG legislation and corporate best practice
- Reviewing and monitoring the effectiveness of ESG risk management systems
- Reviewing the company's environmental and greenhouse gas footprint and tracking performance against recognised benchmarks and reporting on the company's performance
- Reviewing human capital state to ensure there is sufficient internal ESG related expertise to manage risk and opportunity
- Assessing compliance with the company's ESG Policies and reviewing the effectiveness of the company's policies that support human rights (including modern slavery) in the company's operations and supply chain
- Upskilling the Board on ESG issues and trends
- Educating sectors of the business on compliance with the company's ESG framework
- Responding to specific questions and issues referred by the Board, other committees or management
- Understanding expectations of company stakeholders in relation to ESG
- Educating new directors about key stakeholders and facilitating considered dialogue between stakeholders, directors and management as part of an agreed governance approach
- Determining how engagement with ESG issues can create value for the company
- Overseeing the development and implementation of ESG initiatives and policies
- Establishing a framework for the collection and analysis of ESG data
- Integrating ESG priorities into the company's governance framework and values
- Aiding the Board as requested in relation to the identification of risks related to climate change and the potential impact of those risks on the company's strategy and business
- Promoting a culture of continuous improvement in sustainability throughout the business
- Reviewing the effectiveness of the company's policies and initiatives on community engagement and social responsibility
- Overseeing the delivery of the company's climate transition plan and disclosures regarding ESG commitments and targets

4.2 DESIGNATION OF RESPONSIBILITIES BETWEEN COMMITTEES

As explained earlier in this guide, there will inevitably be some degree of overlap between board committees in respect of ESG. Accordingly, it can be useful for committee charters to set out the 'when' and 'how' regarding communication and cooperation between committees on ESG matters.

For example, the Audit Committee will have the ultimate responsibility for overseeing the verification of legal and regulatory reporting but may delegate the day-to-day leg work of preparing ESG related reports and the working with auditors on assurance to the Sustainability Committee. Accordingly, the Sustainability Committee Charter might include the following language: "overseeing the audit of sustainability reporting and providing assistance to the Audit Committee as requested in relation to the verification of reporting".

The charters of other committees might state that certain functions are performed "in consultation with the Sustainability Committee" or that specific ESG issues are to be "referred to the Sustainability Committee".

BOARD CHARTER UPDATES

The addition of a dedicated Sustainability Committee will trigger a need to update and adjust the charters for each of a company's existing committees. To ensure consistency, it is preferable that this work is completed as a holistic, as opposed to piecemeal, workstream.

4.3 SUSTAINABILITY COMMITTEE REPORTING

Sustainability Committees should provide reports to the Board as to any material matters arising out of Sustainability Committee meetings. Sustainability Committees should also consider if any material matters arising out of the committee meeting should be advised to any other Board Committee and, if so, ensure that this occurs.

A copy of the minutes of all Sustainability Committees should also be provided to the Board with the Board papers.

4.4 REVIEW AND ASSESSMENT OF SUSTAINABILITY COMMITTEES

Sustainability Committees should regularly undertake a formal process of self-assessment to determine the committee's adequacy in relation to its membership, responsibilities, functions and efficacy. The results of this assessment should be communicated to the Board to assist the Board in its own periodic review of the Sustainability Committee's effectiveness.

Any Sustainability Committee charter should be periodically reviewed by the Board.

Appendix: Template Sustainability Committee Charter

NOTES TO THIS TEMPLATE CHARTER

This template charter assumes that the Board will establish a stand-alone Sustainability Committee, rather than having the risks and issues relating to environmental, social and governance (ESG) and broader sustainability forming part of the broader responsibilities and mandate of other standing committees.

This charter is intended as a starting point only. Each company's approach will need to reflect its specific circumstances, existing committees, and the intended purpose of a dedicated Sustainability Committee.

In this template, language in [square brackets] is optional or requires tailoring to the specific circumstances of your company.

If there is a group of related companies to which this charter will apply, the term 'Company' may be replaced with 'Group' throughout this charter.

1. INTRODUCTION

The name of the Committee can be tailored to reflect the scope of its role and responsibilities, for example some companies may refer to this committee as an 'ESG Committee'.

a. The Board of directors (**Board**) of [insert company name] (**Company**) has established a Sustainability Committee.

b. This charter (**Charter**) sets out the specific responsibilities delegated by the Board to the Sustainability Committee as well as the Sustainability Committee's composition and operation.

2. PURPOSE

The specific purpose and scope of a Sustainability Committee's role is usually limited to ESG matters, but the language below should be adjusted to fit the specific scope of the Sustainability Committee's role. For example, some Sustainability Committees also have responsibilities in relation to Work, Health and Safety regulations.

a. The purpose of the Sustainability Committee is to assist the Board by reviewing the Company's performance with respect to **[**environmental social and governance (**ESG**)**]** and broader sustainability issues (such as with respect to climate change, human rights and other ESG matters), including its compliance with related laws, regulations, and policies.

b. The Sustainability Committee acts primarily as an advisory body to the Board, except where certain powers and authority are expressly delegated by the Board.

If the Company has an existing framework of committees, policies and processes which intersect with the Sustainability Committee's role, it may be useful to set those out in this section of the Charter.

3. MEMBERSHIP AND CHAIR OF THE SUSTAINABILITY COMMITTEE

There is no applicable legal requirement (or relevant recommendations in the ASX Corporate Governance Principles and Recommendations) regarding the composition of a Sustainability Committee.

