

# Review of the ASX Corporate Governance Council's Principles and Recommendations

**Public Consultation**

**2 May 2018**

## Invitation to comment

The ASX Corporate Governance Council is seeking submissions on the accompanying consultation draft of the fourth edition of its *Corporate Governance Principles & Recommendations*.

Submissions are due by **Friday, 27 July 2018**, and should be sent by email to:

[mavis.tan@asx.com.au](mailto:mavis.tan@asx.com.au)

or by mail to:

ASX Corporate Governance Council  
c/o ASX Limited  
PO Box H224  
Australia Square NSW 1215  
Attention: Mavis Tan

The Council would prefer to receive submissions in electronic form.

Submissions not marked as 'confidential' will be made publicly available on the ASX Corporate Governance Council section of ASX's website.

If you would like your submission, or any part of it, to be treated as confidential, please indicate this clearly in your submission.

### Contacts

For general enquiries, please contact:

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ASX Corporate Governance Council

# Public Consultation: Review of the ASX Corporate Governance Council's Principles and Recommendations

## 1. Introduction

The ASX Corporate Governance Council (the "Council") is consulting on proposals to update and issue a fourth edition of its Corporate Governance Principles and Recommendations (the "*Principles and Recommendations*"). The closing date for submissions is **Friday 27 July 2018**.

The Council will consider all submissions it receives in response to this consultation before finalising the fourth edition of the *Principles and Recommendations*. The Council envisages that the final version of the fourth edition will be released in early 2019 and will take effect for an entity's first full financial year commencing on or after 1 July 2019.

## 2. About the Council

The Council was convened in August 2002. It brings together various business, shareholder and industry groups, each offering valuable insights and expertise on governance issues from the perspective of their particular stakeholders. Its primary work has been the development of the *Principles and Recommendations*.

The Council is chaired by Elizabeth Johnstone. The members of the Council are:

- Association of Superannuation Funds of Australia Limited
- ASX Limited
- Australasian Investor Relations Association
- Australian Council of Superannuation Investors
- Australian Financial Markets Association
- Australian Institute of Company Directors
- Australian Institute of Superannuation Trustees
- Australian Shareholders' Association
- Business Council of Australia
- Chartered Accountants Australia and New Zealand
- CPA Australia Ltd
- Financial Services Council
- Financial Services Institute of Australasia
- Governance Institute of Australia
- Group of 100
- Institute of Internal Auditors - Australia
- Institute of Public Accountants
- Law Council of Australia
- Property Council of Australia
- Stockbrokers and Financial Advisers Association Limited

Further information about the Council, including a copy of its charter, is available at:

<http://www.asx.com.au/regulation/corporate-governance-council.htm>

### 3. How the *Principles and Recommendations* operate

The *Principles and Recommendations* apply to all entities admitted to the ASX official list as an ASX listing,<sup>1</sup> regardless of the legal form they take,<sup>2</sup> whether they are established in Australia or elsewhere, and whether they are internally or externally managed.

Each ASX listed entity is required under Listing Rule 4.10.3 to include in its annual report either a corporate governance statement that meets the requirements of that rule, or the URL of the page on its website where such a statement is located. The corporate governance statement must disclose the extent to which the entity has followed the recommendations set by the Council during the reporting period. If the entity has not followed a recommendation for any part of the reporting period, its corporate governance statement must separately identify that recommendation and the period during which it was not followed and state its reasons for not following the recommendation and what (if any) alternative governance practices it adopted in lieu of the recommendation during that period. For this reason, Listing Rule 4.10.3 is often referred to as the ‘if not, why not’ reporting requirement.

By requiring listed entities to compare their corporate governance practices with the Council’s recommendations and, where they do not conform, to disclose that fact and the reasons why, Listing Rule 4.10.3 acts to encourage listed entities to adopt the governance practices suggested in the Council’s recommendations but does not force them to do so. It leaves a listed entity with the flexibility to adopt alternative governance practices, if its board considers those to be more suitable to its particular circumstances, subject to the requirement for the board to explain its reasons for adopting those alternative practices instead of the Council’s recommendations.

The *Principles and Recommendations* are structured around, and seek to promote, eight central governance principles. There are specific recommendations intended to give effect to these general principles, as well as explanatory commentary in relation to both the principles and the recommendations.

It is the recommendations that listed entities must specifically report against under Listing Rule 4.10.3. The principles and the commentary do not form part of the recommendations and therefore do not trigger formal disclosure obligations under Listing Rule 4.10.3.

### 4. Background to this consultation

The *Principles and Recommendations* were first introduced in 2003. A second edition was published in 2007 and a third in 2014.

While the standards of corporate governance in Australia remain high by international standards,<sup>3</sup> the Council recognises the need to regularly assess and evolve the *Principles and Recommendations* to address emerging domestic and global issues in corporate governance.

In May 2017, the Council resolved to commence work on a fourth edition of the *Principles and Recommendations* to address a number of such issues, including:

- social licence to operate;
- corporate values and culture;
- whistleblower policies;

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<sup>1</sup> The *Principles and Recommendations* do not apply to entities admitted to the ASX official list as ASX debt listings or ASX foreign exempt listings. References in this consultation paper to a “listed entity” mean an entity admitted to the ASX official list as an ASX listing.

<sup>2</sup> That is, whether they are a listed company, listed trust or listed stapled entity.

<sup>3</sup> According to the Asian Corporate Governance Association’s 2016 CG Watch survey, Australia was ranked #1 in corporate governance practices compared to 11 other jurisdictions in Asia.

