NEXT

EDITION FOUR

JUNE 2022

BUSINESS, RISK AND THE ENVIRONMENT TODAY

GREENWASHING SCRUTINY

CLIMATE REPORTING'S FUTURE

SUSTAINABLE FINANCE EXPLAINED

ESG IN TAX?

PODCAST: ETHICAL DATA & AI

Tidal Marks by Marilyn Wallace

KING & WOOD MALLESONS
金杜律师事务所

FOREWORD

DAN CREASEY, HEAD OF RESPONSIBLE BUSINESS

55.4%

of respondents to KWM's recent *Directions* survey said creating and maintaining a diverse workforce is a top priority, suggesting organisations are taking a wider view of what ESG involves.

A lack of specialised personnel or knowledge to support ESG commitments, was identified as a key challenge by

43.5% of respondents.

"IT SEEMS THAT THE FUTURE HAS ARRIVED ALL AT ONCE."

Hironori Kamezawa, President & Group CEO of Mitsubishi UFJ Financial Group Inc, said recently.

In just several short years, the fusing of global social, regulatory, environmental and market forces have created an extraordinary and rapid shift towards a new understanding of what it means to be 'best practice'.

The expectation on boards, executives and community leaders to understand and manage environmental, social and governance (ESG) considerations now makes them business-critical. This new reality elevates climate & environment, risk & compliance, equity & inclusion, social mobility, responsible procurement and social impact. No longer can they remain siloed under 'Corporate Social Responsibility' – it is imperative they are woven into fundamental strategy, vision, and operational thinking.

Against a backdrop of devastating natural disasters, the most significant global pandemic in more than 100 years and rousing social movements concerning gender, inclusion and racial equity, this shift is being reflected in boardrooms, courtrooms and in community halls (both virtual and in person) around the world. The message from shareholders, employees and community leaders is clear: companies and organisations must significantly step up their efforts to meet this intense demand for better ESG outcomes through greater action, stronger leadership, enhanced transparency and authenticity.

It will be hard. As Sanda Ojiambo, CEO of UN Global Compact, and Peter Lacy, Chief Responsibility Officer of Accenture, explain: "Global supply chains are fracturing, and inequality continues to rise. Couple this with the fallout from the COVID-19 pandemic, and many businesses are ill-prepared for the coming reality."

It will be worth it. New business opportunities, enhanced reputational benefits and licences to operate will flow most strongly to responsible businesses and organisations that give primacy to how their operations impact people and planet, who hold themselves accountable for their actions, who are authentic and responsive, demonstrate leadership, and govern with the highest standards of integrity and transparency.

How? Telstra puts it perfectly: "Responsible business is everyone's business". Being a responsible business is a whole of business task and requires a joined-up approach to be effective. What's more, no organisation alone can achieve the sort of ESG progress being called for, so close collaboration with all stakeholders has never been more relevant. In turn, there is a significant market advantage to be had infor businesses aligning with evolving best practices in ESG.

As we approach 2030, the prospect of meeting and exceeding the UN Global Goals looks daunting. But as a highly optimistic person, I continue to hold bucket loads of hope. I'm buoyed by the actions of business and community leaders across the globe, who are amplifying ESG issues, drawing on immense brain power, resources and networks, showing up in world-class ideas and innovation. This is generating the momentum needed for the seismic changes the world needs.

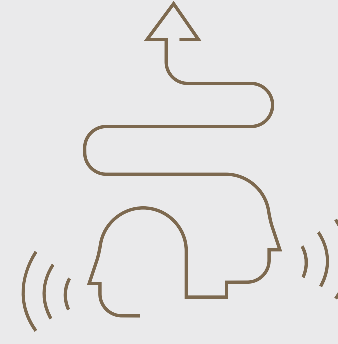
This and future editions of NEXT are to channel this optimism. We will continue to focus on the emerging opportunities and significant advantages on offer from re-positioning an organisation as a responsible business.

I hope you enjoy this edition and I welcome the opportunity to discuss all things ESG with you over coffee.

INTRODUCTION

CLAIRE ROGERS, HEAD OF CLIMATE

The fourth edition of NEXT illustrates how rapidly the notion of good corporate citizenship is evolving. CSR (corporate social responsibility) has yielded to ESG (environmental, social and governance) - these three words represent the simultaneous expansion and greater focus for companies on impact – for both people and planet. While clearly vastly more influential now than ten or even five years ago the mechanics of the concept remain unchanged. The discipline is about recognising the many relationships between an organisation and those people and places who drive it, depend on it, or are touched by it in some way – whether they be investors, employees, customers or simply citizens impacted by a company's actions.



In this edition we take a deeper looks at the risks and opportunities this presents for companies and highlight the importance of staying on top of the ever-changing landscape.

In particular we consider:

- **Greenwashing** and understanding the ACCC's focus
- What will the **future of climate reporting** look like?
- The role for **sustainable finance** in meeting climate and environmental targets
- How to think about **tax** in the context of ESG
- **Managing data and deploying AI** – how can businesses do it well and ethically?

We've chosen these subjects based on our conversations with the clients we are assisting to navigate this space. Tellingly, there are many organisations for whom every single one of the angles above will be immediately and directly relevant. For anyone not already facing into these issues, it is certainly clear that as they continue to ripple outwards, it will be important to consider what sort of strategy and specific action will be needed in the medium term.

We trust you find these articles interesting and insightful to guide you and your organisation on this journey.

ABOUT THE AUTHORS

FROM THE EDITORS

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CLAIRE ROGERS appointment as Head of Climate Change Strategy at KWM is supported by her impressive resume in the renewables sector, with a wide range of project financing experience acting for sponsors and financiers in relation to major renewable energies developments and acquisitions. With a unique practice in the Australian market, Claire advises sponsors and lenders on highly complex projects including cutting edge renewable energy transactions and low emissions technologies.

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CAROLINE COOPS is a partner in the Competition team, and is one of Australia's leading competition and consumer specialists. Caroline advises across competition regulatory investigations, complex merger clearance matters and consumer protection litigation. Caroline guides clients through ACCC and other regulatory investigations. She is heavily involved in policy debate, including as a member of the Law Council of Australia's Business Law Section Executive.

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KEEPING YOUR "GREEN CLAIMS" OUT OF THE "RED ZONE"

SIX GOLDEN RULES TO FOLLOW

Public pressure, consumer demand and investor expectation are all fuelling the exponential growth in corporates moving to address climate change, typically via responsible business and social licence commitments. More and more businesses are going "carbon neutral" or committing to emissions reduction targets. KWM's Climate Disclosure Trends of the ASX50 report shows 86% of Australia's largest 50 listed companies made a net zero or carbon neutral pledge in 2021. And, to the extent businesses are not yet seeking to address their environmental impact in this way, they often face pressure from shareholders to take environmental action. Once they have gone "green" businesses understandably want to tell customers and shareholders. However, as more and more corporates espouse their environmental credentials, there has been a commensurate increase in interest and scrutiny from regulators and strategic litigants, including activist shareholders.

