SINGAPORE EXCHANGE SUSTAINABILITY REPORTING: COMPLY OR EXPLAIN

ABOUT THE PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

The PRI is the world's leading initiative on responsible investment. It represents nearly 1,500 signatories managing US$60 trillion. The six Principles for Responsible Investment offer a menu of possible actions for incorporating environmental, social and governance (ESG) issues into investment practices. They were developed by investors and are supported by the UN.

The PRI will host its annual conference, PRI In Person, in Singapore on 6-8 September 2016. The conference takes place alongside the Sustainable Stock Exchanges (SSE) initiative global dialogue on 6 September 2016. The SSE conference will put the international investor spotlight on exchange practices in Singapore, with ESG disclosure requirements being a central component to deliver informed investment decisions and the new global sustainable development agenda.

The SSE initiative looks with interest towards Asian stock exchanges and their leadership in advancing ESG disclosure. The Singapore Exchange is invited to join the largest peer-to-peer sustainability learning group, where 46 partners exchanges working together to enhance corporate transparency – and ultimately performance – on ESG factors.

We believe partners exchanges will benefit from SGX's leadership role, its knowledge in sustainability and its know-how in market consultation processes.

SUMMARY

The PRI is responding to this consultation as ESG factors are material to issuers' performance and improved transparency is critical for investors to make informed investment decisions.

By responding to this consultation, the PRI also supports its signatories' efforts to apply:

- Principle 2: "We will be active owners and incorporate ESG issues into our ownership policies and practices", by:

  - participating in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights);
  - engaging with companies on ESG issues;

- Principle 3: “We will seek appropriate disclosure on ESG issues by entities in which we invest”, by:
  - asking for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative);
  - asking for ESG issues to be integrated within annual financial reports;
  - asking for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact);
  - supporting shareholder initiatives and resolutions promoting ESG disclosure.

The PRI welcomes and endorses the move towards a ‘comply or explain’ approach for ESG reporting in Singapore, and considers that this may set a model for other exchanges and encourage reporting on the governance of material environmental and social issues.

The PRI would like to comment on five areas:

- **Comply or explain**
  The PRI strongly supports the efforts of SGX to progress sustainability reporting for primary-listed issuers from a voluntary to a ‘comply or explain’ basis.

- **Frequency of reporting**
  ESG data should be published at least annually, in line with annual financial reporting, integrated reporting and/or sustainability reporting, and ahead of annual shareholder meetings.

- **Materiality**
  Many ESG issues are of concern to investors: they should be treated equally within a sustainability reporting framework and reported based on the judgement of companies and investors. Other reporting obligations should be used to address issues of specific concern to the exchange in the conduct of its market.

- **Responsibility of the board**
  The PRI suggests to SGX to explore the idea of Professor Bob Eccles and Timothy Youmans of an annual board *Statement of Significant Audiences and Materiality,* that clarifies fiduciary duty and the significant audiences for the corporation’s vitality and long-term success**.**

- **Independent assurance**
  As investors are constantly looking for robust reporting from corporations to make informed investment decisions, the PRI would encourage SGX to require independent assurance, consistent with other financially material data provided to investors.

CONSULTATION RESPONSE

CONSULTATION QUESTIONS

The PRI is providing supporting evidence to questions 1, 2, 5, 6, 7 and 8.

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?

The PRI strongly supports the efforts of SGX to progress sustainability reporting for primary-listed issuers from a voluntary to a 'comply or explain' basis.

PRI signatories that manage assets are required to report publicly and annually on their responsible investment activities. In 2014, 830 signatories responded; in 2015, over 950 signatories responded. The PRI Reporting Framework demonstrates that, globally, not only do many investors disclose information on their ESG practices, but they integrate ESG issues into their investment decision-making and require enhanced ESG disclosure from issuers.