- anti-bribery and corruption policies;
- an apparent slowing in the rate of progress in achieving gender diversity at board level;
- a recommendation from the Senate Economics References Committee<sup>4</sup> for increased guidance around carbon risk;
- cyber-risks; and
- other areas for improvement identified by KPMG in a review commissioned by the ASX Education and Research Program on the adoption of the recommendations in the third edition of the *Principles and Recommendations*.<sup>5</sup>

The Council’s proposed changes anticipated and respond to some of the governance issues identified in recent enquiries, such as the Hayne Royal Commission.

The Council firmly believes that these emerging governance issues can be effectively and flexibly addressed within the existing “if not, why not” framework of the *Principles and Recommendations*. It also believes it is important that they are in fact addressed to ensure that the *Principles and Recommendations* remain contemporary and continue to deliver good corporate governance outcomes for ASX listed entities, investors and other stakeholders. Otherwise, pressures will inevitably mount for a more prescriptive legislative or rules-based response to these issues.<sup>6</sup>

The Council notes that a number of other jurisdictions are currently undertaking reviews of their corporate governance codes.<sup>7</sup>

## 5. Overview of proposed changes being consulted upon

The consultation draft of the fourth edition adopts the same hierarchy of principles, recommendations and commentary, and preserves the ‘if not, why not’ framework, that have underpinned all of the prior editions of the *Principles and Recommendations*.

### 5.1. Proposed changes to principles

In common with the second and third editions, the consultation draft of the fourth edition has eight principles covering the same broad governance themes.

The primary change to the principles on which the Council is consulting is a substantial redraft of principle 3, currently worded in its abbreviated form as “act ethically and responsibly” and in its longer form as “[a] listed entity should act ethically and responsibly”. This is proposed to be re-worded as “instil the desired culture” and “[a] listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner” respectively.

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<sup>4</sup> The Senate Economics References Committee released its report on carbon risk in April 2017. The Committee used the term “carbon risk” as a shorthand term for risks to a company from climate change. Its report is available online at: [https://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Carbonriskdisclosure45/Report](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Carbonriskdisclosure45/Report).

<sup>5</sup> KPMG *Adoption of Third Edition ASX Corporate Governance Council Principles and Recommendations: Analysis of disclosures for financial years between 1 January 2015 and 31 December 2015* (2016), available online at: <https://www.asx.com.au/documents/asx-compliance/asx-corp-governance-kpmg-report.pdf>.

<sup>6</sup> For example, as has occurred with the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018* that passed into law in February 2018.

<sup>7</sup> The Hong Kong Exchange commenced consultation in November 2017, the UK Financial Reporting Council (“UK FRC”) in December 2017 and Singapore Exchange in January 2018 on proposed changes to their corporate governance codes and related listing rules.

These proposed changes respond to various enquiries<sup>8</sup> and reviews<sup>9</sup> that have taken place since the publication of the third edition in 2014 that have highlighted governance issues arising from poor conduct or culture and a perceived lack of accountability. The Council considers it important to address these issues around corporate values and culture in the *Principles and Recommendations* as a way to help arrest the loss of trust in business.<sup>10</sup>

The Council is proposing in revised principle 3 to recognise the fundamental importance of a listed entity's social licence to operate and the need for it to act lawfully, ethically and in a socially responsible manner in order to preserve that licence. It also proposing to acknowledge that, in doing this, a listed entity must have regard to the views and interests of a broader range of stakeholders than just its security holders.

Revised principle 3 is proposed to be supported by three new recommendations – recommendation 3.1 (core values), 3.3 (whistleblowing policies) and 3.4 (anti-bribery and corruption policies), discussed further in section 5.2 of this consultation paper – and by important amendments to:

- the commentary to existing recommendation 1.1 (role of board and management):
  - to add to the list of usual responsibilities of the board:
    - defining the entity's purpose;
    - approving the entity's statement of core values and code of conduct to underpin the desired culture within the entity;
    - overseeing management in its implementation of the entity's business model, achievement of the entity's strategic objectives, instilling of the entity's values and performance generally; and
    - ensuring that the entity's remuneration framework is aligned with the entity's purpose, values, strategic objectives and risk appetite; and
  - to clarify that the information provided to the board by the senior executive team should not be limited to information about the financial performance of the entity, but also its compliance with material legal and regulatory requirements and any material misconduct that is inconsistent with the values or code of conduct of the entity; and
- existing recommendation 3.1 (codes of conduct) – to become recommendation 3.2 in the fourth edition – to require the board to be informed of any material breaches of a listed entity's code of conduct by a director or senior manager and of any other material breaches of the code that call into question the culture of the organisation.

These new and amended recommendations are intended to assist a listed entity to set “the tone from the top” and to ensure that the board is provided with the information it needs to monitor the culture of the organisation.

The Council is also consulting on some minor changes to principles 1 (lay solid foundations for management and oversight), 2 (structure the board to add value), 4 (safeguard integrity in corporate reporting), 6 (respect the rights of security holders) and 8 (remunerate fairly and responsibly). These changes are mostly directed to refining the drafting of the principles and establishing a stronger linkage between the principles and their supporting recommendations.

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<sup>8</sup> For example, two separate Senate Economics References Committees looking into whistleblowing in Australia and foreign bribery available online at:

[https://www.aph.gov.au/~media/Committees/economics\\_ctte/Scrutiny\\_of\\_Financial\\_Advice/whistleblowing\\_paper.pdf?la=en](https://www.aph.gov.au/~media/Committees/economics_ctte/Scrutiny_of_Financial_Advice/whistleblowing_paper.pdf?la=en)  
[https://www.aph.gov.au/~media/Committees/economics\\_ctte/Foreignbribery45th/report.pdf?la=en](https://www.aph.gov.au/~media/Committees/economics_ctte/Foreignbribery45th/report.pdf?la=en).

<sup>9</sup> For example, the current Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, and the earlier Sedgwick independent review into retail banking remuneration available online at:

[https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL\\_Rem-Review-Report.pdf](https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf).

