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14 November 2013

The Secretariat,
ASX Corporate Governance Council

**Re: Comments on Draft 3rd Edition of the ASX Corporate Governance Principles and Recommendations**

Dear ASX Corporate Governance Council,

I would like to thank the Council for the opportunity to comment on the draft 3rd edition of the ASX Corporate Governance Principles and Recommendations. D H Flinders is a corporate advisory firm which focuses particularly on emerging listed companies and has a particular interest in ensuring that the governance framework for small listed companies is appropriate and fit for purpose for this group. Set out below are, a number of general principles which it is requested be given further consideration by the Council, and specific comments on the proposed principles, recommendations and commentary.

## 1. General Principles for further consideration by the Council

The boundary between pursuit of a social versus a good governance agenda needs further consideration. This is a concern the Council itself has raised. There are however some potential inconsistencies in approach (e.g. diversity/tenure) which will be addressed in the detailed commentary below.

The appropriateness of duplication, overlap or extension of matters addressed by the legislature also needs further consideration. The intersections with legislation can be complex and confusing without substantial support which has a cost. These have a cost. As far as possible it is desirable that duplication, overlap and extension of legislation are avoided with a focus on application of good governance principles and processes in a commercial setting.

The same principles and recommendations apply (with some limited exceptions) to all listed companies regardless of size. Greater consideration needs to be given to small companies (e.g. ASX 300 and below) and the cost/benefit of the governance processes proposed which involve substantial time and resources to install and maintain. Large companies are clearly in a better position to absorb complex and detailed bureaucratic processes. This potentially results in boiler plate disclosures or at worst could result in costs/resource implications which place small companies at a disadvantage. Further engagement with small listed companies would be helpful to better understand the impact of the governance framework on them and whether the costs/resources required are justified by the enhanced governance achieved.

There is a focus in the recommendations on committee structures as the primary vehicle for addressing governance issues. Further consideration should be given to whether the

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focus should be on the issue the committee is being set up to address rather than the committee. This would mean making the alternative proposed in a number of recommendations (recommendations 2.4, 4.1, 7.1 and 8.1) the default with the committee as the option. This would produce a more outcome focused and less bureaucratic approach. Similarly, there is a focus on tools, such as skills matrices and electronic media forms, which also potentially detract from a principles and outcomes based approach to the good governance framework.

The option to set out the Governance Disclosures on the Company's website as an alternative to including it in the Annual Report is a welcome development. It is important however that the new Appendix 4G document remain a checklist and location document and that it does not take on a life of its own in terms of the overall compliance requirements.

## 2. Comments on Proposed Principles and Recommendations

Comments on a number of the Principles and Recommendations are set out below with reference to the relevant principle or recommendation number.

**Recommendation 1.2(b).** ***The Council should not proceed with this recommendation***.

It should be sufficient assurance that Companies carry out the checks proposed under 1.2 (a). The requirement for disclosure of any material information revealed by these checks is unnecessary and is likely to create significant privacy issues which companies would need to navigate through.

**Recommendation 1.3.** ***The recommendation is sound however the commentary requires some revision in relation to the list of issues to be covered in senior executive employment agreements***.

An outline of remuneration arrangements should be included and take the place of the proposed specific comment on clawback which is out of place in this general list of agreement features. Further comment on this matter is outlined under recommendation 8.3.

**Recommendation 1.5.** ***The recommendation on diversity should be removed.***

Diversity is an extremely important issue which all companies must address. However, since the 2nd edition a comprehensive overhaul of legislation has taken place and the Workplace Gender Equality Act really covers the field in terms of policy, objectives and standards for gender diversity including for Boards. These new standards apply to all companies with more than 100 employees. Having 2 sets of obligations, which go beyond statistics, is unnecessarily confusing. For example, the Workplace Agenda Equality Agency has a standard reporting year (February to March) which will in most cases not align with the financial reporting year of companies. It also seems to be



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unreasonable to impose requirements on companies which the legislature has chosen to exclude.

**Recommendation 1.7.** ***Consideration should be given to removing this recommendation.***

The recommendation largely duplicates the requirements of S300A of the Corporations Act which already requires an explanation of performance based elements of remuneration.

**Principle 2.** ***It is suggested that the reference in the principle should be to the discharge of duties "appropriately" rather than "effectively".***

Effectiveness may be difficult to judge. Outlining how the discharge of duties is appropriate is likely to be more informative and useful for security holders.

