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PERSPECTIVE

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Getting On Board with Climate Change: A New Challenge for Company Directors in Southeast Asia

*Michael T Schaper**

Singapore is amongst the most active countries in the region addressing climate issues, with strategies that include a sophisticated whole-of-government approach to the issue, as well as an existing carbon tax. This photograph taken on 22 January 2021 shows a worker checking a floating solar power farm at sea, off Singapore's northern coast, just across the Malaysian state of Johor. Picture: Roslan RAHMAN, AFP.

* *Michael T Schaper is Visiting Senior Fellow with the ISEAS – Yusof Ishak Institute, an Adjunct Professor at the John Curtin Institute of Public Policy, Curtin University, and a Fellow of the Australian Institute of Company Directors. Email: michael.schaper@gmail.com. These are his personal views.*

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EXECUTIVE SUMMARY

- Legal, regulatory, strategic and external pressure is growing on company directors and boards to address climate change, reduce emissions and adapt to a warmer world.

- However, the level of activity and focus in Southeast Asia on this matter is lower than in many other jurisdictions.

- Only one country in ASEAN – Malaysia – is currently a member of the Climate Governance Initiative, which works with the World Economic Forum to upskill directors on climate abatement and adjustment. A Singapore chapter and an ASEAN hub are currently being considered.

- Governance scrutiny and board independence in the region are often held back by high levels of ownership concentration, family-based business control and stock holdings by government-linked entities. Professional director associations are often new and small.

- More ASEAN member states should consider forming a Climate Governance Initiative (CGI) chapter; assisting national director bodies to upskill their climate knowledge; broaden the pool of qualified independent director candidates; and encourage consideration of climate issues by the boards of non-profit, SME and statutory organisations.

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INTRODUCTION: A SHIFTING GLOBAL CLIMATE – AND ECONOMY

An increasing range of scientists, governments, multilateral agencies, large corporations, investment bodies, public interest bodies and advocacy groups have acknowledged the need to limit global warming to no more than 1.5°C to 2°C by 2030, and ultimately move to a zero-net-emission economy. To do so, substantial changes will be needed which can have an impact on all firms in Southeast Asia.

This transformation will affect many different aspects of how companies operate, including production processes, finance, management, supply chains, transportation, energy consumption, stakeholder relationships, marketing and human resources.

Ultimate responsibility for this activity will rest with the boards of corporations, as they – and the individual directors who constitute them – are accountable in law for the oversight and control of the business entities they direct.

These governance changes are already well underway in many other parts of the world, but have been markedly slow in Southeast Asia to date.

CLIMATE CHANGE AS A CORPORATE RISK

Company boards around the world are increasingly being asked how they are addressing a range of issues related to climate change. Dealing with this problem is not simply a matter of emissions reduction. Risks which are increasingly becoming important to companies, shareholders and senior management now include:

- *Extreme weather events.* The United Nations' Intergovernmental Panel on Climate Change in July this year noted that temperatures have already begun to increase, and are being accompanied by noticeable changes in weather patterns around the world. These are increasing the number and severity of business disruptions, hampering transportation and supply systems, increasing insurance premiums for firms, and creating more damage to people and property (IPCC 2021).

- *Regulatory and legal risk.* Whilst businesses have usually been encouraged to reduce emissions on a voluntary basis, there is an increasing risk of more formal regulation, mandatory emissions trading systems and limits on output being imposed by governments. At the same time, an increasing number of corporations are being sued by external groups for allegedly breaching their duties of care by failing to adequately deal with emissions reductions: by May 2020, more than 1,500 cases of climate change litigation had been filed globally against various companies (Yap, Seow & Tan 2021)[1].

- *Financial impacts.* An increasing number of financial institutions (including banks, venture capital funds, managed investment funds, and retirement/annuity funds) are critically examining where they place their money, and disinvesting from companies with poor environmental, sustainability and emissions records. This can curtail a firm's ability to borrow capital, and lead to the withdrawal of investor funds. The growth and

mainstreaming of sustainability principles across pension funds, mutual funds and lending requirements represent a very powerful reason for directors to assiduously manage climate risks.

- *Consumer and stakeholder expectations.* Firms are increasingly subject to pressure from shareholders, consumers, suppliers, NGOs, advocacy groups, labour unions and other external stakeholders in regards to climate change. These bodies are seeking more commitment by public corporations to promptly move to net-zero (or, in some cases, negative) emissions outputs. In many cases, advocacy bodies and consumer groups are increasingly willing to support boycott campaigns against firms seen as high carbon emitters.

- There has also been increased shareholder activism at company general meetings and in voting for director elections.