<sup>10</sup> See for example the *Edelman Trust Barometer Australia* results available at:

<https://www.slideshare.net/EdelmanInsights/2018-edelman-trust-barometer-australia-results>.

## 5.2. Proposed new recommendations

The Council is consulting on proposals to expand the number of recommendations from 29 in the third edition to 38 in the fourth edition. The nine new recommendations and the reasons for their proposed inclusion in the fourth edition are:

- **Recommendation 2.7:** *A listed entity with a director who is not fluent in the language in which board or security holder meetings are held or key documents are written should disclose the processes it has in place to ensure the director understands and can contribute to the discussions at those meetings and understands and can discharge their obligations in relation to those documents.*

New recommendation 2.7 is intended to address an emerging governance issue that ASX has brought to the attention of the Council, with some listed entities – particularly those domiciled in emerging markets – appointing board members who are not fluent in the language in which board or security holder meetings are held or key documents are written.

- **Recommendation 3.1:** *A listed entity should articulate and disclose its core values.*
- **Recommendation 3.3:** *A listed entity should:*
  - *have and disclose a whistleblower policy that encourages employees to come forward with concerns that the entity is not acting lawfully, ethically or in a socially responsible manner and provides suitable protections if they do; and*
  - *ensure that the board is informed of any material concerns raised under that policy that call into question the culture of the organisation.*
- **Recommendation 3.4:** *A listed entity should:*
  - *have and disclose an anti-bribery and corruption policy; and*
  - *ensure that the board is informed of any material breaches of that policy.*

As mentioned previously, new recommendations 3.1, 3.3 and 3.4 are intended to buttress the important changes being consulted upon to principle 3 around corporate values and culture, and social licence to operate. The new recommendations are directed to setting “the tone from the top” and ensuring that the board is provided with the information it needs to monitor the culture of the organisation.

The Council is aware that the Australian government is proposing to introduce new laws to better protect whistleblowers<sup>11</sup> and to improve anti-bribery and corruption measures. To those who might say that the Council should not be introducing any new recommendations in these areas that might potentially conflict with these new laws or impose additional compliance burdens on listed entities, the Council would note the following:

- the new recommendations include a requirement for the board of a listed entity to be informed of any material incidents reported under its whistleblowing policy and any material breaches of its anti-bribery and corruption policy – the Council considers this fundamental to the board receiving the information it needs to monitor the culture of the organisation;
  - for listed entities established in Australia, aside from the board reporting obligation mentioned in the preceding bullet point, the new recommendations are unlikely to impose any additional compliance obligations or burdens that they won’t have to meet under these new laws in any event; and
  - approximately 10% of ASX listed entities are established in places other than Australia and they will not necessarily be subject to these new laws – the new recommendations therefore ensure that their governance arrangements for whistleblowers and anti-bribery and corruption measures are on a similar footing to listed entities established in Australia.
- **Recommendation 4.4:** *A listed entity should have and disclose its process to validate that its annual directors’ report and any other corporate reports it releases to the market are accurate, balanced and*

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<sup>11</sup> Via amendments to the Corporations Act 2001 and the Taxation Administration Act 1953.

*understandable and provide investors with appropriate information to make informed investment decisions.*

This new recommendation responds to the comments made by some in relation to the third edition that recommendations 4.1, 4.2 and 4.3 currently only deal with financial reporting, whereas principle 4 refers to “corporate reporting” more broadly.

- **Recommendation 5.2:** *A listed entity should ensure that its board receives copies of all announcements under Listing Rule 3.1 promptly after they have been made.*
- **Recommendation 5.3:** *A listed entity that gives a new investor or analyst presentation should release a copy of the presentation materials on the ASX Market Announcements Platform ahead of the presentation.*

New recommendations 5.2 and 5.3 are intended to improve continuous disclosure practices.

- **Recommendation 6.4:** *A listed entity should ensure that all resolutions at a meeting of security holders are decided by a poll rather than by a show of hands.*

New recommendation 6.4 is intended to improve voting processes at meetings of security holders and to ensure that the results of a vote fairly reflect the will of the meeting.<sup>12</sup>

- **Recommendation 8.4:** *A listed entity should only enter into an agreement for the provision of consultancy or similar services by a director or senior executive or by a related party of a director or senior executive:*
  - *if it has independent advice that:*
    - *the services being provided are outside the ordinary scope of their duties as a director or senior executive (as applicable);*
    - *the agreement is on arm’s length terms; and*
    - *the remuneration payable under it is reasonable; and*
  - *with full disclosure of the material terms to security holders.*

New recommendation 8.4 also is intended to address emerging governance issues that ASX has brought to the attention of the Council.

### 5.3. Proposed changes to existing recommendations

The Council is consulting on proposals to amend a number of the existing recommendations in the third edition, including notably:

- recommendation 1.1 (role of board and management) to recommend that a listed entity has a board charter;
- recommendation 1.2 (background checks) to recommend that a listed entity undertake appropriate background checks on senior executives, as well as directors, before engaging them;
- recommendation 1.5 (diversity) to achieve better gender diversity outcomes, including a new provision recommending that an entity in the S&P/ASX 300 have as a measurable objective at least 30% of directors of each gender on its board within a specified period;
- recommendations 1.6 (board reviews) and 1.7 (management reviews) to specify that such reviews should take place “each reporting period” (ie annually);
- recommendation 2.3 (disclose independence and length of service of directors) and the related box 2.3 to:
  - simplify the drafting;

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<sup>12</sup> A February 2017 Asian Corporate Governance Association report identified voting by poll as an area where Australia lagged best practice in Asia. For example, listed entities in Hong Kong and Singapore have been required to implement voting by poll under their listing rules since 2009 and 2015 respectively.