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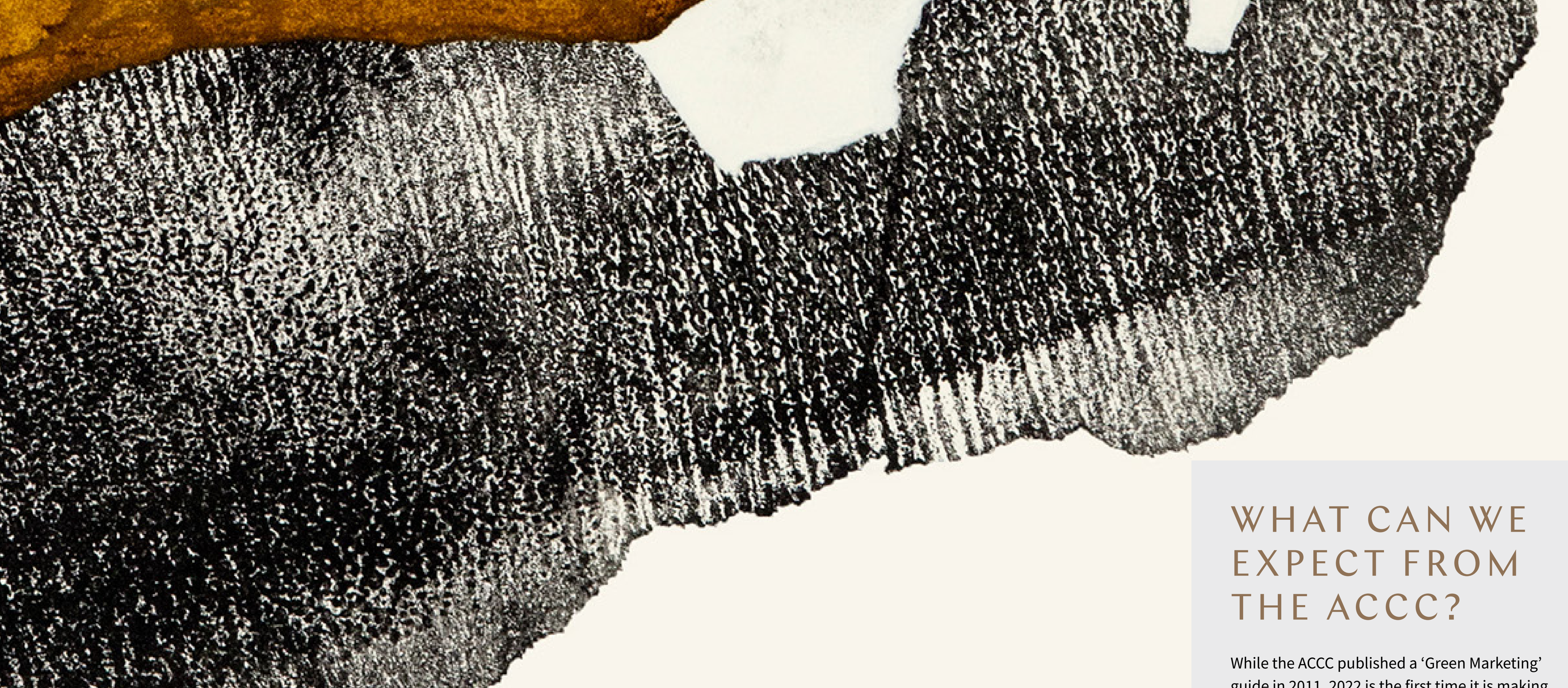


This is now a key area of regulator interest. The Australian Competition and Consumer Commission (**ACCC**) has announced *“consumer and fair-trading issues in relation to environmental claims and sustainability”* as a compliance and enforcement priority for 2022. A key focus under this priority will be “green” claims and “greenwashing”.

Green claims are representations about environmental practices or the environmental attributes of products or services, including claims about carbon neutrality, renewable energy, and clean energy. Where a company makes false or misleading green claims, this is known as “greenwashing”. Just like any other false or misleading representation made by a business, greenwashing will breach the Australian Consumer Law (**ACL**) prohibitions on misleading or deceptive conduct and false or misleading representations.

This article explores the regulatory and legal risks associated with making green claims, and provides some practical, golden rules to help make sure your “green claims” stay out of the “red zone”.

WHAT CAN WE EXPECT FROM THE ACCC?

While the ACCC published a ‘Green Marketing’ guide in 2011, 2022 is the first time it is making environmental and sustainability claims - and greenwashing in particular - a compliance and enforcement priority. This means businesses should assume that any “green” claims they make will be more highly scrutinised by the ACCC than ever before. In announcing this priority, the ACCC also made clear that:

- it considers that greenwashing can also distort demand and supply-side incentives and generate unfair competition and outcomes for businesses (in addition to consumer harm);
- it will be closely scrutinising carbon neutral claims made in the manufacturing and energy sectors; and
- it will closely engage with other regulators, in particular ASIC and the Clean Energy Regulator, who are also separately targeting greenwashing.

In particular, businesses in the energy sector should be keeping this risk front of mind when communicating their environmental credentials, given the above and also because the ACCC has made “competition and consumer issues arising from the pricing and selling of essential services, with a focus on energy and telecommunications” a priority for 2022.

KEY LEGAL RISKS

Misleading and deceptive conduct

There is no specific consumer-protection legislation in Australia that specifically regulates greenwashing. Instead, the general consumer protections in the ACL equally apply to “green” and environmental claims. Key risks to manage include misleading and deceptive conduct and false representations, which carry significant pecuniary penalties and the risk of injunctions, corrective advertising orders and court-enforceable undertakings.

There are also equivalent misleading and deceptive conduct prohibitions to be mindful of in the *Corporations Act 2001* (Cth) (Corporations Act) and *Australian Securities and Investments Commission Act 2001* (Cth).

Carbon neutral and net zero claims in the “hot seat”

Popular green claims in recent years include claims of carbon neutrality, emissions reductions and net zero emissions targets. These types of claims are being increasingly made by the private sector as they’ve become more proactive in tackling climate change.

A critical starting point for any business seeking to make such a claim is to ensure that there is evidence to substantiate they are accurate. For carbon neutral claims, this will often involve obtaining carbon neutral certification from organisations like Climate Active, who awards its certification to organisations that have reached a state of carbon neutrality (either in respect of their operations or products/services). However, carbon neutral claims still carry inherent complexity and risk and have recently been the subject of shareholder activism. Importantly, obtaining certification does not provide a business with complete carte blanche to use the words “carbon neutral” in all circumstances. Businesses always need to keep in mind the scope of their carbon neutrality and avoid implicitly or explicitly exaggerating that scope.

For claims about emissions reduction targets and net zero targets it is even more critical to have evidence to substantiate the claims at the time they are made. This is because, being representations, these kinds of statements will be taken to be misleading unless a business can point to evidence showing they had reasonable grounds for these types of claims at the time they were made.

Our golden rules provide some practical guidance on key things to consider when making these types of claims.

GOLDEN RULES FOR GREEN CLAIMS

Companies need to ensure that advertising and communications do not suggest that their business operations, or products or services they supply, are more environmentally positive / friendly than they actually are.

1. Be clear

Given the complexity of the scientific calculations/basis sitting behind green claims (and the potential for technical language to be used), it is especially important to ensure that the message conveyed is clear, unambiguous and not too broad in scope. To the extent that an ambiguous, unclear or overly broad claim creates a false or misleading impression, there is a risk of contravening the ACL despite not having any intention to do so. For example, when making a claim about carbon neutrality, companies need to be clear about what the carbon neutrality relates to – e.g. its business operations or a product or service – and may need to explain what it means to be carbon neutral (to avoid customers assuming that they produce zero emissions, rather than purchase offsets to neutralise those emissions).

2. Make sure you can substantiate your claims

All claims must be scientifically sound and able to be substantiated. It is important to ensure that communications do not convey a level of scientific acceptance or "authority" of a particular environmental claim that is unwarranted. For example, the Climate Active certification is a mechanism by which carbon neutral claims can be substantiated. However, as we discuss in golden rule #3, this does not mean that the certification can be used to substantiate all advertising.

3. Always consider context

Despite certifications (such as Climate Active), care still needs to be taken about how that certification is represented to consumers in the context of a particular advertisement. For example, adding words like "certified carbon neutral by Climate Active" or "certified carbon neutral" to every advertisement would be risky without considering what is being advertised, and whether it is included in the scope of your certification.

4. Representations can be implied, not just express

Claims in advertising may be express or implied. "Green" claims are particularly prone to containing implied representations which may present additional risk when considering advertising. They attract additional scrutiny from regulators and competitors because of their social value to customers, but also their scientific complexity. Remember to consider any implied, as well as express, messages that communications may convey.

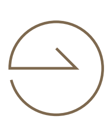
5. Have reasonable grounds for making a claim about a future matter

"Green" marketing claims can often amount to representations with respect to future matters (e.g. aspirational statements about carbon neutral ambitions or forecasts about meeting certain emission reduction targets). A representation with respect to a future matter is deemed to be misleading unless its maker has reasonable grounds for making the representation. This heightens the importance of substantiation – which is particularly important for "green" claims.

6. Be extra careful about aspirational claims

Aspirational claims can be particularly fraught. As we discuss in golden rule #5, an aspirational claim can be a form of representation with respect to future matters. This means that, e.g., carbon neutral goals or commitments must be objectively based on reasonable grounds – you can't just pick a figure and hope for the best. The level of substantiation will depend on whether absolute or qualifying language is used. How you couch the claim will also depend on whether it is aspirational or a "stretch goal".

