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13 November 2013

Submitted via email to mavis.tan@asx.com.au

Dear Ms Tan,

ASX Corporate Governance Council - Review of the *Corporate Governance Principles and Recommendations*

On behalf of our members, CFA Societies Australia welcomes the opportunity to comment on the ASX Corporate Governance Council's (the 'Council') review of its *Corporate Governance Principles and Recommendations* ('*Principles and Recommendations*').

Our comments on this consultation represent an independent voice without the conflicts of interest that may face any particular industry association. We thank you for the opportunity to provide these comments and contribute to improving the corporate governance practices of listed entities.

The CFA Societies of Sydney, Melbourne and Perth are not-for-profit associations of more than 1,500 investment professionals formed to lead the investment profession in Australia by setting the highest standards of education, integrity and professional excellence. Our members are engaged in a wide variety of roles across investment management and advice. Most of our members are holders of the Chartered Financial Analyst (CFA) designation.

CFA Societies Australia

Together we represent the three Australian chapters of CFA Institute[1]. CFA Institute stands for ethical excellence in the global financial community. It is a leading voice on global issues of fairness, market efficiency, and investor protection. CFA Institute offers a range of educational and career resources, including the Chartered Financial Analyst (CFA) and the Certificate in Investment Performance Measurement (CIPM) designations, as well as a new program called the Claritas Investment Certificate[2].

In Appendix A we have identified recommendations in the revised 3rd Edition where the Council has:

1. Proposed new recommendations;
2. Revised existing recommendations; and has
3. Upgraded commentary into recommendations.

We have provided comments on only these recommendations. These selected recommendations, together with our detailed comments are outlined in Appendix A.

General Comments

The revisions made in the third edition of the *Corporate Governance Principles and Recommendations* are a welcome improvement. The appropriateness of corporate governance practices changes over time and what was considered suitable 10 years ago, may not be considered suitable now. The Global Financial Crisis highlights this point. We believe good corporate governance practices seek to ensure that companies act in the best interests of shareholders at all times. This is accomplished through the implementation of various internal controls and procedures, such as an independent and qualified board, accessible shareholder rights and transparent corporate communications and disclosure.

As such we are very supportive of increased disclosure and transparency around matters affecting shareholder's right to make informed decisions about director election. This includes the increased focus on director training as we believe that it will not only increase knowledge but it will also increase professionalism and engagement on the board. We also believe the broader definition of director independence in Box 2.1 is now more in line with best practice and a necessary improvement.

[1] CFA Institute is a global, not-for-profit professional association of more than 116,000 investment analysts, portfolio managers, investment advisors and other investment professionals in 130 countries of which more than 100,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

[2] For more information please see http://www.cfainstitute.org/programs/Pages/index.aspx

The recommendations for greater risk oversight by the board are also very welcome. The GFC has highlighted that increased awareness, understanding and communication of risk management is essential. We believe risk thinking needs to be embedded in the way businesses are run and overseen.

Overall we are happy with structural changes made to the format of the *Principles and Recommendations*, except for the section on externally managed listed entities. We believe that the commentary is too brief, especially around the remuneration of the manager in the alternative recommendations to 8.1 – 8.3. More specifically we question the appropriateness of excluding recommendations 2.2 and 2.3 from applying to externally managed listed entities.

Comments on the related ASX Consultation Paper

The most significant change to the ASX Listing Rules is the greater flexibility listed entities have to make their corporate governance disclosures in either their annual report or website. We question the proposal which allows listed entities elect to disclose their corporate governance statement on their website rather than their annual report. From our understanding, ASX is proposing that if the entity chooses to disclose the corporate governance statement on their website, the annual report only needs to include the URL of the webpage where its corporate governance statement can be found. We believe the annual report should be a complete reference investors can refer to that includes all relevant financial statements and disclosures. Therefore, we do not believe it is enough to only include the URL referencing where the corporate governance statement can be found. If entities chose to report the corporate governance statement on their website they must also include a copy in their annual report as well.

Concluding remarks

CFA Societies Australia is supportive of the proposed changes the ASX Corporate Governance Council is making to improve corporate governance practices among listed entities. Solid corporate governance practices are an essential part of ensuring shareholder value is protected and the rights of shareholders are promoted. As an organisation that prides itself on upholding the highest ethical and professional standards and promoting investor protection, we are very supportive of reforms that promote similar ideals.