- add a further example in box 2.3 covering directors who receive performance based remuneration (including options or performance rights) or participate in an employee incentive scheme; and
- changing the reference to “close family ties” in box 2.3 to “close personal ties”;
- recommendation 2.6 (director induction and professional development) so that it now reads: “[a] listed entity should have a program for inducting new directors and for periodically reviewing whether there is a need for existing directors to undertake professional development to maintain the skills and knowledge needed to perform their role as directors effectively”;
- recommendation 3.1 (code of conduct)<sup>13</sup> to recommend that the board is informed of any material breaches of a listed entity’s code of conduct by a director or senior manager and of any other material breaches of the code that call into question the culture of the organisation;
- recommendation 6.2 (investor relations program) so that it now reads “[a] listed entity should have an investors relations program that facilitates effective two way communication with investors”;
- recommendation 6.3 (participation at meetings of security holders) so that it now reads: “[a] listed entity should disclose how it facilitates and encourages participation at meetings of security holders”;
- recommendation 7.2 (annual risk review) elevating the commentary in the third edition that a board should satisfy itself that the entity is operating with due regard to the risk appetite set by the board so that it forms part of the recommendation; and
- recommendation 7.4 (sustainability disclosures) to refer to “environmental and social risks” rather than “economic, environmental and social sustainability risks”.

#### 5.4. Changes to commentary

The Council is consulting on proposals to expand the commentary in the fourth edition to provide guidance on the new and modified principles and recommendations and also on the existing principles and recommendations in areas where it has received feedback that greater guidance is needed or would be appreciated.

#### 5.5. Detailed summary of proposed changes

A detailed summary of the proposed amendments in the fourth edition is included in Annexure A to this consultation paper.

### 6. Accompanying documents

Accompanying this consultation paper are:

- a consultation draft of the fourth edition of the *Principles and Recommendations*; and
- a mark-up of the consultation draft against the third edition of the *Principles and Recommendations*.

### 7. Issues for consultation

The primary purpose of this consultation is to seek feedback from listed entities, their advisers, security holders and other stakeholders on the consultation draft of the fourth edition of the *Principles and Recommendations* accompanying this consultation paper. The Council wishes to ensure that the fourth edition of the *Principles and Recommendations* strikes the right balance between the needs and interests of all stakeholders.

The Council is especially interested to receive comments on:

- whether stakeholders agree with the nine proposed new recommendations and, if not, why not;

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<sup>13</sup> To become recommendation 3.2 in the fourth edition.

- whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;
- specifically, whether stakeholders agree with the Council’s proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date;
- whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7;
- whether stakeholders agree with Council’s proposed changes to box 2.3, setting out the factors relevant to assessing director independence;
- whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity’s values, culture and social licence to operate;
- whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities;
- whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations; and
- whether there are any other gaps or deficiencies in the *Principles and Recommendations* that have not been addressed by the proposed changes in the consultation draft of the fourth edition.

## 8. Due date for submissions

Please provide all comments on the consultation draft of the fourth edition of the *Principles and Recommendations* in writing by the **close of business on Friday 27 July 2018**

by email to:

[mavis.tan@asx.com.au](mailto:mavis.tan@asx.com.au)

or by mail to:

ASX Corporate Governance Council  
 c/o ASX Limited  
 PO Box H224  
 Australia Square NSW 1215  
 Attention: Mavis Tan

The Council would prefer to receive submissions in electronic form.

Submissions not marked as ‘confidential’ will be made publicly available on the ASX Corporate Governance Council section of ASX’s website. If you would like your submission, or any part of it, to be treated as confidential, please indicate this clearly in your submission.

## 9. Indicative timetable for implementation of the fourth edition

The Council will consider all submissions it receives in response to this consultation before finalising the fourth edition of the *Principles and Recommendations*.

It is envisaged that the final version of the fourth edition will be released in early 2019 and will take effect for an entity’s first full financial year commencing on or after 1 July 2019.

Accordingly, entities with a 30 June balance date will be expected to measure their governance practices against the recommendations in the fourth edition commencing with the financial year ended 30 June 2020.

Entities with a 31 December balance date will be expected to measure their governance practices against the recommendations in the fourth edition commencing with the financial year ended 31 December 2020.



## Annexure A: Detailed summary of proposed changes in the fourth edition

Set out below is a detailed summary of the changes being consulted upon in the fourth edition of the *Principles and Recommendations*:

- more detailed guidance in the **preface to the recommendations** on what should be disclosed by listed entities that follow the Council’s recommendations;
- a new section in the **preface to the recommendations** dealing with recommendations that are not applicable,<sup>14</sup> explaining that in such a case the Council has no issue with an entity stating that it follows all of the Council’s recommendations provided, of course, it does in fact follow all of the Council’s recommendations, apart from those that technically do not apply to it, and it otherwise makes appropriate disclosures for all of the recommendations that it does follow;
- an amendment to **recommendation 1.1** (role of board and management) requiring a listed entity to have and disclose a board charter, plus amendments to the commentary:
  - to add to the list of usual responsibilities of the board:
    - defining the entity’s purpose;
    - approving the entity’s statement of core values and code of conduct to underpin the desired culture within the entity;
    - overseeing management in its implementation of the entity’s business model, achievement of the entity’s strategic objectives, instilling of the entity’s values and performance generally; and
    - ensuring that the entity’s remuneration framework is aligned with the entity’s purpose, values, strategic objectives and risk appetite;
  - to clarify that the information provided to the board by the senior executive team should not be limited to information about the financial performance of the entity, but also its compliance with material legal and regulatory requirements and any material misconduct that is inconsistent with the values or code of conduct of the entity;
  - to provide additional guidance on the role and responsibilities of the chair;
- an amendment to **recommendation 1.2** (background checks) that a listed entity should undertake appropriate background checks on senior executives, as well as directors, before engaging them, plus an amendment to the commentary stating that that the information given to security holders in relation to the election or re-election of a director should not only include a statement as to whether the board supports their election or re-election, but also the board’s reasons for doing so;
- amendments to the commentary to **recommendation 1.3** (written contracts of appointment):
  - including a statement that letters of appointment for directors and service contracts for senior executives should be with the director or senior executive personally rather than an entity supplying their services, so as to ensure that the director or senior executive is personally accountable to the listed entity for any breach of the agreement;
  - including a footnote that:

