Sustainability / ESG & Directors Responsibilities

Sustainability encompasses the long-term viability of a company, considering its environmental, social and economic impacts. It emphasizes that a sustainable organization not only thrives economically but also contributes positively to society and reduces its environmental footprint. Investors are integrating sustainability factors into their decision-making. Stakeholders are showing concern about companies' action towards Sustainability.

ESG is a set of specific criteria used to evaluate a company's performance and behaviour in three key areas: environmental, social, and governance. ESG provides a structured framework for assessing how well a company manages risks and opportunities related to sustainability issues. ESG is gaining significance as the Global Sustainability reporting landscape heads towards standardization. ESG has now become a global baseline for sustainability disclosures.

SECP has recently issued ESG Disclosure Guidelines and amended Code of Corporate Governance 2019 for listed companies. We are pleased to share this memorandum on the subject which provides a brief on Sustainability and ESG related developments taking place in Pakistan and the responsibilities of directors under the corporate law.

Contents of this document

History of Regulatory Developments in Pakistan concerning Sustainability & ESG

Code of Corporate Governance 2002

- The Code of Corporate Governance was introduced, in the year 2002 which provided the framework for governance of a listed company in the interest of its stakeholders. The Code recomposed the Board of Directors of listed companies by bringing in independent and non-executive directors.

- The Code of 2002 required the Boards to approve a policy on health, safety, and environment and to keep an oversight on environment related matters of the company.

Companies (Corporate Social Responsibility) General Order 2009

- Companies (Corporate Social Responsibility) General Order was issued in the year 2009 and it requires all listed and unlisted public companies to provide in their Director's Report, a descriptive and monetary disclosure of all CSR activities undertaken by a company during the relevant financial year.

Code of Corporate Governance of 2012

- The Code of Corporate Governance of 2012 added a board approved policy for CSR initiatives and required that a report be placed with the Board on the CSR activities of the Company.

Corporate Social Responsibility Voluntary Guidelines 2013

- Corporate Social Responsibility Voluntary Guidelines 2013 were issued to suggest a framework for companies taking CSR initiatives.

The Companies Act, 2017

- The Companies Act, 2017 outline the duties of directors where it explicitly states that "*a director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and <u>for the protection of environment</u>*.

- The directors of a listed company, while reviewing the business performance of the Company in their report, are now required by the Act to state the impact of Company's business on the environment.

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History of Regulatory Developments in Pakistan concerning Sustainability & ESG........continue

Listed Companies Corporate Governance Regulations in 2017 & 2019

- After the promulgation of Companies Act 2017, the Code was replaced with Listed Companies Corporate Governance Regulations in 2017. Subsequently CCG Regulations 2019 came into force. These regulations make it mandatory for every listed company to have female representation on its board.

- CCG Regulations 2019 use the term Sustainability and provide for a policy framework for Environment, Social and Governance aspects which also encompasses health and safety (H&S) and CSR, as catered to in the earlier Codes. Also, the Regulations require the Board to have much more comprehensive views and oversight on ESG, H&S, and CSR.

Guidelines for Code of Conduct for listed Companies 2019

- Guidelines for Code of Conduct for listed Companies were shared by the SECP in the year 2019 to help meet the Board of listed companies the requirement of developing a Code of Conduct for its directors, senior management and employees. These guidelines give comprehensive coverage to ESG, H&S, and Diversity and Inclusion.

ESG Regulatory Roadmap in 2022

- The above has led to SECP coming up with the ESG Regulatory Roadmap map in 2022 and the draft of ESG Disclosure Guidelines, in the year following.

ESG Disclosure Guidelines 2023

- These guidelines were finalized on June 12, 2024, which encouraged adoption of IFRS Sustainability Standards.

CCG Regulations, 2019 amended in 2024

- Changes made in CCG Regulations 2019 to emphasis on the responsibilities of the listed companies' boards related to sustainability and ESG. The amendments were notified on June 12, 2024

Directors Responsibilities under the Companies Act, 2017 and Code of Corporate Governance, 2019

Responsibilities of Directors pertaining to Sustainability and ESG laid down in the Companies Act, 2017 and the Code of Corporate Governance 2019 (CCG 2019), are as follows:

REQURIEMENTS UNDER THE COMPANIES ACT, 2017

SECTION 223(7)

Contents of directors' report and statement of compliance for listed companies:

'In the case of a listed company, the business review must, to the extent necessary for understanding the development, performance or position of the company's business, include—

(a) the main trends and factors likely to affect the future development, performance and position of the company's business;

(b) the impact of the company's business on the environment;

(c) the activities undertaken by the company with regard to corporate social responsibility during the year.'

The requirements under Part(a) can also consider this in terms of risk and opportunities of businesses, Part(b) should cover environmental, social and governance factors to give a holistic overview and Part (c) to philanthropic donations and investing in the community, although a progressive business can also use this to disclose report activities related to employee welfare, employee engagement, and the impact on the supply chain.