- *Supply chain risks.* Many Southeast Asian firms are closely integrated into various international supply chains, and so are also indirectly vulnerable to global warming impacts on other firms they trade with. For example, they may experience adverse ripple effects if another corporation in the same system is damaged by extreme weather events. As ASEAN seeks to build a stronger cross-border regional economy, more firms will be exposed to an increasingly complex suite of environmental impacts on supply chains.

CHALLENGES FOR DIRECTORS

Given that many directors have had no prior experience in managing climate-related matters, it can often be quite difficult for individual directors, and boards collectively, to decide how they should rise to the challenge. Whilst companies in high-emitting industries (such as aviation, transportation, chemicals, energy and manufacturing) are relatively familiar with the phenomena, the risks posed by climate change can often be hard to identify in other commercial sectors. Nevertheless, as many professional company director associations have noted (MinterEllison/AICD 2021), there are questions that directors in all companies need to consider:

Initial assessment. The first issue is to understand the company's current exposure to climate-related issues. This can include its current "carbon footprint" (emissions impact); the legal obligations imposed by governments; understanding the sentiments of the firm's major stakeholders; and the level of preparation for future extreme weather events. What risks does the company face, and what is the overall fiduciary, legal and practical responsibility of the firm with regards to climate change?

What emissions target should the firm aim for? There are several different targets currently being bandied around in public debate, with many leading firms now moving to a net-zero emission goals by 2030 or 2050. Other corporations have committed themselves to becoming negative emitters.

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How should the company operationalise and oversee the governance of climate risks? Having identified the firm's risks and the changes that need to be made, implementation and oversight becomes important. Who is operationally responsible? What metrics should be reported to the board? Should it become part of the purview of the board's audit and risk committee?

Cost. What will the overall expenses of carbon abatement be in the next few years, and of longer-term adjustment to a warmer world? These figures can often be substantial, and difficult for firms to accurately forecast in advance. In addition to new operating and capital costs, there is an increasing risk of stranded assets if plant and equipment can only operate when producing a high level of emissions. Insurance premiums are also likely to increase for firms exposed to extreme weather vulnerabilities, and it may be difficult to obtain suitable policies going forward. Finally, directors will also need to determine if their firm is likely to face a carbon tax, which already exists in jurisdictions such as the European Union and in Singapore, and is likely to become more common and more expensive over time.

What is the likely future regulatory and reporting environment? The clear trend over time has been for various governments to demand increasingly higher levels of environmental performance. Does the firm have a clear understanding of what these might be? New sustainability reporting and climate-related disclosures may also be required for some particular firms, such as those listed on a stock exchange or operating under an industry code of practice.

Corporate skills base. What skills and knowledge do the firm's employees have in order to deal with this issue? Is additional training and development needed? Do specialist staff need to be recruited?

Personal knowledge. Many directors do not know a great deal about global warming, emissions and associated issues, making it difficult to exercise due diligence and consideration when dealing with these issues across the board table. Although directors are not generally expected to be a subject matter expert in every area they oversee, a general baseline level of knowledge is still needed.

Controversy. Whilst the need to deal with climate change is a given in many communities, in other jurisdictions it can remain a highly contested area with a significant body of sceptics and critics. For large corporations with a significant market or international presence, this can lead to high profile – and sometimes very negative – publicity and criticism. Board directors need to develop a clear sense of their risk appetite with regards to this issue.

AN EMERGING GLOBAL TREND

A director-specific focus on climate change is a relatively new phenomenon, and perhaps indicative of the speed with which global warming is increasingly becoming a core issue for much of the business community.

Much of it has been generated by the work of the World Economic Forum and a number of other initiatives, such as the International Corporate Governance Network's (ICGN) *Global Governance Principles*. Boards have also been spurred on by the accounting and reporting requirements of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD), and enhanced disclosure regimes on many bourses.

Many CEOs and directors have now recognised the need for more attention on the issue. Between 2014 and 2019, for example, respondents to the WEF's annual *Global Risks Report* consistently cited climate change and extreme weather events as the leading future macro-economic risk they were likely to face. In response, that year the WEF and PwC jointly set out a series of guiding principles for company boards on the issue, the major elements of which are shown in Table 1 below.