*“The Council is aware that some directors of listed entities supply their services through a “personal services company” and have their fees paid to that company rather than to the director personally. Provided the director has a personal letter of appointment with the listed entity setting out the*

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<sup>14</sup> Examples of recommendations that might not apply to an entity include recommendation 2.7 (which will not apply if the entity does not have a director who is not fluent in the language in which board or security holder meetings are held or key documents are written), 8.3 (which will not apply if the entity does not have an equity-based remuneration scheme) or 8.4 (which will not apply if the entity has not entered into an agreement for the provision of consultancy or similar services by a director or senior executive or by a related party of a director or senior executive).

*director's duties and responsibilities, such an arrangement is not inconsistent with this recommendation. However, listed entities and directors should be cognisant of the perception that such an arrangement may create of the director being afforded preferential treatment."*

- adding to the suggested contents for a director's letter of appointment a requirement to notify the entity of, or to seek the entity's approval before accepting, any new role that could impact upon the time commitment expected of the director or give rise to a conflict of interest;
- substantial changes to **recommendation 1.5** (diversity) directed to achieving better gender diversity outcomes, including:
  - splitting the requirement to have a diversity policy from the requirement to set measurable gender diversity objectives;
  - making it clear that a listed entity's measurable gender diversity objectives should be targeted at achieving gender diversity in the composition of the entity's senior executive team and workforce generally, as well as in the composition of the board;
  - stating that if the entity was in the S&P / ASX 300 index at the commencement of the reporting period, the measurable objective for achieving gender diversity in the composition of its board should be to have not less than 30% of its directors of each gender within a specified period;
  - requiring the board or a board committee to charge management with designing, implementing and maintaining programs and initiatives to help achieve its measurable objectives and to undertake an annual review with management of the entity's progress towards achieving its measurable gender objectives and the adequacy of the entity's programs and initiatives in that regard;
  - requiring the entity to disclose in relation to each reporting period whether that review has taken place;
  - including in the commentary a suggestion that a listed entity consider disclosing any insights from that review and any changes the entity has made to its gender diversity objectives and programs as a result;
  - requiring a listed entity to disclose its diversity policy in full and removing its ability to disclose only a summary of the policy;<sup>15</sup>
  - including in the commentary a suggestion that entities disclose the outcomes and actions taken as a result of any gender benchmarking they do against their peers or gender pay audits<sup>16</sup> they undertake so that security holders and other stakeholders gain an insight into the effectiveness of the entity's gender diversity programs and initiatives;
  - moving the suggestion that the board or a committee of the board consider setting diversity KPIs for senior executives from the suggested contents of a diversity policy in Box 1.5 to the commentary;
  - including guidance in the commentary that a listed entity's diversity policy should express its commitment to embrace diversity at all levels and in all its facets, including gender, marital or family status, sexual orientation, gender identity, age, physical abilities, ethnicity, religious beliefs, cultural background, socio-economic background, perspective and experience; and

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<sup>15</sup> The option for a listed entity to disclose a summary of its diversity policy rather than the full policy originated when these disclosures had to be included in the entity's annual report. Brevity was therefore a virtue. With the changes made in the third edition to allow an entity to make its governance disclosures on its website, it is now easier for the entity simply to disclose the full policy on its website. Disclosing the full policy also removes the possibility of an inadvertent omission of material information when providing a summary. Note also the footnote in the consultation draft of the fourth edition that an entity may redact from the disclosed copy of its diversity policy personal or confidential information such as the names and contact details of individual staff involved in diversity issues.

<sup>16</sup> The Council notes that companies in Great Britain with more than 250 employees were required to report their gender pay gap to the Government Equalities Office by 4 April 2018. Companies were also required to publish details of the proportion of men and women in the company who received bonuses and the breakdown of men and women in different pay quartiles. Some of the early reported results have been enlightening.

- including guidance in the commentary that boards of listed entities should have regard to other facets of diversity in addition to gender when considering their make-up and that having directors of different ages and ethnicities and from different cultural or socio-economic backgrounds can help bring different experiences and perspectives to bear and avoid “groupthink” in decision making;
- an amendment to **recommendation 1.6** (board reviews) to state that an entity should have and disclose a process for evaluating the performance of the board, its committees and individual directors “*each reporting period*” (ie annually);
- an amendment to **recommendation 1.7** (management reviews) to state that an entity should have and disclose a process for evaluating the performance of its senior executives “*each reporting period*” (ie annually);
- an amendment to **principle 2** (structure the board to be effective and to add value) to recognise the importance of the board having directors with “knowledge of the entity and the industry in which it operates”;<sup>17</sup>
- amendments to the commentary on **recommendation 2.2** (board skills matrix):<sup>18</sup>
  - giving greater guidance on what should be included in a board skills matrix;
  - noting that boards are increasingly being called upon to address new or emerging issues including around culture, conduct risk, digital disruption, cyber-security, sustainability and climate change and suggesting that the board regularly review its skills matrix to make sure it covers the skills needed to address existing and emerging business and governance issues;
  - suggesting possible formats for presenting the board skills matrix; and
  - stating that an entity should explain what it means by each skill referenced in its board skills matrix.
- amendments to **recommendation 2.3** (disclose independence and length of service of directors):
  - removing unnecessary duplication and simplifying the drafting in the list of examples of interests, positions, affiliations and relationships that might cause doubts about the independence of a director in box 2.3;
  - replacing the references to “associations”, which has a technical meaning under the Corporations Act, with references to “affiliations”;
  - adding a further example in box 2.3 covering directors who receive performance based remuneration (including options or performance rights) or participate in an employee incentive scheme;
  - extending the example in box 2.3 regarding a person who has “close family ties with any person who falls within any of the categories described above” to a person who has “close personal ties”, along with the inclusion of commentary that these ties may be based on “family, friendship or other social or business connections”;
  - adding guidance in the commentary to recommendation 2.3 that where a director falls within one or more of the examples in box 2.3, the board should rule the director not to be independent<sup>19</sup> unless it is clear that the interest, position, affiliation or relationship in question is not material and will not interfere with the director’s capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally; and