The PRI's Reporting Framework asks signatories to indicate what ESG information is used in ESG incorporation strategies: 73% of global respondents use raw ESG company data, which highlights the importance of issuers reporting in a consistent, transparent and comparable way. The data also demonstrates that PRI signatories systematically require enhanced ESG disclosure in their investment decision processes.

The 'comply or explain' approach proposed by SGX will give companies the option to comply with requirements or explain why they take a different approach. The model will allow companies to report in accordance to their particular situation.

The PRI supports the shift to a 'comply or explain' approach as we believe that sustainability reporting will achieve higher standards of transparency in Singapore's equity market. This will promote more active and engaged ownership of companies, and ultimately, sustainable long-term growth.

However, the PRI recognises that the success of the 'comply or explain' model will be based on the quality of reporting, including consistency and comparability, and in particular, dialogue between investors and issuers.

Stock exchanges in Asia are making considerable progress on ESG reporting for issuers (e.g. the recent HKEX strengthening of the ESG Guide in its Listing Rules) and SGX is well-placed to ensure lasting and meaningful implementation.

The PRI recommends that SGX reviews effectiveness of the reporting requirements on an annual basis, starting with the number of issuers that are reporting, as well as analysing actions taken and outcomes achieved. SGX should put in place a monitoring process, whereby failure to adequately explain non-compliance leads to consequences.

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?

Companies need to fully incorporate sustainability risk assessment and management into their strategies and governance models. Companies should treat material ESG information as market sensitive and disclose them in a timely way.

ESG data should therefore be published at least annually in line with annual financial reporting, integrated reporting and/or sustainability reporting, and ahead of annual shareholder meetings. This will result in improved quality of information available to investors and other stakeholders, and therefore, improved investment decision-making.[1]

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

Materiality is a dynamic concept, and the materiality of ESG issues evolves over time as well as being industry- and sector-specific. This evolution is driven by changes in legislation and policy, by changes in risk and the understanding of risk, by changes in the social, environmental and economic impacts of the ESG issue in question, and by changes in societal (and beneficiary) expectations and norms.

When looking at ESG issues, it is useful to divide them into three categories (acknowledging that there is significant overlap between them)[2]:

- Financially material issues: these are issues that the investor sees as having the potential to significantly affect (positively or negatively) the financial performance of the company over the relevant time period. Stakeholders would expect these issues to be assessed by companies as a matter of course.
- Non-financially material issues: these are issues that, while they may be important to stakeholders, if managed well, do not present a significant threat to (or opportunity for) the business. Stakeholders would expect companies to demonstrate that they are managing these issues effectively, and should intervene if they were concerned that a failure to manage these issues could lead to financial detriment.
- Wider social, economic and environmental issues: these are issues that have the potential to significantly affect the company's ability to deliver on its organisational or business objectives

[1]IIRC, Creating Value Integrated Reporting and Investor Benefits, 2015 http://integratedreporting.org/wp-content/uploads/2016/01/1323_CreatingValue_No3_8a-1.pdf
[2] PRI, UNEP FI, UNEP Inquiry and UN Global Compact, Fiduciary Duty in the 21 Century, 2015 http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf

but that may have limited financial impact within the relevant time period. For example, these could be issues that affect the stability and health of economic and environmental systems, or they could be issues that are, or have the potential to be, important to customers, shareholders or other stakeholders.

Companies should consider all ESG issues, assessing if and why they are material to allow investors to understand the company's business and to make informed investment decisions.

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?

Issuers should, as a matter of course, identify the material ESG factors for their company and report on them. As mentioned under Question 5, materiality is a dynamic concept, and the materiality of ESG issues evolves over time as well as being industry- and sector-specific.

It is reasonable for the exchange to seek to protect the integrity of the market by requiring information from issuers about their activities. If particular issues are seen to be relevant to companies listed on the exchange, it may be appropriate to require this information directly through relevant listing rules.