Table 1: WEF Principles for Effective Climate Governance

1	Climate accountability	Boards should be accountable for the company's long-term resilience relating to climate change.
2	Command of the (climate) subject	Boards should include directors with knowledge, skills, and background in climate-related issues.
3	Board structure	Climate considerations should be integrated into the board structure and committees.
4	Material risk and opportunity assessment	Regularly assess short-, medium- and long-term materiality of climate-related risks and opportunities.
5	Strategic and organisational integration	Climate issues should be part of strategic investment planning, decision-making processes and risk management.
6	Incentivisation	Consider including climate-related targets and indicators in executive incentive schemes.
7	Reporting and disclosure	Ensure material climate-related risks, opportunities and strategic decisions are consistently and transparently disclosed to stakeholders.
8	Exchange	Stay informed about latest climate-relevant risks and regulations; regularly exchange ideas with peers, policy makers, investors and other stakeholders.

Source: WEF/PwC (2019: 11-17)

One of the leading global forums for climate change and company directors today is the Climate Governance Initiative, a network of director organisations across more than 20 different countries. The CGI exists to promote the WEF's *Principles* for boards, focusing on non-executive directors. It aims to raise climate awareness within director communities and their professional bodies; embed climate issues into board responsibilities and decision-making; provide practical suggestions to directors; and help them develop the skills needed to deal with a changing climate (Climate Governance Initiative 2021).

CGI chapters now exist in over twenty countries, including Canada, Brazil, Chile, France, Russia, Iceland, the USA and the UK, with the greatest concentration being in Europe. In

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and around Southeast Asia, however, only four jurisdictions are members, or in the process of joining: Malaysia, Singapore, Hong Kong and Australia.

The emergence of CGI comes at a time when there is also a growing number of other international business networks, organisations and coalitions that are working to raise awareness and generate meaningful action on climate change. These include the International Chamber of Commerce, the We Mean Business Coalition, Business Ambition for 1.5°C, SME Climate Hub, and the UNFCCC's Race to Zero. What makes the CGI unique, however, is its singular focus on the role of company directors.

THE DIRECTOR LANDSCAPE IN SOUTHEAST ASIA

As much as it is anywhere else, climate change is an emerging challenge for companies and their directors across Southeast Asia. The IPCC has forecast that, under current trends, climatic patterns in Southeast Asia will see temperatures in the region continuing to rise. Rainfall trends will not be consistent, but are likely to increase in some parts of the region and decrease in other areas. There will be fewer but more extreme tropical cyclones, especially affecting countries around the Pacific Ocean. The combined impact of climate change, land subsidence, and local human activities will lead to more extensive flooding in the Mekong Delta. Finally, sea level rises are also "virtually certain" (IPCC 2021).

These changes will have a major impact on the commerce and consumer populations of ASEAN member states, a region which has more than 70 million trading businesses (Schaper 2020). For example, higher sea levels will threaten the viability of major metropolitan regions such as Manila, Bangkok and Jakarta. There may be greater flooding in littoral zones, where much of the region's population lives. Greater cyclonic activity may cause more losses of infrastructure, buildings, agricultural crops and human lives. Weather variation could also lead to potential substantial declines in rice yields. Other parts of the agricultural sector, which is still a major part of many Southeast Asian economies, are also likely to be adversely affected (ASEAN 2021).

To date, however, the amount of director activity in climate governance appears to be quite limited. Only one country – Malaysia – is a full signatory to the Climate Governance Initiative. It was an early starter in work on this topic: Climate Governance Malaysia was launched in May 2019, and claims to have been only the second country in the world – and the first in Asia – to advocate for the CGI. Overseen by a group of non-executive directors, it is largely run on a voluntary basis (Climate Governance Malaysia 2021).

A second chapter, that of CGI Singapore, is in the process of being formed, and an ASEAN hub is being launched in the near future.

Several hundred firms in SE Asia are also signatories to the Global Reporting Initiative, which allows firms to report on their sustainability performance using a common set of international metrics, including carbon emissions. An ASEAN office has been based in Singapore since 2019 (GRI 2021).

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In April 2021, company directors in SE Asia's most sophisticated and valuable bourse – the Singapore Stock Exchange – were effectively put on notice by the publication of a legal opinion commissioned by the Commonwealth Climate and Law Institute. It concluded that directors of corporations were obliged to consider climate change risks as part of their commitment to the best interests of the company, and (building upon the 2016 sustainability reporting requirements imposed by the SGX) had a clear duty to disclose any material impacts of climate change risks. It also pointed out the personal liabilities of directors who breach these requirements (Yap, Seowl & Tan 2021). Singapore is amongst the most active countries in the region addressing climate issues, with strategies that include a sophisticated whole-of-government approach to the issue, as well as an existing carbon tax.

Malaysian regulators have also recently stepped up their activities in this area, with both Bank Negara and Bursa Malaysia issuing corporate and director guidance this year (Commonwealth Climate and Law Initiative 2021).

