

# **ASX Corporate Governance Council**

## **Review of Corporate Governance Principles**

**Submission by**

**Allianz Australia Limited**

**November 2013**

## 1 ALLIANZ AUSTRALIA BACKGROUND

Allianz Australia is one of Australia's leading general and specialist insurers and employs over 3,800 people. Having operated in Australia since 1914, initially under the name "*The Manufacturers Mutual Accident Insurance Association*", the company became a wholly owned subsidiary of Allianz SE in 1998.

Headquartered in Munich, the Allianz Group is the largest property and casualty insurance group in the world and operates in over 70 countries with a global workforce of more than 140,000 people. The Allianz Group covers risk for more Fortune 500 companies than any other insurer and has a strong standing in the Australian market. For example, Allianz Australia is:

- one of the largest workers compensation insurers in Australia, providing cover for approximately 1 in 5 working Australians;
- the largest insurer of marine pleasure craft in Australia through its specialist subsidiary Club Marine;
- a major supplier of Compulsory Third Party (CTP) insurance in NSW and Queensland; and
- a major supplier of the full range of commercial, industrial, household and personal general insurance products.

## 2 OVERVIEW

The ASX Corporate Governance Council (**ASX**) has proposed, in its Public Consultation paper dated 16 August 2013 (**Review Paper**), that changes are made to the defining characteristics of an independent director, as set out in Box 2.1 of the ASX Corporate Governance Principles and Recommendations (**ASX Governance Principles**). Specifically, it is proposed that Box 2.1 set out examples of matters that "*might cause doubts about the independence of a director*" and that those examples include:

*"if the director... has been a director of the entity for more than 9 years."*

In the Review Paper, the ASX states that it proposes to make this change on the basis of a similar provision having been introduced in the United Kingdom, Singapore, South Africa and Hong Kong. No other explanation is provided.

Allianz Australia Limited is not a listed entity. However, it is subject to the Australian Prudential Regulation Authority (**APRA**) Prudential Standard requirements relating to the independence of directors, which are based on the ASX Governance Principles<sup>1</sup>. As stated in Prudential Standard CPS 510, those requirements are:

*"adapted from the guidance on 'Relationships affecting independent status' to be considered by a Board when determining the independent*

*status of a director set out in Box 2.1 of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (2nd Edition 2007)."*

This has been APRA's approach since 2006. As such, Allianz Australia expects that APRA would pay close regard to any changes to the contents of Box 2.1 in determining whether similar changes need be made to its Prudential Standards. The ASX's proposed changes to the contents of Box 2.1 are therefore relevant to Allianz Australia Limited.

Allianz Australia submits that a reference in Box 2.1 to a fixed 9 year period of tenure as a factor that might cause doubts about the independence of a director is totally inappropriate and has the potential to reduce, rather than improve, the effectiveness of independent directors. In summary, the reasons for Allianz Australia's view (set out in more detail in section 3 below) are as follows:

- The ASX has not advanced, and Allianz Australia is not aware of, any empirical or factual evidence from anywhere in the world that independent directors lose their independence after a specified period of time. Why a 9 year timeframe has been chosen rather than another period appears to be without basis. A director could become too close to management in just a couple of years, or could remain independent of management after 20.
- Having regard to the frequency with which CEOs turnover within companies (every 4.4 years according to a recent study of ASX 200 companies), there is little opportunity for independent directors to become too close to management over time.
- Independent directors need time to understand the fundamentals and drivers of the business, and become more valuable and effective once they have gained that knowledge.
- There is great value in having independent directors who have seen and understand the lengthy business cycles that can have such a significant impact on companies. Insurance cycles, for instance, can extend for periods of 7 years or more, which means that only directors with a tenure of approximately 14 years will have served through a full cycle, with the benefit of having experienced a full one before.
- Unlike the other factors referred to in Box 2.1, the reference to 9 year tenure is not an "*interest, position, association or relationship*" which a Board can consider in determining the independence of a director. It is merely the passage of time.
- The inclusion of a 9 year timeframe in Box 2.1 could result in a less robust approach being taken by Boards to the assessment of independence of newly appointed directors.

To the contrary:

- Allianz Australia believes that the current ASX Governance Principles (which do not include a provision relating to the tenure of independent directors) are producing knowledgeable and experienced independent directors capable of making significant and effective contributions to the corporate governance of the companies to which they are appointed. The ASX proposal to include a reference to tenure in Box 2.1 has the potential to bring the benefits accruing from this improved experience to an end.
- There is also an increasing incidence of younger independent directors being appointed to Boards who, if the ASX proposal were to proceed, may have to leave those Boards just as they come into the prime of their experience. This would be a regrettable trend.

### 3 INDEPENDENCE - DIRECTOR TENURE

As stated above, Allianz Australia submits that it is inappropriate to include a new provision in Box 2.1 regarding whether a director has been a director of the entity for more than 9 years, as a factor that might cause doubts about the independence of a director. The basis of Allianz Australia's submission is as follows.

#### ***No evidence that tenure leads to loss of independence***

In 2006, the ASX amended Box 2.1 of the ASX Governance Principles to remove references to a director's tenure as an element relevant to the assessment of independence. Most significantly, it deleted the provision stating that, for a director to be independent, he or she must not have served on the board:

*“for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company”.*

The ASX explained this change by saying:

*“In Council's view, length of service on a board is an issue relating to succession which is discussed under Recommendation 2.5 about nomination committees.”<sup>2</sup>*

Allianz Australia agrees with this view.