The private sector is increasingly being recognised for the leading role it can play in combatting climate change. While navigating this area can be complex, it also presents an exciting time and opportunity for businesses and organisations. Organisations have a chance to demonstrate their values – and authenticity, clarity and substantiation will be the key to success.



For a deeper look on substantiating environmental claims, see our Sustainable Finance article, p20

NO STANDARD ANSWERS – WHAT DO POTENTIALLY DIVERGENT DISCLOSURE RULES MEAN FOR CLIMATE RISK REPORTING?

Companies hoping for harmonised climate disclosure rules face fresh uncertainty with recently-released draft regimes diverging on key requirements. The regulatory inconsistency is likely to embolden activist investors, many of whom are pressuring companies frustrated by inaction from governments and authorities.

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The answer to the question 'How does your Board oversee climate risks?' might depend on who is asking. New proposals from key standard-setters/regulators differ in how they expect entities to report on whether they have the skills and expertise to meet the climate challenge.

For example, the climate disclosure rule recently proposed by the US Securities and Exchange Commission (SEC) requires entities to say whether any board member has expertise in climate-related risks. To comply, disclosure must be in sufficient detail as to 'fully describe' the nature of the expertise. This is one of many proposed disclosure requirements which differs to the International Sustainability Standards Board's (ISSB's) exposure draft on climate-related disclosures. The ISSB's version requires disclosure of how the Board ensures that appropriate climate skills and competencies are available to oversee the entity's climate strategies.

Three things flow from this.

Firstly, companies may respond to the proposed SEC rule by giving more weight to climate expertise when searching for directors. This is particularly likely in sectors where climate strategy forms an integral and significant part of overall strategy, e.g. extractive and energy industries.

While many Australian companies won't be caught by the US SEC's proposed rule, it's likely they will face investor expectations to raise voluntary disclosures to levels commensurate with mandatory rules. It's also likely the direction set by the SEC will ultimately help to inform Australia's own inevitable mandatory climate disclosure regime.

Secondly, it may spur more investor pressure on Board composition, as well as more action like that seen in the Exxon Board spill last year. In that case, 3 of the 12 Exxon directors were replaced with independent directors nominated by an activist firm targeting Exxon over its dependence on fossil fuels.

Already in 2022 activist investors have called for votes against two directors (the Lead Director, and Chair and CEO) at Chevron's annual meeting on the basis (i) Chevron has failed to adequately respond to successive majority vote shareholder resolutions on greenhouse gas reductions and lobbying, and (ii) Chevron's targets, investment plans and policy influence are demonstrably out of alignment with shareholder demands on climate impact. A Californian public pension giant also disclosed in the leadup to Chevron's annual meeting that it would vote against four directors – the members of Chevron's public policy and sustainability committee – in response to what it describes as Chevron's failure "to adequately respond to the Climate Action 100+ engagement initiative". Notwithstanding this, all of these directors were elected at Chevron's annual meeting.

Closer to home, three of the four proxy advisers in Australia have said they will recommend votes against directors for climate oversight failures. Typically, such recommendations focus on the individual director most accountable for oversight of climate risk, for example the chair of the Board or the chair of the risk, sustainability or similar sub-committee.

	Institutional Shareholders Services (ISS) Australia Proxy Voting Guidelines	CGI Glass Lewis Policy Guidelines	Australian Council of Superannuation Investors (ACSI) Climate Change Policy
Proxy voting guideline/ policy relating to director or board failure in relation to climate risk oversight	Generally vote against directors individually, committee members, or the entire board, due to material failures of risk oversight, including in relation to climate change	Where it is clear that a company has not properly managed or mitigated environmental risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, CGI Glass Lewis may consider recommending that shareholders vote against members of the board who are responsible for oversight of environmental risks (or, in the absence of explicit board oversight of environmental issues, CGI Glass Lewis may recommend shareholders vote against members of the audit committee)	Where companies consistently fall short of ACSI's detailed expectations on climate change, ACSI may recommend a vote against directors of ASX200 companies, on a case-by-case basis. Recommendations will focus on the individual directors most accountable for oversight of climate-change related risks, for example company chairs, and the chairs of the risk and sustainability committees or similar

Similar positions are being taken among some of the world's largest asset managers, with BlackRock not supporting the election of 281 directors globally in 2021 due to climate-related concerns. An example of this in Australia was BlackRock voting against the re-election of the longest serving director up for re-election (in lieu of a vote against the sustainability chair, who was not up for re-election) at the 2021 AGM of an ASX50 oil and gas company due to the company's "inadequate progress on scope 3 target setting".

Thirdly, it highlights an emerging issue with jurisdictions (e.g. the US and EU) pushing ahead to develop their own local disclosure rules and standards alongside the ISSB's ongoing consultation on its exposure drafts. While the ISSB was established to drive a globally consistent and comparable sustainability reporting baseline, this won't happen if jurisdictions jump the gun and put in place their own detailed sets of rules that differ from the ISSB's ultimate standards.

Fortunately the ISSB is already moving to address this and has established a working group to enhance compatibility between the global baseline and jurisdictional initiatives. Members of the working group include the US SEC, the European Commission, the European Financial Reporting Advisory Group and others.

The G7 has also been quick to welcome the ISSB's work to deliver a global baseline of sustainability disclosures, and has urged national and regional standard-setters to cooperate with the aim of reaching standards that can be implemented globally. The G7 includes, of course, the US.

The ISSB's working group will need to move quickly to establish its standard before competition becomes entrenched. Consultation on the US SEC's proposed rule ended on 17 June 2022, the ISSB's feedback period on its exposure drafts running until 29 July 2022, and the consultation period for the European Sustainability Reporting Standards running until 8 August 2022.

Ultimately, the need for globally comparable and consistent climate risk disclosure remains. If done right, climate risk disclosure can help to reduce systemic under-pricing of climate risk in the market, and foster demand for investment opportunities aligned with the Paris Agreement goals. But to get there will require cooperation between international bodies and national and regional regulators and standard-setters.

WHAT CAN DIRECTORS DO IN THE MEANTIME?

- continue participating in regular training and keeping frequently and sufficiently informed about climate-related risks relevant to their industry;
- continue ensuring robust processes are in place to monitor and track climate-related risks and that material information is brought to their attention in a form that allows them to consider, stress test and assess whether more work or information is needed;
- continue considering climate-related risks as part of business strategy, risk management, and financial oversight;
- continue overseeing progress against any targets set, including any interim targets; and
- continue overseeing reporting of climate risk disclosures in line with internationally recognised frameworks such as the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB) standards and the Global Reporting Index (GRI) standards.

SUSTAINABLE FINANCE – EXPONENTIAL GROWTH CONTINUES

Just a few years ago, raising finance linked to the achievement of environmental, social and governance (ESG) objectives may have been viewed by borrowers as a "nice to have" and a relatively easy way to enhance their reputations and boost their ESG credentials. Now, sustainable finance is widely embraced and continues to gain momentum at a rapid pace. The opportunities and incentives it offers to support and fund transition to a sustainable economy mean sustainable finance is an essential part of treasury toolkits and investment portfolios and is expected to grow exponentially. In this article, we explore the market's growth, key benefits for investors and borrowers, and discuss potential pitfalls like greenwashing.

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Through sustainable finance, borrowers apply ESG considerations to their use of the debt borrowed. The rise of sustainable finance is leading to more long-term investments in sustainable economic activities and projects.

ESG IN FINANCE

Environmental considerations include climate change mitigation, use of sustainable resources, waste management, biodiversity protection and pollution prevention.

Social considerations include the promotion of human and animal rights, equality, inclusiveness, labour relations, consumer protection, investment in human capital and communities and access to healthcare and education.

Governance considerations include employee relations, executive remuneration and compensation practices and management structures of both public and private organisations.

ESG linked debt is commonly raised through the issuance of bonds to investors or through loans from banks. Each type of debt has a set of voluntary guidelines published by the International Capital Markets Association (ICMA), the Loan Markets Association (LMA), the Asia Pacific Loan Markets Association (APLMA) or the Loan Syndications and Trading Association (LSTA), depending on the market in which the debt is borrowed and whether the debt is borrowed in the form of a bond or a loan. The following table sets out the most common types of sustainable finance.