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<sup>17</sup> While this may seem self-evident, ASX has reported to the Council instances of entities seeking to list without any directors having relevant industry experience.

<sup>18</sup> Recommendation 2.2 was introduced in the third edition. KPMG’s 2016 review, cited in note 5 above, reported a number of issues with the disclosures made by listed entity under this recommendation and suggested that extra guidance be provided.

<sup>19</sup> The Council notes that the UK and Singapore are proposing to take a more prescriptive approach to determining whether or not a director is independent. The Council favours the approach proposed in the fourth edition.

- adding a more detailed explanation in the commentary why a director who is or represents a substantial holder should not be considered independent;
- the addition of a passage in the commentary to **recommendation 2.4** (a majority of the board of a listed entity should be independent directors) stating that:
 

*“Without detracting in any way from the preferred position that a listed entity should have a majority of independent directors, if a listed entity chooses not to follow this recommendation, the Council suggests that it have more than one independent director at all times. Having a single independent director can lead to that director being isolated and less effective in holding management to account.”*
- an amendment to **recommendation 2.6** (director induction and professional development) so that it now reads: “[a] listed entity should have a program for inducting new directors and for periodically reviewing whether there is a need for existing directors to undertake professional development to maintain the skills and knowledge needed to perform their role as directors effectively” and changes to the commentary:
  - suggesting that if a new director is not familiar with the legal framework that governs the entity<sup>20</sup>, the entity’s induction program should include training on their legal duties and responsibilities as a director under the key legislation governing the entity and the Listing Rules (including ASX’s continuous and periodic reporting requirements);
  - noting again that boards are increasingly being called upon to address new or emerging issues including around culture, conduct risk, digital disruption, cyber-security, sustainability and climate change; and
  - suggesting that the board or the nomination committee of a listed entity should regularly assess whether the directors as a group have the skills, knowledge and experience to deal with new and emerging business and governance issues and that professional development for directors should be considered where gaps are identified and they are not expected to be addressed in the short term by new appointments;
- a new **recommendation 2.7** that a listed entity with a director who is not fluent in the language in which board or security holder meetings are held or key documents are written should disclose the processes it has in place to ensure the director understands and can contribute to the discussions at those meetings and understands and can discharge their obligations in relation to those documents;<sup>21</sup>
- substantial changes to principle 3 and the supporting recommendations and commentary<sup>22</sup> to address matters to do with values, culture and social licence to operate, including:
  - changing **principle 3** from “[a] listed entity should act ethically and responsibly” to “[a] listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner”;
  - amending the commentary to principle 3 to acknowledge that a listed entity’s social licence to operate is one of its most valuable assets and that it can be lost or seriously damaged if the entity or its officers or employees are perceived to have acted unlawfully, unethically or in a socially irresponsible manner;
  - a new **recommendation 3.1** that a listed entity should articulate and disclose its core values;

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<sup>20</sup> The amendments to this commentary recognise the globalisation of capital markets and the ever-growing number of entities with management and operations based outside Australia that are listed on ASX.

<sup>21</sup> This new recommendation similarly recognises the globalisation of capital markets and the ever-growing number of entities with management and operations based outside Australia that are listed on ASX.

<sup>22</sup> The Council notes that the UK FRC is proposing a new Code principle for the board to establish the company’s purpose, strategy and values and align those with its culture, and a provision requiring the board to promote that culture and explain in the annual report how it does so and how it has taken corrective action where there has been a misalignment between behaviours and the company’s values.

- amendments to the existing recommendation on codes of conduct (currently recommendation 3.1 in the third edition but to be renumbered as **recommendation 3.2** in the fourth edition):
  - requiring a listed entity to disclose its code of conduct in full and removing its ability to disclose only a summary of the code;<sup>23</sup> and
  - requiring the board to be informed of any material breaches of a listed entity’s code of conduct by a director or senior executive and of any other material breaches of the code that call into question the culture of the organisation;
 and including in the commentary:
  - a statement that with appropriate training and reinforcement from senior management, a listed entity’s code of conduct can help to instil a culture of acting lawfully, ethically and in a socially responsible manner;
  - a statement encouraging a listed entity to disclose in general terms the actions it has taken to enforce its code of conduct (recognising that legal and other constraints may prevent it disclosing specific details of any individual action); and
  - a suggestion that a listed entity should review its code of conduct at least once every 3 years<sup>24</sup> to ensure it remains “fit for purpose” and addresses any emerging conduct issues;
- a new **recommendation 3.3** that a listed entity should: (a) have and disclose<sup>25</sup> a whistleblower policy<sup>26</sup> that encourages employees to come forward with concerns that the entity is not acting lawfully, ethically or in a socially responsible manner and provides suitable protections if they do; and (b) ensure that the board is informed of any material concerns raised under that policy that call into question the culture of the organisation; and
- a new **recommendation 3.4** that a listed entity should: (a) have and disclose<sup>27</sup> an anti-bribery and corruption policy; and (b) ensure that the board is informed of any material breaches of that policy;
- a change to **principle 4** from “safeguard integrity in corporate reporting” to “produce corporate reports of high quality and integrity” and an addition to the commentary acknowledging that for investors to make informed investment decisions, a listed entity needs to provide corporate reports of high quality and integrity and those reports should give the reader a reasonable understanding of the entity’s business model, strategy, risks and opportunities, remuneration policies and practices and governance framework, as well as its financial performance;
- the addition of a new **recommendation 4.4** that “[a] listed entity should have and disclose its process to validate that its annual directors’ report and any other corporate reports it releases to the market are