If you have any questions in regards to this submission or would like to discuss anything further, please feel free to contact Richard Brandweiner at president@cfas.org.au or Angela Pica at advocacy@cfas.org.au.

Yours sincerely,

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APPENDIX A

Principle 1: Roles and responsibilities of the board

Recommendation 1.2: A listed entity should:

(a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director; and **NEW**

(b) provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a director. **UPGRADE**

CFA Societies Australia response

We strongly support the changes to Recommendation 1.2. It is only by increasing transparency and the quality of information disclosed to shareholders sufficiently in advance of the AGM that will allow shareholders to make informed decisions on whether or not to elect or re-elect a director. The disclosures should include academic and professional qualifications, all previous and current directorships, all relevant experience and the nature of any relationships of the person that could affect his/her ability to act objectively. The information should also explain to investors what needed skills each director will bring to the board, such as risk management, audit, specific industry experience etc. Even though this may be discussed within the context of director qualifications we believe it should be explicitly stated so investors can clearly see how each director's qualifications aligns with the existing skill set of directors already on the board.

Recommendation 1.3: A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment. **UPGRADE**

CFA Societies Australia response

We support the changes to Recommendation 1.3.

Recommendation 1.4: The company secretary of a listed entity should have a direct reporting line to the chair of the board. **UPGRADE**

CFA Societies Australia response

We support the proposed Recommendation 1.4. However we believe the language of the recommendation should change as the company secretary should report to the *full board, through the chair.*

The language should be changed to reflect that the company secretary's role is to support the entire board in its governance and administrative function and as such should report to the *full board, through the chair*. This is especially important if the chair is not independent as the company secretary supports

the function of the board committees, succession planning, and performance measurement and should not be unduly influenced by a non-independent chair.

A large part of the company secretary's role is operational and to effectively carry this out the company secretary needs to be free to liaise with executive management such as the CEO.

Principle 2: Structure of the board

Box 2.1 – the defining characteristics of an independent director

A director of a listed entity should be characterised and described as an independent director only if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, his or her 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.

Examples of interests, positions, associations and relationships that might cause doubts about the independence of a director include if the director:

- is, or has been, employed in an executive capacity by the entity or any of its related entities and there has not been a period of at least three years between ceasing such employment and serving on the board;
- is, or has within the last three years been, a partner, shareholder, director or senior employee of a professional adviser or consultant to the entity or any of its related entities;
- is, or has within the last three years been, a material supplier or customer of the entity or any of its related entities, or an officer of, or otherwise associated directly or indirectly with, such a supplier or customer **(REVISED)**;
- is a substantial shareholder of the entity or an officer of, or otherwise associated directly or indirectly with, a substantial shareholder of the entity;
- has a material contractual relationship with the entity or its related entities other than as a director;
- has close family ties with any person who falls within any of the categories described above **(UPGRADE)**; or
- has been a director of the entity for more than 9 years **(NEW)**.

In each case, the materiality of the interest, position, association or relationship needs to be assessed to determine whether it might interfere, or might reasonably be seen to 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.

CFA Societies Australia response

We support the changes to Box 2.1 as listed above. Maintaining independence on the board is an essential element of good corporate governance. The ability of the board to demonstrate independent and objective judgment helps to proactively identify and prevent conflicts, effectively monitor managerial performance and maintains the board's focus on maximising shareholder value.

We strongly support the inclusion of bullet point six in Box 2.1 "has close family ties with any person who falls within any of the categories described above". Familial ties are strong and can greatly impair the independent judgment of directors. Identifying and managing this conflict of interest is important.

Although we support the inclusion of the length of tenure in this list, prescribing an absolute number of years of service after which you are no longer considered 'independent' is arbitrary and subjective. Therefore we believe it is important for independent directors to be reviewed against the independence criteria in Box 2.1 annually and this assessment should be disclosed to shareholders in the annual report.

Where a director has an interest, position, association or relationship as described in Box 2.1 but is deemed by the board that it does not compromise the director's independence we believe it is important that the relationship is disclosed in the annual report as well as in the director nomination circulars at the time of election or re-election.

Recommendation 2.6 (UPGRADE): A listed entity should:

(a) have a program for inducting new directors and providing appropriate professional development opportunities for continuing directors to develop and maintain the skills and knowledge needed to perform their role as a director effectively; and

(b) disclose a summary of the main features of that program.