TYPES OF SUSTAINABLE FINANCE

Green Bonds **Social Bonds** **Sustainability Bonds** **(GSS Bonds)**	**Green Loans** **Social Loans**	**Sustainability-Linked Loans (SLLs)** **Bonds (SLBs)**
Bonds where the proceeds are used by the issuer to fund new or existing eligible green projects or social projects or a combination of green and social projects.	Loans where the proceeds are used by the borrower for green or social purposes.	Unlike GSS Bonds and green and social loans, the proceeds of SLLs and SLBs are not earmarked and can be used for general corporate purposes. SLBs and SLLs incentivise the borrower's achievement of certain ESG objectives measured against KPIs and Sustainability Performance Targets (SPTs) with interest rate adjustments applied based on compliance with them.

SUSTAINABLE FINANCE CAN NOT BE IGNORED

Global call for action

With increasing global attention and industry support for a transition to a sustainable economy, sustainable finance continues to gain momentum at a rapid pace.

In 2015, important international agreements were concluded with the adoption of the United Nations 2030 agenda, the Sustainable Development Goals (SDGs) and the Paris Agreement. The Paris Agreement includes a commitment to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. More recently, a key objective of the 2021 United Nations Climate Change Conference (COP26) was the promotion of sustainable finance, focusing on mobilising public and private sector finance to support the securing of global net-zero emissions (NZEs).

From a governmental standpoint, Australia has demonstrated its commitment to a sustainable economy by ratifying the Paris Agreement, adopting the SDGs and committing to upholding its obligations under the UN human rights conventions. Australia has also recently released its plan for achieving NZEs by 2050.

From a business standpoint, commitment to ESG goals is driven by strong market forces. The impact of business on the progress of sustainable finance has arguably been greater than that of government.

Rising demand for sustainable investments

It is clear that sustainable finance has become a top priority for corporates, investors and regulators alike. Companies without clear and credible transition strategies in line with the Paris Agreement are beginning to experience an adverse impact on access to and cost of funding.[1] Sustainable finance is no longer just a public relations matter for companies. Investors are shifting their focus from financial returns to broader investment considerations, including environmental and societal impacts as a means of creating and protecting long-term value.

There has been a substantial increase in sustainable investment in Australia in recent years and this trend is expected to continue. Australia's market trajectory is in line with global developments. The Climate Bonds Initiative forecasts that global sustainable debt issuance will reach US$1.9-2.2 trillion in 2022 compared to US$977 billion in 2021. By 2025, ESG-linked finance is expected to reach US$53 trillion.

For institutional investors with growing ESG mandates, ESG factors play a fundamental role when making long-term investment decisions and are increasingly being viewed as more important than traditional financial metrics. Investors are aware of the positive impact that investing in companies which embed ESG principles into their practices can have on their business performance. Most institutional investors agree that companies which focus on ESG issues are more likely to outperform their competitors, produce better long-term returns and reduce investment risk. Understandably, for these reasons, the proportion of both retail and institutional investors globally who apply ESG principles to at least a quarter of their portfolios jumped from 48% in 2017 to 75% in 2019. It is expected that ESG-mandated assets will grow almost three times as fast as non-ESG-mandated assets to comprise half of all professionally managed investments by 2025.

Supportive regulatory environment

Governments globally are supporting sustainable finance as a means of meeting their commitments to climate change by influencing the actions of the private sector. Policymakers are developing initiatives to incentivise investment in low-carbon business and further ESG objectives. Regulators now consider a business's assessment of climate risks to be a fundamental component of compliance for organisations that deliver financial services.

In line with these developments, the recently established Australian Sustainable Finance Institute (**ASFI**) has launched its own sustainable finance roadmap, establishing new frameworks, standards and practices to realign the Australian finance sector to support better environmental, social and economic outcomes, including the achievement of the NZE target by 2050.

[1] Ibid, quoting David Jenkins, Global Head of Sustainable Finance at National Australia Bank Limited.

BENEFITS FOR BORROWERS

Sustainable finance is not only beneficial for the planet, it is also beneficial for borrowers. Why?

Better terms and pricing

Borrowers can expect better terms and pricing for their debt as the market for green, social and sustainable investments continues to grow and develop, as the cost of capital is being driven down and investors view borrowers that pursue sustainable finance as better-placed to deal with future risks and opportunities.

The pool of investors and lenders has also grown and diversified, driven by pressure from stakeholders of banks and investors to boost their own ESG credentials. This meant an increase in demand for sustainable financial products.

Reputation

It is increasingly the case that without committing at least part of its debt to ESG objectives, the reputations of corporate borrowers will suffer. Sustainable finance serves to boost a borrower's green credential and its social licence to operate.

Better ESG outcomes

Sustainable finance can help to mitigate the exposure of borrowers to ESG-related risks by helping them to meet their ESG commitments and objectives.

"ITS NOT EASY BEING GREEN"

KERMIT THE FROG

BEWARE OF GREENWASHING

In the context of sustainable finance, "greenwashing" refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally (or socially) friendly, when in fact basic environmental (or social) standards have not been met. Greenwashing can occur when borrowers exaggerate the green or other credentials of a financial product or project or set ambitious or unrealistic targets which they are unable to meet.

For more, see our article on Greenwashing, p10 of this edition.

As there are a variety of principles which may be applied in setting green or social goals and a lack of metrics to evaluate and measure whether green or social targets are being met, there can be a lack of rigour around the selection and measurement of KPIs by borrowers when raising green finance. There are generally few consequences under ESG loan and bond terms for breaching ESG undertakings and reporting obligations.

Greenwashing may constitute misleading or deceptive conduct under Australia's consumer and corporate laws, which may lead to scrutiny and enforcement action from regulators and/or actions by investors and lenders. Even if it doesn't constitute misleading or deceptive conduct, greenwashing could adversely affect a borrower's reputation, its ESG credentials and its relationship with investors and lenders.

Reputational risks

- Greenwashing scandals can result in stakeholders losing trust and cause significant reputational damage, even if the behavior does not amount to misleading or deceptive conduct.
- Greenwashing can reduce a borrower's resilience and competitiveness, as its peers actively pursue tangible ESG objectives and gain market share.

Legal and regulatory risks

- Greenwashing may contravene specific prohibitions against misrepresentations or constitute misleading or deceptive conduct with legal consequences (e.g. scrutiny or enforcement proceedings from regulators such as APRA, ASIC or ACCC for breaches of the Australian Consumer Law, Corporations Act or the ASIC Act and/or litigation and class actions).
- The market for independent verification of SLB frameworks is currently relatively underdeveloped (compared with the credit rating market), meaning that the lack of an arms-length relationship between borrower and verifier may reduce the legitimacy of sustainability claims.

Uncertainty of future regulation

- A lack of certainty regarding regulatory standards could affect the future classification and pricing of sustainable finance products.
- Risk that a proliferation of rules and regulations across different markets will cause more confusion, rather than providing clarity (especially if there is a lack of harmonisation) and make it even more difficult for investors to adequately assess and compare products.
- Principles, guidelines, policies and the like are being developed by countries and regions around the world at a rapid rate and there is no clear indication at this time where the market might settle.

HOW IS THE RISK OF GREENWASHING BEING ADDRESSED?

Regulation

There remains a real risk of greenwashing in the absence of a clear regulatory framework and global standardisation of ESG, with a wide range of approaches being taken,[2] in part, due to the range of products, assets, sectors and financing markets in this space. However, the market is evolving, maturing and moving towards greater harmonisation and the development of market norms as a result of the work done by leading industry bodies (such as the LMA, APLMA, LSTA, ICMA and others).

There is a general consensus among market participants that increased regulation of sustainable financing is needed. This will assist borrowers in demonstrating the legitimacy of their products and differentiate them from those who are merely greenwashing. It should also allow for the development of reliable market data against which the risk, return and ESG objectives of various sustainable finance products can be better assessed, positively influencing demand and pricing.

Reporting

ESG reporting involves the disclosure of performance in relation to material ESG risks and opportunities, both qualitatively and quantitatively, to explain how these aspects inform a company's strategy and overall performance. There are several frameworks and approaches for reporting and reporting comes with its own set of challenges as a result.

Companies have broad discretion over which standard-setting organisation to follow, and what information to include in their ESG reports. Moreover, borrowers set goals on the basis of their capabilities or aspirations, rather than following corporate emissions allocations or adopting science-based targets.