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<sup>23</sup> The option for a listed entity to disclose a summary of its code of conduct rather than the full code originated when these disclosures had to be included in the entity’s annual report. Brevity was therefore a virtue. With the changes made in the third edition to allow an entity to make its governance disclosures on its website, it is now easier for the entity simply to disclose the full code on its website. Disclosing the full code also removes the possibility of an inadvertent omission of material information when providing a summary. Note also the footnote in the consultation draft of the fourth edition that an entity may redact from the disclosed copy of its code of conduct personal or confidential information such as the names and contact details of individual staff involved in conduct issues.

<sup>24</sup> A report released by the Australian Council of Superannuation Investors (ACSI) in March 2018 found that 58% of the codes of conduct of entities in the S&P/ASX 200 had not been reviewed in the last two years or were undated; while 8% had not been reviewed for five years or longer. ACSI noted that the New York Stock Exchange recommends that codes of conduct be reviewed every two years or after significant corporate compositional changes.

<sup>25</sup> Note the footnote in the consultation draft of the fourth edition that an entity may redact from the disclosed copy of its whistleblower policy personal or confidential information such as the names and contact details of individual staff involved in the whistleblower process.

<sup>26</sup> See note 11 above.

<sup>27</sup> Note the footnote in the consultation draft of the fourth edition that an entity may redact from the disclosed copy of its anti-bribery and corruption policy personal or confidential information such as the names and contact details of individual staff involved in anti-bribery and corruption issues.



accurate, balanced and understandable and provide investors with appropriate information to make informed investment decisions”, and with commentary that an entity’s corporate reports for these purposes include any quarterly activity reports and quarterly cash flow reports the entity may be required to provide under the Listing Rules and, if the entity produces them, an integrated report or sustainability report;

- the addition of commentary to **principle 5** (make timely and balanced disclosure) acknowledging that for investors to make informed investment decisions, a listed entity needs to make timely and balanced disclosure of information that a reasonable person would expect to have a material effect on the price or value of its securities;
- an amendment to **recommendation 5.1** (disclosure policy) requiring a listed entity to disclose its continuous disclosure compliance policy in full and removing its ability to disclose only a summary of the policy;<sup>28</sup>
- a new **recommendation 5.2** that “[a] listed entity should ensure that its board receives copies of all announcements under Listing Rule 3.1 promptly after they have been made”;
- a new **recommendation 5.3** that “[a] listed entity that gives a new investor or analyst presentation should release a copy of the presentation materials on the ASX Market Announcements Platform ahead of the presentation”;
- an amendment to the commentary to **principle 6** (respect the rights of security holders) acknowledging that the provision of high quality corporate reporting and continuous disclosure are important for security holders to be able to exercise their rights as owners effectively;
- an amendment to the commentary on **recommendation 6.1** (information on website) to suggest a listed entity include on its website links to its “other corporate reports”, as well as to its annual directors’ report and financial statements;
- amendments to the commentary on **recommendation 6.2** (investor relations program):
  - referring to proxy advisers in the list of possible stakeholders to be covered in the investor relations program of a larger listed entity;
  - adding a statement that while the focus of many investor relations programs will be on larger investors and financial market participants who service larger investors, listed entities should also seek opportunities to engage with retail investors and the organisations that represent them, to understand the matters of concern or interest to smaller investors;
  - adding a suggestion that a listed entity should also consider monitoring popular social media forums used by retail investors for comments about the entity; and
  - adding a statement that where significant comments or concerns are raised by investors, they should be conveyed to the entity’s board and relevant senior executives.
- a change in the text of **recommendation 6.3** (facilitate participation at meetings of security holders) from “[a] listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders” to “[a] listed entity should disclose how it facilitates and

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<sup>28</sup> The option for a listed entity to disclose a summary of its continuous disclosure policy rather than the full policy originated when these disclosures had to be included in the entity’s annual report. Brevity was therefore a virtue. With the changes made in the third edition to allow an entity to make its governance disclosures on its website, it is now easier for the entity simply to disclose the full policy on its website. Disclosing the full policy also removes the possibility of an inadvertent omission of material information when providing a summary. Note the footnote in the consultation draft of the fourth edition that an entity may redact from the disclosed copy of its continuous disclosure policy personal or confidential information such as the names and contact details of individual staff involved in the disclosure process.

encourages participation at meetings of security holders”, plus the addition of guidance in the commentary to the recommendation that a listed entity should:

- choose a venue for a meeting of security holders that is reasonably accessible to security holders who wish to attend the meeting in person or by proxy; and
- if it has a large or geographically diverse register, consider having hybrid meetings that allow shareholders to attend and vote in person, by proxy or online;
- a new **recommendation 6.4** that a listed entity should ensure that all resolutions at a meeting of security holders are decided by a poll rather than by a show of hands;<sup>29</sup>
- an amendment to the commentary to **principle 7** (recognise and manage risk) stating that a sound risk management framework is based on an informed understanding of the key drivers of an entity’s long term success and a thorough assessment of the material risks inherent in its business model and strategy and that it should address financial and non-financial risks, as well as risks with a short, medium or longer term horizon;
- amendments to the commentary to **recommendation 7.1** (risk committee) adding more detail about the usual role of a risk committee;
- amendments to **recommendation 7.2** (annual risk review):
  - moving the commentary in the third edition that a board should satisfy itself that the entity is operating with due regard to the risk appetite set by the board into the text of the recommendation; and
  - including in the commentary statements that an entity’s annual risk review should have regard to the considerations set out in the commentary to principle 7 and encouraging the board of a listed entity not only to disclose that it has reviewed the entity’s risk management framework but also any insights it has gained from the review and any changes it has made to that framework as a result;
- the addition of a footnote to the commentary to **recommendation 7.3** (internal audit) that listed entities that have or wish to have an internal audit function may find the International Standards for the Professional Practice of Internal Auditing published by the International Internal Audit Standards Board helpful in determining how best to structure and staff that function;
- amendments to **recommendation 7.4** (sustainability disclosures)<sup>30</sup> to refer to “environmental and social risks” rather than “economic, environmental and social sustainability risks”, plus amendments to the commentary to that recommendation:
  - acknowledging that a listed entity’s “social licence to operate” is one of its most valuable assets and that the licence can be lost or seriously damaged if the entity conducts its business in a way that is not environmentally or socially responsible;
  - replacing the current statement in the commentary that to make the disclosures called for under this recommendation does not require a listed entity to publish a “sustainability report”, but an entity that does publish a sustainability report may meet this recommendation simply by cross-referring to that report, with:

*“To make the disclosures called for under this recommendation does not require a listed entity to publish an “integrated report” or “sustainability report”. However an entity that does publish an integrated report in accordance with the International Integrated Reporting Council’s International <IR> Framework, or a sustainability report in accordance with a recognised international standard, may meet this recommendation simply by cross-referring to that report.”*

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<sup>29</sup> See note 12 above.

<sup>30</sup> Recommendation 7.4 was introduced in the third edition. KPMG’s 2016 review, cited in note 5 above, reported a number of issues with the disclosures made by listed entity under this recommendation and suggested that extra guidance be provided.

- adding a suggestion that entities that believe they do not have any material exposure to environmental and social risks should consider carefully their basis for that belief and benchmark their disclosures in this regard against those made by their peers;
- as recommended in the Senate Economics References Committee report on Climate Risk Disclosure,<sup>31</sup> giving greater guidance on the disclosure of climate change risk (also referred to as “carbon risk”), including:
  - explaining the different types of climate change risk (physical risks, transition risks and liability risks);
  - noting that many listed entities will be exposed to these types of risks, even where they are not directly involved in mining or consuming fossil fuels; and
  - suggesting that listed entities with material exposure to climate change risk implement the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures;<sup>32</sup>
- the addition of a reference in **principle 8** (remunerate fairly and responsibly) and the accompanying commentary to remuneration being aligned with “the creation of value for security holders over the short, medium and longer term” and changes to the commentary to that principle:
  - altering the description of the remuneration process from “formal” to “rigorous”;
  - adding a statement that an entity’s remuneration policy should not reward conduct that is contrary to the entity’s values or risk appetite;
  - adding a reference to the impact on the entity’s social licence to operate if it is seen to pay excessive remuneration to directors and senior executives; and
  - suggesting that listed entities should benchmark their remuneration against that of their peers to verify that it is not excessive;
- amendments to the guidelines for executive remuneration in box 8.2 under **recommendation 8.2** (disclosure of executive and non-executive director remuneration policies) adding statements that:
  - the targets for performance based remuneration should be aligned to the entity’s short, medium and longer term performance objectives and should be consistent with its circumstances, purpose, strategic goals, values and risk appetite; and
  - equity based remuneration should be aligned to the entity’s short, medium and longer-term performance objectives;

plus the addition of a statement in the commentary to that recommendation that an entity’s remuneration policies and practices should have regard to the considerations set out in the commentary to principle 8;

- a new **recommendation 8.4** that a listed entity should only enter into an agreement for the provision of consultancy or similar services by a director or senior executive or by a related party of a director or senior executive: (a) if it has independent advice that: (i) the services being provided are outside the ordinary scope of their duties as a director or senior executive (as applicable); (ii) the agreement is on arm’s length terms; and (iii) the remuneration payable under it is reasonable; and (b) with full disclosure of the material terms to security holders;
- amendments to the section at the back of the *Principles and Recommendations* dealing with **externally managed entities**:
  - suggesting when it is addressing the alternative recommendation to recommendation 1.1 (disclose the arrangements between the responsible entity and the listed entity for managing the affairs of the

<sup>31</sup> See note 4 and accompanying text.

<sup>32</sup> The TCFD’s recommendations have been widely endorsed by investors, companies and regulators globally, including APRA.

listed entity and the role and responsibility of the board of the responsible entity for overseeing those arrangements), the responsible entity should disclose the extent to which the responsible entity has outsourced any aspects of the management of the listed entity and the role and responsibility of the board for overseeing the performance by the outsourced service provider; and

- adding a reference to ASIC Regulatory Guide 259 in the commentary on recommendation 7.2 (annual risk review);
- changes to the **glossary** to:
  - add new definitions of “environmental risk” and “social risk” to tie in with the changes to recommendation 7.4 mentioned above; and
  - amend the definition of “substantial holder” to address some technical issues with the way in which that term is defined in the Corporations Act;
- the addition of commentary for each of the new recommendations; and
- other minor consequential changes and drafting improvements.