The challenge facing the exchange in requiring a higher level of accountability for only some issues in a sustainability framework is that it would be ascribing universal priority to the selected issues regardless of their materiality. This has the effect of undermining other sustainability issues that may be important to investors and for which investors would expect to see commensurate disclosure.

There are many ESG issues that are of concern to investors. In September 2015 PRI released the results of a consultation that gauged signatories' interest levels in different ESG topics. Detailed input was received through written responses and conversations with more than 55 signatories. The breakdown of submissions was consistent with participation in our existing engagement activities: 20% of responses were from asset owners, 71% from investment managers, and 9% from service providers. The following ESG issues arose from the consultation with PRI signatories. Anti-corruption and aspects of diversity rank among important sustainability issues to investors:

- Climate Change
- Water risk
- Deforestation
- Rare earth minerals and environmental degradation
- Supply chain labour standards
- Human rights
- Income inequality and disparity of wealth within societies
- Cybersecurity
- Corporate tax responsibility
- Anti-corruption

- Director nominations
- Political activities
- Risk management and culture at banks

In November 2015, the World Federation of Exchanges (WFE) released the first generation of sustainability indicators[3] (33), which include one question and three indicators on gender and anti-corruption:

- Gender Pay Ratio – Ratio: Median Male Salary to Median Female Salary
- Gender Diversity – Percentage of FTE, Contractor, and Consultant Positions Held by Women
- Board – Diversity, Percentage of Board Seats filled by Independents & Women
- Bribery/Anti-Corruption Code (BAC), Does your company publish and follow an BAC: Yes, No?

Many ESG issues are of concern to investors and they should be treated equally within a sustainability reporting framework and reported based on the judgement of companies and investors. Other reporting obligations should be used to address issues of specific concern to the exchange in the conduct of its market.

Question 7: Responsibility of the Board
Do you agree with the specific roles and responsibilities assigned to the Board with regard to sustainability reporting?

The PRI suggests to SGX to explore the idea of an annual board *Statement of Significant Audiences and Materiality* that clarifies fiduciary duty and the significant audiences for the corporation's vitality and long-term success. The idea has been elaborated by Professor Bob Eccles and Timothy Youmans at Harvard Business School[4], in reviewing the fiduciary duties of Boards in 25 countries, including Singapore[5].

Question 8: Independent assurance
Do you agree that assurance should be voluntary? If you disagree, please give reasons.

Investors are constantly looking for robust reporting from corporations to make informed investment decisions.

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[3]World Federation of Exchanges, World Exchanges Agree Enhanced Sustainability Guidance, 2015 http://www.world-exchanges.org/home/index.php/news/world-exchange-news/world-exchanges-agree-enhanced-sustainability-guidance

[4] Eccles, Robert G. and Youmans, Timothy, Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality (September 3, 2015). Harvard Business School General Management Unit Working Paper No. 16-023 http://ssrn.com/abstract=2654199

[5] American Bar Association, Sustainable Development Task Force, 2015 http://www.americanbar.org/groups/leadership/office_of_the_president/sustainable_development_task_force.html

In the academic paper *Assurance on Sustainability Reports: An International Comparison*[6] the results support the argument that companies seeking to enhance the credibility of their reports and build their corporate reputation are more likely to have their sustainability reports assured. According to the latest CFA Institute ESG Survey, 69% of respondents agree that it is important that ESG disclosure is subject to independent verification.[7] Of this 69%, 44% would like a level of verification similar to an audit (high level of assurance) and 49% would like to see limited verification (lower level of assurance).

On a sustainability reporting framework level, reporters who use the Global Reporting Initiative (GRI) Guidelines are strongly encouraged to submit their sustainability reports to external assurance.

According to the GRI, benefits of assurance include[8]:

- increased recognition, trust and credibility;
- reduced risk and increased value;
- improved Board and CEO level engagement;
- strengthened internal reporting and management systems;
- improved stakeholder communication.