Although strides are being made in setting tangible targets and goals, and accurately reporting on these, there is still progress to be made. Another challenge is the gaps in reporting metrics, as not all information can be credibly or as easily disclosed. For instance, from a governance perspective, it is easy to report on 'hard' information, which is quantifiable and verifiable, like the number of jobs created for women in a year; it is more difficult to report on 'soft' information, such as the quality of those jobs, which is difficult to quantify.[3]

Disclosure

Investors are demanding more transparency and accountability from borrowers on ESG matters. In response to this, a new standard-setting board known as the International Sustainability Standards Board (**ISSB**) was established at COP26. The ISSB aims to provide a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about borrowers' sustainability-related risks and opportunities to help them make informed decisions. The ISSB will work alongside and operate in conjunction with the IASB.[4] ASIC and other key standard setting bodies in Australia have welcomed the establishment of the ISSB.

Third-party verification

By having a credible third party verify the framework under which ESG finance is raised, lenders and investors are less likely to be concerned about the potential for greenwashing. In the absence of regulatory standards, third-party verification may provide greater certainty to investors of the climate, reputational and other risks associated with the product or asset.

Borrowers should exercise restraint in their disclosure

Borrowers should ensure that any statements or KPIs relating to an ESG loan or bond don't overstate the potential ESG benefit of the project, activity or asset being funded by the proceeds of the loan or bond. In the absence of clear regulation and with differing ideas of what constitutes dark green, light green, vanilla or even brown in different financing markets and by different market participants, this is of vital importance.

CONCLUSION

While sustainable finance might once have been considered niche, it is now the new normal and is expected to continue to grow rapidly. Borrowers financing for the future must embrace sustainable finance in order to maintain stakeholder support and remain competitive, while at the same time being mindful of the risks and opportunities presented in this fluid and evolving environment.

[2] For instance, the EU recently adopted a legal framework introducing a taxonomy that seeks to define which investments or economic activities can be considered sustainable or climate friendly. The US Securities and Exchange Commission has also announced its task force to identify gaps or misstatements in ESG disclosures, as well as compliance issues relating to the ESG strategies of managed funds.

[3] Alex Edmans, M Heinle and C Huang, 'The Real Costs of Financial Efficiency When Some Information is Soft', (2016) 20 Review of Finance 2151–82, available at <http://faculty.london.edu/aedmans/Disclosure.pdf>; See also, Alex Edelmans, 'The Dangers of Sustainability Metrics' (Website, 11 February 2021), available at <https://voxeu.org/article/dangers-sustainability-metrics>.

[4] IIFRS, 'IFRS Foundation announces International Sustainability Standards Board, Consolidation with CDSB and VRF, and Publication of Prototype Disclosure Requirements' (IFRS website, 3 November 2021), available at <https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/>; See also, 'ASIC welcomes new International Sustainability Standards Board and updated climate-related disclosure guidance' (ASIC website, 14 December 2021), available at <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-349mr-asic-welcomes-new-international-sustainability-standards-board-and-updated-climate-related-disclosure-guidance/>.

ESG FACTORS IN TAX? THAT'S A YES

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As environmental, social and governance (ESG) concerns' feature ever more prominently in shareholders' decision-making, the scope of their application is simultaneously expanding. Put simply, companies and organisations must expect that an ever-wider array of their actions will be judged on whether they're responsible as well as profitable. Tax policies and structures ought to be re-examined in this light.

Today, we are seeing a trend towards increasing voluntary transparency through such examples as early engagement with revenue authorities such as the Australian Taxation Office, best practice internal tax policies and increasing international information sharing. What does this all mean and what impact does it have on your business? We believe that businesses both large and small should be thinking about their stance towards formal, informal and more intangible ESG factors as they relate to tax.

In this piece we break down [or try to grasp] what ESG as a concept is, in a taxation context, what external and internal factors businesses need to consider and share six ideas on what we think businesses should be starting to think about.

A WIDE FIELD OF INQUIRY

ESG in a tax context concerns companies doing the "right", "responsible" and/or "fair" thing with regard to their taxes.

Grasping ESG as a concept is not without difficulty, particularly in a taxation context.

Academic literature on the topic frequently refers to a company paying its "fair share" of tax, for example, but what constitutes "fair", "right" or "responsible" is a matter of significant controversy and judgment. Such views often differ wildly over time, between companies in the same industry, officers within the same company, political parties and indeed countries. Certain types of aggressive tax avoidance strategies may be clearly inconsistent with good governance, but many options are open to companies in structuring their tax affairs that are less obviously "aggressive". Which of those options are consistent with a company paying their "fair share" can be difficult to work out, especially when there are competing pressures at play.

Tax-related ESG concepts can roughly be split into two elements: internal (or private) and external (or more public-facing). Internal aspects may include a company's written taxation policies, which may cover the company's procedures in relation to tax and compliance risk, the use (or non-use) of "aggressive" structures and the levels of justification required towards the tax positions it takes, and its cultural attitude towards engagement with revenue authorities globally. External factors may include participation in early engagement and audit procedures with revenue authorities, voluntary disclosures of tax positions taken, and, in an Australian context, voluntary public disclosure of a company's tax payments and strategy under the Voluntary Tax Transparency Code ("**VTTC**").

It is up to each company to determine its ESG position, having regard to their shareholders' directions and tolerances. Questions which should be asked in determining where each company lands on the issue include:

1. **What guidance or restrictions should there be on a company's tax affairs beyond the bounds of the written law itself?**
2. **How much primacy should ESG considerations take over structures permitted by the law?**
3. **What room is there for differing interpretations of tax laws?**

Other considerations which complicate ESG include the complexity of many businesses' tax affairs, commercial sensitivities and privacy concerns. Given the increasing public pressure on revenue authorities to publicly disclose companies' tax information, is it better for those companies to voluntarily disclose that information themselves?

These issues must be considered not just once, but on an ongoing basis within a specific organisation's context.

Decisions relating to tax (both directly and indirectly) are ultimately made by individuals. A written tax policy is a good start in guiding such decisions, but ESG does not end there. If a company is to take ESG seriously as part of its tax affairs, the person "holding the pencil" needs to be provided with clear, useful guidance about how the tax ESG policy translates into practice for that company and for the individuals that represent the company, and the company needs to foster a culture amongst its people, both within and outside its tax personnel, which places importance on transparency and compliance as outlined in the policy.

EXTERNAL/ PUBLIC FACTORS

As noted earlier, ESG concepts relating to tax can be roughly divided into internal and external factors. Key public-facing elements of ESG in the Australian context include the Voluntary Tax Transparency Code and the ATO's annual Report of Tax Entity Information.

Voluntary Tax Transparency Code

In February 2016, the Board of Taxation released its "A Tax Transparency Code" report. The VTTC is intended to be a set of principles and standards to guide the disclosure of tax information by large (AUD 500m+ turnover) and medium-sized (AUD 100m to AUD 500m turnover) businesses. The code is entirely voluntary and disclosure is not enforced, though misleading disclosures may be penalised under other laws.

Materials disclosed under the VTTC are intended to be used by "general users" (the community at large), "interested users" (shareholders, investors, media etc) and by revenue authorities.

The Board of Taxation suggests disclosure of the following information:

Large and medium businesses	• Reconciliation of accounting profit to tax paid • Identification of material temporary and non-temporary differences • Accounting effective company tax rates for Australian and global operations in accordance with accounting standards
Large businesses only	• Approach to tax strategy and governance • Tax contribution summary for corporate taxes paid • Information about international related party dealings

As a voluntary code, there is not much guidance about how such information should be set out and how much detail should be provided. A review of various companies' recent voluntary disclosures under the VTTC revealed little commonality between them. Some taxpayers provided detailed documents which explained how their tax strategy was aligned with their core values, while others took a "minimum required" approach.

A key issue with voluntary transparency is explaining complex tax issues for the various users of that information. Banks and other financial institutions typically did a reasonable job of breaking down complex taxation concepts into plain English, while other entities provided a dense report which had a high level of assumed knowledge. Our review also evidenced tax disclosures both as a standalone document and alternatively as part of a broader ESG report.

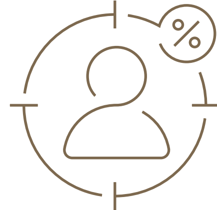
The examples generally did not discuss their entities' offshore operations, or taxes other than corporate income tax.