However, overall the level of director activity in climate change issues appears to be low.

Many ASEAN businesses seem to be generally aware of climate change, and some have developed strategies relating to energy efficiency and greenhouse gas emissions reduction. But few of them have looked more strategically at, and integrated climate change into their overall business planning (Amran, Ooi, Wong & Hashim 2016).

There are a number of reasons for this.

As the OECD has noted, a fundamental issue across the region is the high level of ownership concentration, and the predominant role of family ownership in many businesses. Both of these factors tend to lead to a "business as usual" approach to governance due to the lack of new, external board members with different ideas. Its recent examination of board structures and processes across Asia found that many corporations are effectively controlled by a small number of families, especially in The Philippines, Indonesia and Malaysia. In addition, government-linked entities also hold considerable stock in firms in Malaysia, Singapore and Vietnam (OECD 2017).

The role of independent directors[2] and independent board chairs is often weak in many Asian jurisdictions. For example, only Indonesia requires the chair of a board to be separate to that of the CEO, whereas in many cases firms in The Philippines, Malaysia, Singapore and Thailand can permit the same person to hold both positions. The number of independent, professional directors on most corporate boards is also limited to a minority position, typically sitting at only a third of all positions (OECD 2017). These structures can make it difficult to successfully bring new ideas and change to board deliberations.

Professional director associations are still somewhat nascent. As Table 2 below shows, not all countries in ASEAN have a national professional body representing directors (Laos and Brunei do not appear to have any publicly-visible association). Moreover, many of those that exist are relatively new: whilst a handful date back to the 1990s (Singapore, Thailand), several others (Cambodia, Myanmar, Vietnam) are only one or two years old. In some cases,

membership numbers are also quite low (for example, the Philippines' Institute of Corporate Directors states on its website that it has about 300 members, a very small figure for a country with more than a million businesses in existence).

Table 2: Director Institutes/Associations in Southeast Asia

Brunei	No apparent organisation.
Cambodia	Institute of Directors, Cambodia *Formed 2020*
Indonesia	Indonesian Institute for Corporate Directorship *Formation date not stated*
Laos	No apparent organisation.
Malaysia	Institute of Corporate Directors *Formed 2018* Malaysian Alliance of Corporate Directors *Formation date not stated*
Myanmar	Myanmar Institute of Directors *Formed 2018*
Philippines	Institute of Corporate Directors *Formation date not stated*
Singapore	Singapore Institute of Directors *Formed 1998*
Thailand	Thai Institute of Directors *Formed 1999*
Vietnam	Vietnam Institute of Directors *Formed 2018*

WHAT NEXT?

Clearly, there is more that can be done in the region to facilitate greater director focus on climate change adaptation. Change in this field is coming for company directors in Southeast Asia – along with a range of new responsibilities and expectations.

A first step for many ASEAN jurisdictions may be to form a local CGI chapter, or some other similar director-focused climate initiative. This will allow local directors to access some of the global networks of other firms who have already begun the decarbonisation journey. Understanding a firm's risks, examining case studies showing how other companies have made the adjustment, and building relationships with other directors is a useful way to expedite the change process. Given that so few firms in Southeast Asia have become involved in the CGI, there is plenty of scope to encourage much greater participation.

Increasing the direct involvement of director organisations is another step forward. Institutes and director professional bodies can play a leadership role in proactively putting

a focus on emissions abatement and developing client resilience. Just like the CGI at the cross-border level, there is a need for national associations to provide governance guidance, ideas and information directly to their members.

Moreover, education and information about this issue should be offered to all directors, not just those on stock exchange-listed corporations. Unlisted private sector firms, small businesses, non-profit organisations and statutory corporations also face a climate challenge, and their boards need to understand how they can deal with this issue.

Finally, boards in the region should look carefully at their recruitment of new directors. Non-executive director positions, especially, are ideal points in which to secure candidates with a knowledge of climate issues, and can potentially help firms not only to develop resilience, but also to identify some of the many new business opportunities emerging as nations decarbonise. To do so, though, firms will increasingly need to rely on more formal, open and genuinely competitive recruitment processes for NEDs, rather than the traditional "old boys network."

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[1] The most noticeable is the May 2021 Shell case, where the District Court in The Hague, The Netherlands found that Shell must reduce its global net carbon emissions by 45% by 2030 compared to 2019 levels.

[2] Directors who are not also full-time employees of a company are generally referred to here as "non-executive directors," although numerous other broadly synonymous terms are also used in different countries in Southeast Asia, such as "supervisory board members", "outside directors", "independent directors", or "corporate directors," amongst others.

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