According to a recent Financial Reporting Council survey[9]: "Investors welcome the information included in extended auditor's reports, and particularly for smaller companies where there tends to be less independent information available."

The PRI encourages SGX to require independent assurance, consistent with other financially material data provided to investors.

FURTHER INFORMATION

The PRI has experience in sustainability reporting in a number of investment markets. The PRI offers its expertise to support SGX to ensure sustainability reporting reflects best practice, is well-implemented and remains current.

Building on the Fiduciary Duty in the 21st Century report and methodology, the PRI, UNEP FI and the Generation Foundation will partner and extend the analysis to five major Asian investment markets including Singapore. The aim of this project is to better understand the barriers to responsible investment and ESG integration in each of these five countries, and to make

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[6] Roger Simnett, Ann Vanstraelen, and Wai Fong Chua (2009) Assurance on Sustainability Reports: An International Comparison. The Accounting Review: May 2009, Vol. 84, No. 3, pp. 937-967. http://aaapubs.org/doi/abs/10.2308/accr.2009.84.3.937

[7] CFA Institute, ESG Survey, 2015 https://www.cfainstitute.org/ethics/Documents/esg_survey_report.pdf

[8] Global Reporting Initiative, The external assurance of sustainability reporting, 2013 https://www.globalreporting.org/resourcelibrary/GRI-Assurance.pdf

[9] FRC, 'Extended auditor's reports: A further review of experience', 2016 https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Report-on-the-Second-Year-Experience-of-Extended-A.pdf

recommendations on how these might be overcome. Particular attention will be focused on the fiduciary and other duties that institutional investors owe to their beneficiaries and clients. The report will be published in September 2016.

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FURTHER RESOURCES

- Eleanor Chambers, Wendy Chapple, Jeremy Moon & Michael Sullivan CSR in Asia: A seven country study of CSR website reporting

- SSE Initiative, Model Guidance on reporting ESG Information to investors, 2015 http://www.sseinitiative.org/wp-content/uploads/2015/09/SSE-Model-Guidance-on-Reporting-ESG.pdf

- University of Oxford and Arabesque Partners, From the stockholder to the stakeholder. How sustainability can drive financial outperformance, 2015 http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11

- Deutsche Asset & Wealth Management, ESG & Corporate Financial Performance: Mapping the global landscape, 2015 https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf

- EY, Tomorrow's Investment Rules 2.0 , 2015 http://www.ey.com/Publication/vwLUAssets/EY-tomorrows-investment-rules-2/$FILE/EY-tomorrows-investment-rules-2.0.pdf

- WWF, Sustainable Finance in Singapore, Indonesia and Malaysia: a review of financiers' ESG practices, disclosure standards and regulations, 2015 http://d2ouvy59p0dg6k.cloudfront.net/downloads/wwf_frc_forest_risk_commodities_report_2015_online_1.pdf

- Ioannis Ioannou and George Serafeim, The Consequences of Mandatory Corporate Sustainability Reporting: Evidence from Four Countries, 2014 http://www.hbs.edu/faculty/Publication%20Files/11-100_7f383b79-8dad-462d-90df-324e298acb49.pdf

- IIRC, Creating Value Integrated Reporting and Investor Benefits, 2015 http://integratedreporting.org/wp-content/uploads/2016/01/1323_CreatingValue_No3_8a-1.pdf

- Robert G. Eccles, Ioannis Ioannou, and George Serafeim,The Impact of Corporate Sustainability on Organizational Processes and Performance, 2012 http://www.nber.org/papers/w17950

- Robert G. Eccles and Timothy Youmans, Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality (September 3, 2015). Harvard Business School General Management Unit Working Paper No. 16-023 http://ssrn.com/abstract=2654199

- Roger Simnett, Ann Vanstraelen, and Wai Fong Chua (2009) Assurance on Sustainability Reports: An International Comparison. The Accounting Review: May 2009, Vol. 84, No. 3, pp. 937-967.