Overall, our key observation on the VTTC is that a company's response will likely evolve over time, incorporating changing governance practices and social expectations, the legal and commercial environment, and developments in global tax transparency initiatives. It may become increasingly necessary to "voluntarily" comply over time as part of accepted business practices and as a requirement for engagement with government and other businesses.

Report of Tax Entity Information

Separately, the ATO annually publishes the Report of Tax Entity Information, which discloses the total income, taxable income and income tax payable of entities with a total annual income of AUD$100m+. This is a very blunt measure of tax contributions, providing far less information to the public than the VTTC, but it is wholly outside the control of companies.

The key, for those companies whose data is published, is to ensure that it can adequately explain its tax position. Whilst the ATO website provides a brief summary of what might affect a company's tax position (for example, cyclical economic cycles, significant deductible infrastructure investment prior to the derivation of income etc), companies should be prepared to explain its specific circumstances within the context of their broader tax ESG policies.



INTERNAL/ PRIVATE FACTORS

Tax policies

Tax policies differ between each organisation, depending on their size, structure, activities and attitude towards risk. Not every organisation has such a policy, and the existence of a policy alone will do nothing without the understanding and support of the organisation's decision-makers – in other words, the policy must be lived and breathed, and not merely put on a shelf. Nevertheless, the existence of a tax policy is one of the first positive steps in implementing broader tax ESG awareness within an organisation.

We see a number of common factors between tax policies. They typically include:

1. general approach to taxation risk, with specific commentary around relevant issues such as transfer pricing and the use of offshore structures;
2. the company's attitude towards tax compliance, transparency, audits and settlements, including its relationship with revenue authorities;
3. the resources which are to be used in preparing tax work; and
4. an outline of the organisation of the tax function and who is responsible for tax matters.

More sophisticated tax policies go beyond income taxes to other taxes such as consumption taxes and bespoke taxes like resource rent taxes, withholding taxes and state taxes. Entities relying on information provided by outsourced service providers such as custodians and administrators may also have policies covering the assessment of third-party data which feeds into their tax reporting obligations, such that they might minimise the risk of inaccuracies (the ATO's guidance for "governance over third-party data" can be found here).

Engagement with the ATO

Since around 2015, the ATO has operated in a framework of "justified trust". A concept put forward by the OECD in 2013, it involves the ATO asking, if we told the community how we assured the tax paid by a taxpayer, would they be satisfied we did enough?

Justified trust involves a review of the taxpayer's tax risk management and governance framework, identifying tax risks, understanding new and significant transactions, and getting a holistic understanding of a taxpayer's business operations and financial performance to understand their accounting and tax results. The company's risk profile established by the ATO in this process determines the level of scrutiny that the ATO will impose on a company. As such, while ESG in a tax context is still developing as a concept, it has a direct and immediate bearing on a company's interactions with the ATO.

A taxpayer can choose to be more or less compliant during "justified trust" and other interactions with the ATO, though an unwillingness to be transparent and forthcoming at early stages, or an inability to produce a considered tax framework and policy, can result in more intensive reviews being taken later.

The ATO's review processes are presently aimed at large taxpayers, but the process is expanding (from the Top 100, to the Top 500, to the Top 1,000 and to the Next 5,000 taxpayers). As the ATO's net widens, it is not surprising that ultimately, all companies will be asked to provide details of their tax policies and broader tax ESG positions. It therefore pays to be prepared now.

WHAT SHOULD I BE DOING?

ESG in a taxation context is becoming become more prevalent and is weighing more heavily on stakeholders including shareholders, regulators, politicians, employees, customers and the general public. Taxation issues regularly make headlines and the international trend towards governmental information-sharing, anti-abuse rules and minimum tax rates will make risky tax positions increasingly difficult to justify.

In that context, it is well worth thinking about the following:

1. Does my organisation have a taxation policy and framework? What does it say? Does it need to be updated or expanded?
2. What is my organisation's tolerance for tax risk? What level of justification for tax positions is necessary? Is this consistent with my shareholders' expectations?
3. Who makes the decisions in my organisation about its tax affairs? Who might make decisions which affect tax, but is not part of our tax personnel?
4. Are our tax personnel adequately heard in decision-making processes? Are tax compliance considerations given adequate weight?
5. What are our current obligations to disclose information to the ATO and other regulators? Do we want to go beyond what we are obliged to do and voluntarily disclose more?
6. Do we have any "high risk" structures in our organisation (and what do we consider to be "high risk")? Do they need to be addressed?

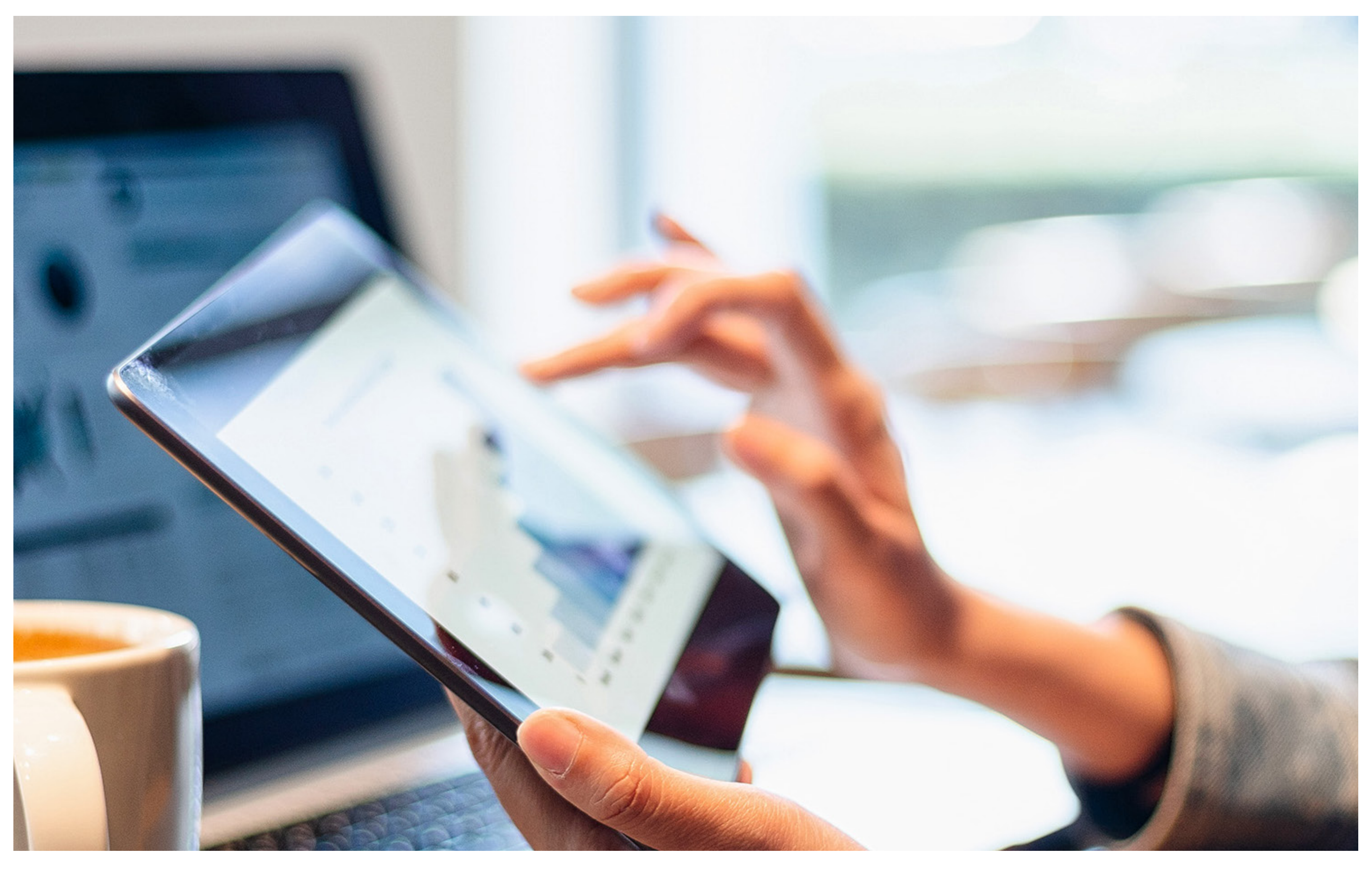
MANAGING AI AND DATA – HOW CAN YOU DO IT WELL?