CFA Societies Australia response

We support the changes to Recommendation 2.6. We believe that induction programs are important to introduce new directors to the company, its operations and strategy as well as the applicable legal and regulatory framework the organisation works in. Professional development is required for existing directors to help them perform their role more effectively. However, we believe attendance at director training should be disclosed and form part of the annual board evaluation.

Principle 4: Safeguarding integrity of financial reporting

Recommendation 4.2 The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity. **(REVISED)**

CFA Societies Australia response

We support the changes to Recommendation 4.2.

Recommendation 4.3: A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit. **(NEW)**

CFA Societies Australia response

We support the addition of Recommendation 4.3.

Principle 6: Rights of security holders

Recommendation 6.1: A listed entity should provide information about itself and its governance to investors via its website. **(UPGRADE)**

CFA Societies Australia response

We support the changes to Recommendation 6.1.

Recommendation 6.4: A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically. **(UPGRADE)**

CFA Societies Australia response

We support the changes to Recommendation 6.4.

CFA Societies Australia

Principle 7: Recognising and managing risk

Recommendation 7.1 (REVISED): The board of a listed entity should:

(a) have a risk committee which:

(1) has at least three members, a majority of whom are independent directors; and

(2) is chaired by an independent director,

and disclose:

(3) the charter of the committee;

(4) the members of the committee; and

(5) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or

(b) include within the responsibilities of the audit committee the responsibilities normally undertaken by a risk committee; or

(c) if it does not have a risk committee (whether as a stand-alone committee or as part of the responsibilities of the audit committee), disclose that fact and the processes it employs for identifying, measuring, monitoring and managing the material business risks it faces.

CFA Societies Australia response

We support the changes to Recommendation 7.1 but note the need for the whole board to be more involved in risk management and oversight.

Risk oversight by corporate boards was examined in a recent CFA Institute study "Visionary Board Leadership: Stewardship for the Long Term"[3]. In this study an expert panel of current and former directors, investors, corporate secretaries, and other investment professionals was used to characterise a 'Visionary Board' by identifying leading board practices.

An excerpt from the report –

> "Recognizing that regulatory requirements will leave some financial services companies with little choice in addressing risk oversight, our panel was not convinced that a standalone risk committee was the most effective mechanism for board risk oversight. Such structures can unintentionally insulate a majority of the board from risk discussions. The quality of the risk

[3] See CFA Institute, 2012, Visionary Board Leadership: Stewardship for the Long Term (June): http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n3.1

oversight activities of the board can be significantly enhanced when the collective knowledge of all board members is sought.

A Visionary Board needs regular training in risk management so that board members know what questions to ask and the types of information to seek. The board cannot be in the position of relying solely on the information management gives to them because they lack knowledge to ask difficult but necessary questions, including, "Why are you confident that you correctly understand the full spectrum of risks facing this company?" or "What if this fails?" In assessing the adequacy of the answer, a board may consider whether the management team has adequately sought outside input and advice rather than relying solely on the internal knowledge and expertise of the company." (p. 21)

The three key takeaways of the study, as relevant here, is that the board;

- Understands that the whole board is responsible for risk oversight (with specific risk management training where necessary),
- Treats risk oversight as a *constant process* discussed at each meeting, not something that is only addressed annually, and
- Clearly explains to investors and stakeholders the process the board uses for risk oversight and the monitoring of strategically important risks.

Recommendation 7.2 (REVISED): The board or a committee of the board should:

(a) review the entity's risk management framework with management at least annually to satisfy itself that it continues to be sound, to determine whether there have been any changes in the material business risks the entity faces and to ensure that they remain within the risk appetite set by the board; and

(b) disclose in relation to each reporting period, whether such a review has taken place.

CFA Societies Australia response

We support the inclusion of Recommendation 7.2 as it is an improvement from the current recommendation which only requires the board to disclose whether management has provided them with a report on the entity's risk management systems. However, as discussed above we believe that risk discussion should be an ongoing process and disclosed accordingly.

The CFA Institute argues that "A Visionary Board treats risk oversight as an ongoing process inextricably linked to the business plan and its execution, not as a compliance exercise or a checklist item to be marked off once a year. Our panel also believes that a Visionary Board makes sure that an update of critical risks is included on the board agenda at every meeting."[4]

[4] See CFA Institute, 2012, Visionary Board Leadership: Stewardship for the Long Term (June): 22 http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n3.1

Recommendation 7.3 (UPGRADE): A listed entity should disclose:

(a) if it has an internal audit function, how the function is structured and what role it performs; or

(b) if it does not have an internal audit function, the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.