This Charter leaves it open for the Board to determine the composition of the Committee, but more prescriptive requirements (such as a requirement for a majority of independent directors) can be built in.

The Company may also consider appointing an external independent adviser (or multiple) to the Sustainability Committee.

a. The Sustainability Committee must consist of a minimum of 3 directors or such other persons appointed by the Board in its absolute discretion (**Members**).

b. Members and the Chair of the Sustainability Committee will be appointed by the Board.

c. Directors who are not Members of the Sustainability Committee have a standing invitation to attend Committee meetings.

d. The Sustainability Committee Chair may invite members of the Company's management to attend meetings as appropriate.

It is common for the composition of a Board Committee to be reviewed by the Nominations Committee (or similar), but this is not always the case (and smaller companies may not have a nominations committee).

e. The Board**[**, together with the Nominations Committee,**]** will review the skills, experience, expertise and diversity represented by Members of the Sustainability Committee and determine whether the composition and mix remain appropriate to fulfil the Sustainability Committee's role and responsibilities.

4. COMMITTEE RESPONSIBILITIES

This template charter adopts a broad approach to the Sustainability Committee's responsibilities. An alternative approach is to list more specific responsibilities under separate headings such as 'environment/sustainability', 'social' and 'governance'.

This Charter does not address the Committee's role with respect to identifying ESG risks in the business, which will necessarily need to reflect and align with the existing accountabilities of the Risk Committee and the Board.

The Sustainability Committee will assist the Board in fulfilling its responsibilities relating to ESG by:

a. **Strategy:** providing recommendations to the Board in respect of the Company's ESG and broader sustainability related strategies and policies;

b. **Company reporting:** reviewing and providing feedback to management on the Company's ESG reporting, including with respect to climate, modern slavery and other ESG matters;

Specific reference to established external targets relevant to the Company may be specified as well (for example, reduction of greenhouse gas emissions).

c. **Targets:** reporting to the Board on the Company's performance with respect to ESG, including by having regard to recognisable external targets and the impact on stakeholders (such as employees, third parties, communities) and the Company's reputation;

d. **Public communication:** reviewing and recommending to the Board the Company's public ESG targets and position statements (including with respect to climate);

e. **Implementation and auditing:** monitoring management's implementation of the Company's strategy as it relates to ESG, including under the Company's internal audit plan;

f. **Trends:** reviewing and reporting to the Board on ESG related trends and emerging areas of interest which may have significant implications for the Company;

g. **Queries:** responding to specific questions and issues referred by the Board, other Board Committees or management; and

h. **Compliance:** monitoring compliance with applicable sustainability and ESG-related laws and regulations and any other external commitments, made on behalf of the Company.

If the Sustainability Committee will interact with other Board Committees, the division of responsibilities between each committee should be specified in this section as well.

5. RIGHTS OF ACCESS TO INFORMATION

The Sustainability Committee has unrestricted access to information it considers relevant to its responsibilities.

The Sustainability Committee has rights of access to management and to auditors (external and internal) without management present, and rights to seek explanations and additional information from both management and auditors.

6. COMMITTEE PROCEDURES

Your Company should adopt consistent administrative and procedural rules for each of the Company's standing committees. You should therefore compare the administrative provisions in your existing Committee Charters and adapt the following procedures as necessary.

Meetings

The Sustainability Committee will meet as often as the Members deem necessary in order to fulfil their role. However, it is intended that the Sustainability Committee will meet at least **[**quarterly**]**.

Meetings of the Sustainability Committee will be convened and conducted on the same principles as those that apply to the Board pursuant to the Company's Constitution, including in respect of conflicts of interest, except as otherwise provided in this Charter.

Quorum

A quorum for the Sustainability Committee is two Members.

Convening and notice of meeting

Any Member may convene a meeting of the Sustainability Committee.

The agenda and papers for Sustainability Committee meetings will be circulated to Members in advance of each meeting so that Members have a reasonable opportunity to review the papers.

Secretary

The Company Secretary, or their delegate, must attend all Sustainability Committee meetings and is responsible for issuing and storing meeting notices, agendas, minutes and papers.

The Secretary will keep minutes of the meetings, which will be circulated to all Members in draft and then confirmed at the next Committee meeting.

Reporting

A copy of the minutes of the Sustainability Committee will be provided to the Board.

The Sustainability Committee Chair will provide a report to the Board as to any material matters arising out of Sustainability Committee meetings.

All directors may, within the Board meeting, request information of members of the Sustainability Committee.

7. INDEPENDENT ADVICE

The Sustainability Committee may seek the advice of the Company's auditors, solicitors or such other independent advisers, consultants or specialists as to any matter pertaining to the powers or duties of the Sustainability Committee or the responsibilities of the Sustainability Committee, as the Sustainability Committee may require.

8. REVIEW AND ASSESSMENT

The Sustainability Committee will undertake a process of self-assessment on at least an annual basis to determine its adequacy in relation to its membership, responsibilities, functions or otherwise. The results of this assessment will be communicated to the Board to assist the Board in its periodic review of the Sustainability Committee's effectiveness.

This Charter is to be reviewed by the Board as required and at least every two years. Any changes to the Charter require approval of the Board.

This Charter was approved by the Board of [insert company name] on [insert date].

About the authors

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