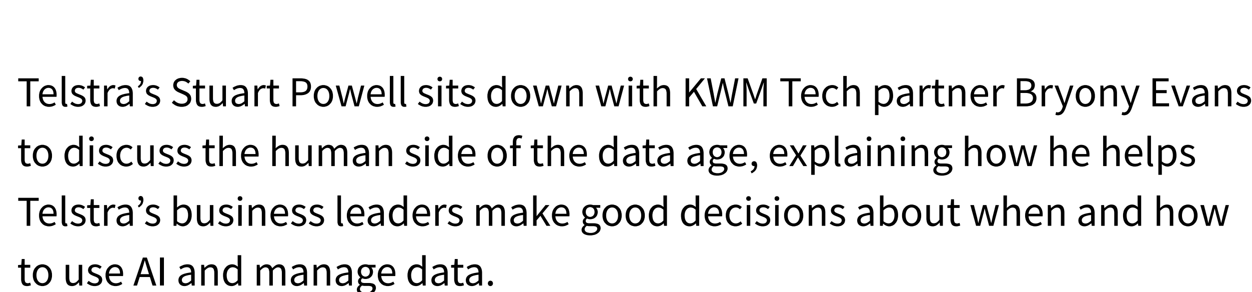
BRYONY EVANS

PARTNER
SYDNEY

STUART POWELL

DATA & AI GOVERNANCE – PRINCIPAL
TELSTRA

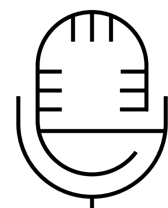




Telstra's Stuart Powell sits down with KWM Tech partner Bryony Evans to discuss the human side of the data age, explaining how he helps Telstra's business leaders make good decisions about when and how to use AI and manage data.

This transcript of their conversation is edited for length and readability.

You can listen to the full conversation via podcast here.



Bryony Evans: I'm here today to speak to Stuart Powell from Telstra on navigating ethical and governance lenses around the use of AI, and how that's being dealt with at Telstra. Stuart leads the data and AI governance program at Telstra which is aimed at empowering Telstra with trusted high-quality data and AI by driving accountability across Telstra. Stuart has a background in technology and design of data systems.

My practice focus is on issues around data and technology of all shapes and sizes. One of my key focuses recently has been on untangling the spaghetti of data ownership in a range of different types of M&A transactions including some recent complex financial services divestments. This has led me into thinking about data and AI and how that fits into different business models and different structures.

Stuart, while people might have a general understanding of what data and AI governance involves, it's also likely to mean different things to different people. Can you break down what you do and how you've seen your role evolve over recent years?

Stuart Powell: Let me start with data governance, because that's where we started as an organisation - knowing that we needed to leverage data in our organisation much better than we had in the past. We see our data as a strategic asset, but we weren't leveraging it properly. That is a big problem for AI because if your data is not right it's very hard to use AI. The main thing we're trying to do is to make good decisions about the data that we have. We have a lot of silos in the organisation and a lot of data issues cross those silos - the tech people implementing things and the business needing those things to be done. AI brings its own challenges around how we do things ethically and how we do things responsibly. So we started down that journey and made sure that we were focussing on outcomes that would deliver value to the business both in data and AI.

BE Picking up your point around silos, I do see a number of clients grapple with that challenge too - organisations often approach data and AI governance through that lens; 'what's the business unit doing and what does that mean for that particular business?'

Can you have a one size fits all approach to data and AI governance, or do you really need to look at it through that idea of one size fits many and customising it for different business units?

SP You can't ignore the silos that exist, since everybody is arranged by business function and the accountability at the top is by business function. What has been an interesting lesson for us is that the primary cut of data must be by business function, otherwise you just won't drive the right accountabilities. So we have a primary view with the focus on the business function and then a secondary view which looks at processes that go across the business functions and drive outcomes across the business. That was really helpful for implementing a practical governance strategy would work to drive accountability in the right way.

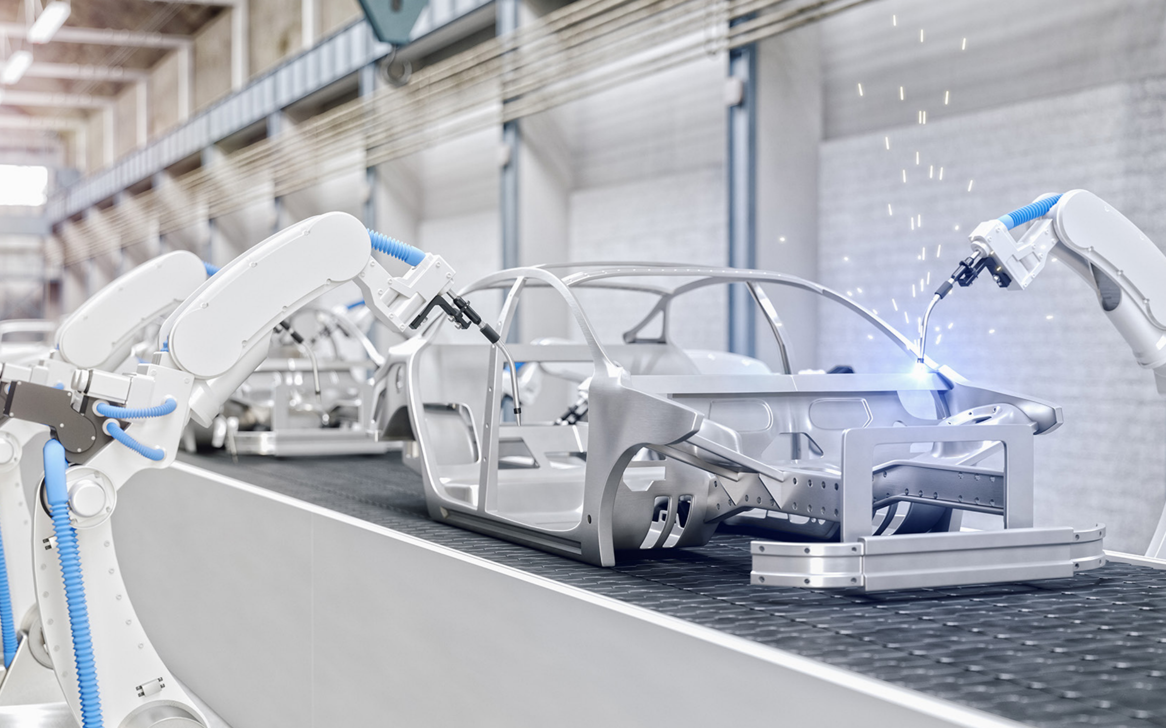
BE: I'm particularly curious about how you describe your work at Telstra as leading a shift in culture and practice.

What have you worked to change? How do you put in place frameworks that really shift the culture around the use of data and AI?

SP: The bigger shift really was data and AI was seen as an IT issue. Everybody thought that if you're talking about data or if you're talking about an AI then it's an IT problem but that doesn't work, because the funding is often driven by the business not by the IT people. So one of the things we had to do was make people aware of the issues that are data related or AI related - focus on how you deliver business value out of governance, not just talk about it as compliance. The big challenge for us was educating people about how to understand data and AI and how to make business decisions about that, not technical decisions.

From the examples that I have seen at Telstra, the trick is really to empower the business to start solving the problems around the management and use of data, understand what their accountabilities are, what decisions we're expecting them to make, and how we're expecting them to drive the business in the right direction without having to be data experts or AI experts. That was a journey. We got our senior management talking about it. The lead from each of our business functions now meet every month on our data and AI council and talk about the real issues and our group execs all meet on a 3 monthly basis to talk about data and AI - that's been a big change and a big education piece for us.

BE: I can see that that's a really significant cultural shift. Part of what we see in AI and how people think about governing AI in particular is around developing some high level frameworks or ethical principles about how to use AI and then thinking about tools to implement those ethical principles.



What do you think is important for organisations looking to adopt AI and conscious of wanting to do that well and ethically - how have you approached that at Telstra?

SP: In order to use AI to improve business we have to do it ethically and responsibly. The government's position in driving the principles has been the same and almost everywhere where people are talking about AI governance it's the same message. The first question we really had to ask was what are we trying to do? Having the senior managers driving from the top, having the people who are doing work on the ground understanding their responsibilities is important. You don't want tech people making ethical decisions on their own, you want to make sure that that's sort of done across the business, so being aware of those issues and knowing when they need to ask for help. So those are some of the things that we would start with. Like data, it was understanding that AI, doing AI responsibly is not an IT function, it's something we all had to buy into.