The ASX's decision to reintroduce tenure as a specific factor relevant to determining the independence of directors is based on the fact that the United Kingdom, Singapore, South Africa and Hong Kong have done so. It has offered no factual or empirical evidence, though, to support the change or to the effect that it will improve the quality of performance of independent directors. Allianz Australia is also not aware of any evidence which would justify the new provision.

At a high level, the rationale for including a reference to tenure in Box 2.1 is presumably that, over time, a director loses the ability to act independently

because of his or her proximity to management or perhaps to other directors. If that is the basis of the ASX's proposal, Allianz Australia contends that it is unfounded.

Independence is an element of a director's state of mind. That can be influenced by relationships, as reflected in the other points set out in Box 2.1. However, Allianz Australia is aware of no evidence to support the contention that it can be influenced by the passage of time alone.

Allianz Australia believes a director's independence should be assessed through a robust process undertaken by the Board. That should be equally so, irrespective of the director's tenure on the Board. Just as the Board should not presume a new director to be independent because of a limited time on the Board, a director with lengthy tenure should not be presumed to have lost their independence as a result of their relatively long period of service.

### ***Limited opportunities to get too close to Management***

According to a recent study, the median tenure of CEOs of ASX 200 companies was just 4.4 years<sup>3</sup>. Having regard to this figure, there is little opportunity for independent directors to become too close to management. Certainly, there does not appear to be a reasonable basis for a general proposition that independent directors who have been on a Board for more than 9 years will tend to have lost their independence as a result of being too close to management.

Allianz Australia submits that any question as to whether a director has lost their independence as a result of their proximity to management should be assessed having regard to the general principles in Box 2.1, namely whether any relationship that exists in a particular case, might influence or be perceived to influence the director's capacity to bring an independent judgement to bear on issues.

### ***It takes time to build expertise***

In Insurance, as with many other industries, it takes independent directors time to understand the fundamentals and drivers of the business. This follows naturally from the relative lack of experience that independent directors will normally have in the industry and the relatively limited business information available to them, compared with their executive colleagues.

Taking insurance as an example, it is Allianz Australia's experience that independent directors take several years to build a strong understanding of the business and industry in which it operates. This is particularly the case for companies which manage long tail classes, such as public liability and compulsory third party insurance. As a result, independent directors tend to become more valuable over time, as their knowledge enables them to apply an increasingly insightful approach to their role.

To include a provision in Box 2.1 which could have the effect of more independent directors stepping down after 9 years will reduce the pool of expertise available to Boards. It will also reduce the ability of independent directors to carry out their roles with a strong understanding of the company and the industry within which it operates. The likely consequence is that independent directors will become more dependent on executive management and, thereby, less effective.

Allianz Australia submits that such a loss of expertise in independent directors would be a high price to pay for including a reference to tenure in Box 2.1.

### ***Value in understanding industry cycles***

As with many other industries, insurance has complex and lengthy business cycles. During these cycles, there can be material swings in premium rates, profitability and underwriting capacity, all of which can be impacted by external factors such as economic conditions and catastrophic claims.

An understanding of insurance cycles is very valuable to directors of insurance companies. The same would be the case in other industries. The inclusion of a provision relating to tenure in Box 2.1 could have the effect of preventing Boards from having independent directors who have seen and understand the impact that business cycles can have on the company concerned.

Allianz Australia submits that, similar to the point made above in relation to expertise, such a loss of understanding regarding business cycles would be a high price to pay for including a reference to tenure in Box 2.1.

### ***Different nature of tenure***

Each of the criteria set out in the proposed amendments to Box 2.1, other than the last bullet point relating to tenure, refer to indicia of relationships which might impact a director's ability to act independently. Allianz Australia's view is that the inclusion of these relationships is appropriate, as any Board assessing the independence of a director should be made aware of and consider such factors.

The last bullet point, however, relating to the tenure of a director, is quite different in nature. It does not describe an interest, position, association or relationship (or any other factor) that, of itself, could impact a director's independence. It merely refers to the amount of time that the director has been with the company in that role.

Allianz Australia submits that, for that reason, it should not be included in the factors set out in Box 2.1.

### ***Adverse effects of an arbitrary timeframe on Board assessment***

The ASX proposal to include a reference to tenure in Box 2.1 includes a fixed timeframe of 9 years. The choice of 9 years as the appropriate measure of tenure appears to be totally arbitrary. No explanation has been provided by

the ASX for deciding upon this period, beyond it having been adopted in other jurisdictions.

Allianz Australia believes the inclusion of a 9 year tenure clause could create a situation where Boards undertake a less rigorous consideration of independence for directors who have been on the Board for less than 9 years, than for those who have been on the Board for more. It is submitted that that would be inappropriate and could result in a reduction to the level of independence of the newer directors.

**Contact:**

If you have any questions in relation to this submission, please feel free to contact Mathew Kaley (General Counsel) on 9390 6262.

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<sup>1</sup> Prudential Standard CPS 510, para 15 states:

*For the purposes of this Prudential Standard, an ‘independent director’ is a non-executive director who is free from any business or other association — including those arising out of a substantial shareholding, involvement in past management or as a supplier, customer or adviser — that could materially interfere with the exercise of their independent judgement. The circumstances that will not meet this test of independence include, but are not limited to, those set out in Attachment A.*

Attachment A to Prudential Standard CPS 510 does not currently include any reference to the tenure of the director.

<sup>2</sup> Review of the Principles of Good Corporate Governance and Best Practice Recommendations, ASX Corporate Governance Council Explanatory Paper and Consultation Paper, 2 November 2006

<sup>3</sup> Booz & Co study dated November 2012 of ASX 200 CEOs departing from their roles during the period from 2009 to 2011.