CFA Societies Australia response

We support the changes incorporated in Recommendation 7.3.

Recommendation 7.4: A listed entity disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks **(NEW)**.

CFA Societies Australia response

We support the proposed addition of Recommendation 7.4 as we believe that considerations of long term risk factors is essential for breaking the challenges of increasing short-termist behaviour of market participants.

Principle 8: Remuneration

Recommendation 8.3 (NEW): A listed entity should:

(a) have a "clawback" policy which sets out the circumstances in which the entity may claw back performance-based remuneration from its senior executives;

(b) disclose that policy or a summary of it; and

(c) disclose as at the end of each reporting period:

(1) whether any performance-based remuneration has been clawed back in accordance with the policy during the reporting period; and

(2) where performance-based remuneration should have been clawed back in accordance with the policy during the reporting period but was not, the reasons for this.

CFA Societies Australia response

We support the proposed addition of Recommendation 8.3.

Increased disclosure and transparency of clawback provisions should prompt a better debate between shareholders and companies on ways to promote and reward decision making in the long term interests of shareholders.

New recommendations for externally managed listed entities

Alternative to recommendations 1.1 and 2.6 for externally managed listed entities:

The responsible entity of an externally managed listed entity should disclose:

(a) the arrangements between the responsible entity and the listed entity for managing the affairs of the listed entity;

(b) the role and responsibility of the board of the responsible entity for overseeing those arrangements; and

(c) its program for inducting new directors and providing appropriate professional development opportunities for continuing directors to develop and maintain the skills and knowledge needed to perform their role as a director effectively.

CFA Societies Australia response

We support the alternative recommendations for externally managed listed entities above. The relationship between the responsible entity (RE) and externally managed listed entities is critical for the performance of the listed entity, however, often because of poor transparency investors have limited understanding of the operations of the RE and how in fact it manages the listed entity. The recommendations refer to 'arrangements' however nowhere in the commentary is this term explained. We believe the term 'arrangements' should be elaborated on in the commentary.

Alternative to recommendations 8.1, 8.2 and 8.3 for externally managed listed entities:

An externally managed listed entity should clearly disclose the terms governing the remuneration of the manager.

CFA Societies Australia response

We support the alternative recommendations for externally managed listed entities above. The determination of how fees are structured between the RE and an externally managed entity is very important to the net return to shareholders and is therefore a key disclosure. We support the full disclosure (base, performance, acquisition, disposal etc.) of all fees actually paid by the externally managed entity to the RE. This disclosure should be cross-referenced to the specific clauses in the management agreement/constitution, which should also be made available to investors on the entity's website.

We believe the commentary in this section could be expanded so it was more in line with the extensive commentary for listed entities in Principle 8. The guidance listed under Recommendation 8.2 should be replicated in the context of externally managed listed entities. For example guidance on appropriate fee structures for the various fees paid by the externally listed entity to the manager could be included in this section. Inappropriate performance fees are often the most common way investor value is destroyed. Performance fees can be compared to performance based remuneration for company executives and therefore should be linked to performance measures that reflect growth in unit holder value. In this way, managers will be rewarded for good performance and penalised for poor performance and it will better align the interests of the unitholders with those of the manager.

General comments on the recommendations for externally managed listed entities

The management of agency problems is extremely important in the case of externally managed entities. Many governance issues arise because of the inherent principal-agent conflict between external management (agent) and the unitholder of the externally managed entity (principal). In some cases, the external management is often owned (wholly or partly) by the sponsor, adding further complications and significant conflicts of interests between the sponsor/manager and the unitholders.

As written in paragraph 99 of the Consultation Paper, recommendations 2.2-2.3 do not apply to an externally managed entity. We are unclear whether this means that manager of externally listed entities no longer need to adhere to the recommendations to have a majority independent board and an independent chair. Again, given the significant conflicts of interests that can arise between the sponsor/manager and the unitholders, the manager's board needs to be trusted to provide independent review and oversight over the manager and the operations of the externally managed entity.

Therefore, we believe that the manager's board should be majority independent, where the definition of independence excludes management, sponsors, and substantial unitholders. The role of the chair should not only be separate from that of the CEO but also independent of management, sponsors and substantial unitholders.

For more information on the governance of externally managed listed entities, in particular real estate investment trusts please refer to the CFA Institute publication Asia-Pacific REITS: Building Trust through Better REIT Governance or contact Angela Pica on advocacy@cfas.org.au.