SP: Working as a lawyer in this space, you see organisations wanting to develop frameworks for governing and using AI, what does that mean from your point of view from a legal perspective?

BE: We often see clients focussing on the use of AI as a compliance or a risk issue or as a tech issue, but when you're thinking about AI and thinking about the challenges, this is even broader. You need a multidisciplinary lens. For me as a lawyer that's recognising that I will look at AI and immediately think about for example privacy law risks in terms of use of personal information and the privacy implications. When we speak to organisations about how they are developing these frameworks, we're speaking with them about how to bring that legal lens into how AI fits in with all of those other factors. We're having conversations with clients about how you develop those frameworks and also how you put in place a process where you're not escalating everything.

SP: In terms of the legislation, I've heard it said that it's almost impossible to effectively legislate the use of AI.

Do you agree with that? Do you think we may end up in a place where legislation will be thrust upon us in a way that is very difficult for compliance?

BE: I do think that from the legislation perspective it is very challenging. The EU legislation released last year shows that actually a one size fits all approach is probably going to be very broad. I personally think that if that type of approach is taken or if there's legislation that's not specific it could be quite onerous for businesses to comply with, because it doesn't take into account specific scenarios and the complexities of AI and how it can be applied in different ways. I think where it could be effective is where there are assumptions under existing laws that need to be changed because they don't work for AI. So how do you be clear on who's responsible for the decisions that AI makes? The person that programmed the software? The person who came up with the algorithm? The end user? Where does that responsibility sit? I also think that legislation would be effective in specific applications of AI. A group from the University of Technology in Sydney, including the previous human rights commissioner, Edward Santow is actually developing a facial recognition model law to propose to the Australian government to regulate the use of facial recognition technology. Those specific uses are probably more consistent with having legislation or specific rules than a broad-brush approach which I can see could be tricky for businesses to comply with.

Back to you, Stuart…

In terms of companies starting their AI journey, what are some of the key governance processes that you think are important to start out with and what can really be developed on the go, on an ad hoc basis?

SP: For us the challenge was knowing what was going on in AI and putting some sort of governance across the top of it. The way that we did that was to form the Risk Council on AI & Data, for which we use as an acronym: RCAID, pronounced "arcade". It has become reasonably well-known in

the company because we talk about the 'RCAID process'. If you've got an idea about AI, you'll come to RCAID where we have people who are experts in the risks for legal, cyber security, privacy, human impact and fairness, communications, and reputation. We assess the impact of the new AI use case from a risk point of view in those different dimensions. We'll approve it or make recommendations to mitigate risks that we find.

Our definition of AI is very broad, capturing everything from robotics process automation to deep learning. One of the things that we do is to expect new AI projects to do an initial risk assessment - that rates the impact of the project and high, medium, or low. The high and medium ones come to RCAID. If there's anything that is particularly high risk, we escalate it, so that the final decision is made by our Data and AI Council that has cross-company representation.

BE: It sounds like it's a mix of having a process nimble enough so that it's really attaching to the most high impact, high exposure type projects, and balancing wanting to be innovative as well – not having so many rules that people don't feel like they can actually do things.

Then, I imagine once you identify the riskiest types of AI, there's then a question of how to get into the black box to understand the algorithm driving AI tools?

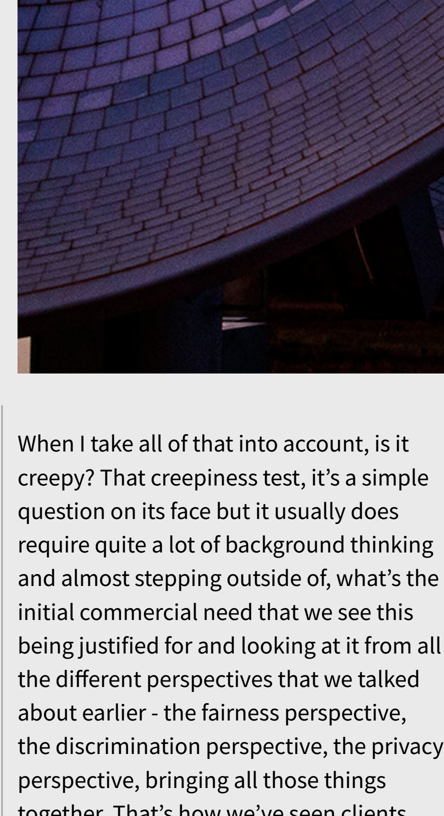
SP: Yes, it is a fascinating area. Especially if you buy an AI system and it's making the high or medium risk decisions, you have to be confident as the operator of that system that it's working effectively. We will probably need our suppliers to give us some access to the models to do our fairness testing. Otherwise, my recommendation would be not to proceed with them and to find some other solution. At the moment that's the only way I see to drive reliable compliance to those ethical AI principles. I'm hoping that over time we might get to the point there are some more standards in place. But at the moment I can't see anything that meets our requirements to do this.

BE: So it's also a matter of being able to explain - not just internally but potentially at some point to regulators or to consumers - what's actually happening in terms of how an output is being generated, so I can see that being really important

SP: Yes, one of the principles is explainability. You can never turn around and say; 'I'm sorry the machine made the decision, not our fault.' So how do you back that up when you've bought the system off the shelf? We've got significant resources and we can usually marshal them to work on sort of some of our biggest problems, but I imagine that's not true for everybody and, no matter who you are, there's going to be a limit on the resources that can be applied to governance.

How are your clients dealing with a question of taking those limited governance resources that they have and prioritising them?

BE: I think this really comes down to one of the points that you made earlier Stuart around the focus on impact and risk. We are seeing a number of clients also take that approach - focussing their governance and analysis resources on the higher-risk scenarios. So thinking about if this output was disclosed and what's the possible impact on individuals? Not doing that for every single case but where it is higher risk or higher impact, thinking about explain ability also thinking about that simple test:



When I take all of that into account, is it creepy? That creepiness test, it's a simple question on its face but it usually does require quite a lot of background thinking and almost stepping outside of, what's the initial commercial need that we see this being justified for and looking at it from all the different perspectives that we talked about earlier - the fairness perspective, the discrimination perspective, the privacy perspective, bringing all those things together. That's how we've seen clients focus on what's important or the highest risk for them from a AI and data governance perspective.

SP: Yes that's actually one of our rules - does it pass the "creepy factor" test?

BE: Don't be creepy!

SP: Yes! Don't be creepy. One of the things we think about all the time. AI governance is often less about the sophistication of the AI and more about the impact it has on people, particularly when it goes wrong. Take Robodebt, for example. It wasn't particularly sophisticated but the impact on people was very big. So I think there is a developing consensus amongst AI governance people that the riskier impact situations need to be identified. I loved your point about the legislation for particular use cases like, do not use face recognition in law enforcement. It's just a very sensible rule given the quality of face recognition and the potential for abuse in that. Legislation in those particular cases makes perfect sense. But we should avoid expanding from there to very broad legislation that isn't particularly helpful.

BE: We opened with what have you changed in your role. This is such a fast moving field I imagine there's little that really stands still.

As a closing question how are you enabling your team and Telstra to continue to adapt?

SP: Good question. The good thing about being in telco is that it's always changing so the idea of change is something that's been built into what we've done all my career. In recent years we've been moving to agile approaches to developing software and systems and solutions. For agile development and managing change, you need to have a very clear idea of what you're trying to achieve. If you have a clear idea of the end goal, even with all the little changes that are happening, you can ensure that you're still progressing towards where you need to be. You might need to tweak things, you might even tweak your end goals as you learn more, but you've always got the objective in mind and every little increment should sort of lead you towards that objective. That's the way I think about it: clarity of thought about what you're trying to achieve and then a bit of flexibility in the way you implement as you go along. And if the organisation changes or if systems change or processes change you can be a little bit flexible about how you implement. But you should have a very clear idea of your goals for the long run.

BE: Thank you. It reflects wonderfully on Telstra that you're able to discuss this journey as well and I know that there's so much work that goes on in that space at Telstra. I've learnt a lot and I think our audience will have too.

SP: Thanks to you and KWM as well Bryony. Good to talk about it as lawyers and data nerds together!

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