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REQUIRMENTS UNDER CCG 2019

APPLICABLE ON ALL LISTED COMPANIES

CCG REGULATION *10(1), 10(2) and 10(3)*:

Generally Board of directors is responsible to ensure:

- adoption of corporate governance policies and monitoring their effectiveness
- governance of risk and for determining the company's level of risk tolerance by establishing risk management policies
- adopt a vision and / or mission statement monitoring effectiveness of company's corporate governance and overall strategy
- a formal code of conduct is in place that promotes ethical culture

Sustainability as a risk should be part of the Risk Management process and should be inbuilt in the culture of the company through vision, mission and code of conduct.

CCG REGULATION 10A:

**** Specific Role of The Board and its Members to address sustainability risks and opportunities, include:***

- responsible for governance and oversight of sustainability risks and opportunities
- encourage the board to adopt ESG Disclosure Guidelines 2023
- ensure policies to promote diversity, equity and inclusion (DE&I)
- take appropriate measures for understanding and proactive management of sustainability risks and opportunities (SRROs) including climate-related SRROs
- ensure DE&I related strategies, priorities and targets, their performance evaluation and monitoring
- establishment of a dedicated sustainability committee, with at least one female director, or assignment of additional responsibilities to an existing committee, to review SRROs and ensure DE&I practices
- disclosures in the directors' report on the assessment of sustainability related risks, their measurement and promotion of DE&I.

**(inserted in CCG 2019 vide notification dated June 12, 2024)*

REQUIREMENTS UNDER CCG 2019 …..continue

CCG REGULATION 10 (4)

Board is responsible for significant policies, those relevant to ESG and Sustainability include:

- ESG policy including health and safety aspects in business strategies that promote sustainability and corporate social responsibility;
- Whistle blowing, including complete mechanism to handle and ensure transparency;
- *anti-harassment policy to safeguard the rights and well-being of employees, incorporating the mechanism of the Protection Against Harassment of Women at the Workplace Act 2010, including;
  - (a) Code of Conduct for protection against harassment at the workplace;
  - (b) Formation of an Inquiry Committee to enquire into complaints in this regard;
  - (c) Designation of a competent authority; and
  - *(d)* Display copies of the Code of Conduct in English as well as in language understood by the majority of employees at a conspicuous place.

**(inserted in CCG 2019 vide notification dated June 12, 2024)*

CCG REGULATIONS 35:

As a voluntary disclosure to encouraging good practices in relation to transparency and accountability, policies may be placed on the company's website include:

- *Risk management policy;*
- *Whistle blowing policy;*
- *Corporate social responsibility / sustainability / environmental / social / governance related policy*
- **Policies for promoting DE&I and protection against harassment at the workplace*

**(inserted in CCG 2019 vide notification dated June 12, 2024)*

ESG Disclosure Guidelines 2023

Realizing the importance of this subject matter, the SECP issued an ESG Regulatory Roadmap in June 2022. Following the path, SECP issued draft Guidelines on ESG Disclosures for Listed Companies, 2023. SECP has notified these guidelines on June 12, 2024; the salient features of which are as follows:

- Guidelines provide a baseline disclosure framework for annual sustainability reporting by listed companies voluntarily using any format i.e. a separate sustainability report, disclosures integrated within the Annual Report or Online Disclosures.

- Key ESG Performance Indicators have been provided for each segment i.e. Environmental, Social, and Governance as per World Federation of Exchanges (WFE) ESG Metrics (Appendix-A to the guidelines). Metrics/Topics covered in each category are:

ENVIRONMENTAL	SOCIAL	GOVERNANCE
GHG Emissions	CEO Pay Ratio	Board Diversity
Emissions Intensity	Gender Pay Ratio	Board Independence
Energy Usage	Employee Turnover	Board competence
Energy Intensity	Gender Diversity	Incentivized Pay
Energy Mix	Temporary Worker Ratio	Collective Bargaining
Water Usage	Non-Discrimination	Supplier Code of Conduct
Environmental Operations	Global Health & Safety	Ethics & Anti-Corruption
Environmental Oversight	Child & Forced Labor	Data Privacy
Sustainable Sourcing	Corporate Social Responsibility	Sustainability Reporting
Climate Risk Mitigation and adaptation	Employee training and Succession Planning	Disclosure Practices External Assurance
	Human Rights	
	Working Conditions	
	Injury Rate	
	Marketing	

- **Globally Recognized Standards/Frameworks** can be used in Reporting Sustainability i.e. Global Reporting Initiative (GRI) Standards, Women Empowerment Principles (WEPs) and International Sustainability Standards Board (ISSB)

- **Listed Companies are encouraged to adopt IFRS Sustainability Standards** using Industry specific SASB/IFRS Foundation Guidance.