**Box 2.1** ***Further consideration should be given to the items included in defining the characteristics of an independent director.***

The indicators of proximity, with reference to 'directly' or 'indirectly', seem to cast such a wide net that it will make these provisions difficult to navigate.

Tenure is not a reasonable indicator of independence. For some Directors, one term may be sufficient while for others a long standing relationship will be beneficial to the Company. In any event, this is a matter which shareholders should be able to decide without the imposition of a default position requiring a defensive response. Consideration also needs to be given, more generally, to the impact of a rapid loss of, effectively, a whole generation of directors as a potential consequence of this prescription.

**Recommendation 2.5.** ***The focus should be on outlining the process the Board has in place for renewal rather than focusing on a particular tool.***

While skills matrices are a useful tool, the focus should be on the outputs of using the tool, not the tool itself. Further consideration also needs to be given to the privacy and commercial sensitivity implications of publishing this information which may cover issues not directly relevant to Board renewal or capability.

**Principle 3.** ***The commentary should be revised to align with the recommendations on the code of conduct.***

The code of conduct in recommendation 3 sets out important principles which all organisations should enshrine in policy. The commentary however pursues a wider social agenda which the Council should review in line with its charter.



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**Recommendation 6.4.** ***The references to electronic communication should remain as commentary.***

Companies should be able to determine what is appropriate in terms of communication with shareholder as there are a range of issues and circumstances which need to be considered, not the least being cost. Small companies are likely to be particularly impacted by this proposal. The focus should be on encouraging and supporting effective communication rather than prescribing a particular form.

**Principle 8.** ***The principle should refer to the creation of long term value for security holders.***

Shareholder value will be impacted by a wide range of factors in the short term. The focus should be on ensuring that there is an appropriate relationship and alignment between remuneration and value creation over the investment cycle.

**Recommendation 8.1(b).** ***The words "not excessive" should be deleted.***

Setting the requirement at an appropriate level provides an opportunity for companies to explain what that means for them. The phase "not excessive" introduces a value judgment which is difficult to quantify and will always be in the eye of the beholder.

**Recommendation 8.3.** ***This new recommendation should not proceed.***

Given that there has been proposed legislation on this matter which is yet unresolved, it would be premature for the Council to proceed with this measure particularly in terms which far exceed the legislation proposed (i.e. that companies demonstrate what action they took to clawback remuneration in circumstances where a financial misstatement had occurred). Clawback, which potentially encompasses both remuneration already paid and payable, is a complex concept involving significant contractual and other legal and commercial issues as outlined in the Treasury Paper on clawback published in December 2010.

Tackling this issue through disclosure is a suboptimal solution creating significant complexity for companies in dealing with the substantial contractual and other legal issues involved. While large companies may have a capacity to deal with this, it will be a much more difficult matter for smaller companies to forge an appropriate approach. A specific and targeted legislative response focused on the clawback of remuneration incorrectly or inappropriately paid, where a financial misstatement occurs, would be a significantly simpler solution. The Treasury paper mentioned above outlines the significant agenda which needs to be addressed in forging appropriate terms for this legislation.

If the Council decides to proceed with this recommendation then it should only be in the terms originally proposed by legislation with clarification that it only applies to



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deferred and payable remuneration. Commentary should also be included to provide an opportunity for companies to develop an appropriate response over at least a 5 year period.

**Recommendation 8.4.** ***This recommendation is no longer required given the legislative response.***

The proposed recommendation, which picks up and extends the disclosure required under recommendation 8.4 in the 2nd edition, has been overtaken by legislation which bans hedging of both vested and restricted equity for Key Management Personnel. The recommendation is therefore no longer required as the legislation covers the field.

I can be contacted on 0409 436 946 if you would like to explore any questions about these comments.

Yours Sincerely

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**The author**

Peter Armstrong is a Director of the Corporate Services Group at D H Flinders and consults on remuneration and HR governance issues. Peter has a wealth of experience in remuneration design and governance as well as an extensive track record in HR general management and business management. His experience includes development of remuneration policies, remuneration structures, incentive plans and broader initiatives associated with developing the employee value proposition. Peter is a Fellow of the Australian Institute of Management, a member of the Australian Institute of Company Directors.

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