- **Existing mandatory disclosure** as required under any other laws must be complied;

- **Other companies** are also encouraged to adopt the ESG guidelines voluntarily.

IFRS Sustainability Standards – An Overview

With the growing need for sustainability reporting, there was a need to harmonize the disclosure requirements pertaining to sustainability. With this objective, the International Sustainability Standards Board (ISSB) issued two IFRS Sustainability Disclosure Standards in June 2023:

- **IFRS S1** sets out general requirements for providing a complete set of sustainability related financial disclosures in a manner which is useful to users of general-purpose financial statements and reports. Many of the conceptual foundations and general requirements of IFRS S1 are adapted from IASB's Conceptual Framework for Financial Reporting, including IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

- **IFRS S2** integrates the recommendations of the Task Force on Climate related Financial Disclosures and sets out the requirements for a company to disclose information about its climate-related risks and opportunities.

  Climate related risks can be a) physical, such as those resulting from increased severity of extreme weather as well as b) transition, such as those associated with policy action and changes in technology.

  Climate related opportunities arise when companies try to mitigate and adapt to climate change, and this can produce opportunities to develop new products or capture new business.

- IFRS S2 is designed to be used with IFRS S1**.** The disclosures under each standard are broadly categorized under four core considerations:

  1. **Governance –** The governance processes, controls and procedures used by the company to monitor and manage sustainability related risks and opportunities.

  2. **Strategy –** Approaches put in place by the Company to manage sustainability related risks and opportunities. Under this area the entity is required by IFRS S2 to disclose quantitative and qualitive information as to how sustainability related risks and opportunities have affected its financial position, financial performance and cash flows. Also, it is required to disclose anticipated financial effects in future under probable scenarios.

  3. **Risk Management –** Processes a company uses to identify, assess, prioritize, and monitor sustainability related risks and opportunities.

IFRS Sustainability Standards – An Overview………continue

4. **Metrics and targets** – Performance of the Company relative to its sustainability related risks and opportunities, including progress towards any targets the company has set or any targets it is required to meet by law or regulation. The following are three broad types of Metrics against which the company is to report under IFRS S2.

   i) ***Green House Gasses Emission*** - companies are required to disclose their absolute Green House Gasses Emission (GHF) under various elements of its value chain e.g., procurement, business travel, waste generation, employee commute, distribution activities etc. A total of 15 such categories are identified.

   ii) ***Cross Industry Metrics*** - companies will have to disclose the amount and percentage of assets or business activities vulnerable to and aligned with climate related risks and opportunities respectively, as well as the capital, financing or investment deployed towards these risk and opportunities. Cost of GHG emissions is to be calculated as internal carbon price and remuneration of executives and management linked to climate related considerations is to be disclosed.

   iii) ***Industry Based Metrics*** - IFRS S2 also requires a company to disclose information on Industry-based Metrics that are associated with common business models and activities in a particular industry. Guidance material is available for industry-specific metrics built on SASB Standards (Sustainability Accounting Standards Board). Such standards have been developed for more than 77 industries up till now. Some of the common metrics are i) Greenhouse Gas Emissions b) Air Quality c) Energy Management d) Water Management e) Waste Management f) Workforce Health & Safety and g) Supply Chain Management.

Applicability - The two sustainability standards are effective for the annual reporting period beginning on or after January 01, 2024. SECP is working with ICAP for devising a practical approach for the adoption of these standards in Pakistan. We foresee that in coming years companies will also be required to obtain third party assurance on the compliance with these standards.

IFRS Sustainability Knowledge Hub has been launched as key component of the IFRS Foundation's capacity building program, link given below: https://www.ifrs.org/sustainability/knowledge-hub/

ISSB Digital Sustainability Taxonomy, has been published in April 2024 which is designed to be consistent with the IFRS Accounting Taxonomy so that companies can provide a holistic digital financial reporting package to investors, the ISSB Taxonomy can also be used with other digital taxonomies:https://www.ifrs.org/issued-standards/ifrs-sustainability-taxonomy/ifrs-sustainability-disclosure-taxonomy-2024/

IFRS Foundation Inaugural Jurisdiction Guide released recently in May 2024 is to help jurisdictions design and plan their journey to the adoption or other use of ISSB Standards: https://www.ifrs.org/content/dam/ifrs/supporting-implementation/adoption-guide/inaugural-jurisdictional-guide.pdf

Some Suggestions for an ESG Policy

In our view it should be a high-level policy and include the following:

- Company's commitment towards ESG
- How ESG is integrated into the business strategy?
- Major ESG areas that the company will work towards.
- How ESG related risks will be mitigated though effective risk management policies?
- What steps will be taken to integrate ESG culture within the organization?
- How ESG related KPI's will be set?
- What would be the ESG reporting mechanism for internal and external stakeholders?
- Inclusion of relevant ESG factors in vision, mission, code of conduct and other policies

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