

Proposed 4th Edition of the ASX Principles and Recommendations

Submission to ASX Corporate Governance Council

By Graham Bradley AM

I welcome the opportunity to submit suggestions for improvements to the consultation draft.

I make this submission in my personal capacity. I do so as a professional director who has served as a non-executive director and chairman of some 20 boards of publicly-listed, private, government and non-profit companies over the past 15 years.

General Observations

Since 2003, the ASX Corporate Governance Council's Principles and Recommendations have served corporate Australia extremely well. They have set benchmarks for public company governance and reporting which have enhanced Australia's international reputation as a leader in corporate governance. They have also influenced beneficially the way boards of government and non-profit companies have operated.

A feature of the 3rd Edition which has, in my view, contributed to its success is its brevity, clarity and succinctness. By and large it avoided using vague and subjective terms. The proposed 4th Edition revisions seem to me to stray from this drafting principle. I fear that, without material changes, this would detract from the respect that the Guidelines rightly enjoy among practicing directors, both here and abroad.

I have had the opportunity to read the AICD's submission and I am in substantial agreement with the concerns which the AICD has expressed. I will not repeat them here at any length. My suggestions include drafting issues

as well as matters of policy and principle. They are set out by reference to pages in the marked-up consultation paper.

I believe that the proposed draft is now excessively long. While the law and corporate governance practice has evolved since the 3rd Edition, I do not believe developments since 2014 justify the significant increase in the number of Recommendations and a number of pages of Commentary and I urge the Council to seek concision and precision in its final version.

Inside Cover

Principle 2

I suggest that Principle 2 be reworded to better reflect what I believe is intended, namely that the Board should “collectively” have the necessary skills, commitment and knowledge of the entity and the industry. The current draft could read to suggest that each director must have these qualities.

Principle 3

I believe the phrase “acting lawfully and ethically” is more than satisfactory and the addition of the phrase “in a socially responsible manner” is fraught with subjectivity and should be removed. The AICD has argued this point cogently.

Principle 4

I believe the word “validate” is likely to drive boards to incur unnecessary cost and complexity. I suggest substituting the word “support”.

Principle 8

I would delete the words “over the short, medium and longer-term”. Properly interpreted, these words would require the creation of value over all time periods. Properly read, the phrase means “over the short term, and the medium term, and the longer-term”. Boards will often have to make trade-offs between long and short-term objectives. This comment applies elsewhere in the draft.

Page 2

I cannot see a good reason to change the phrase “an appropriate level of information” to “a reasonable level of information”. The word reasonable is more subjective and in normal usage would imply a lesser standard than “appropriate”. I also note that this change is inconsistent with the wording of Principle 6 which uses the phrase “appropriate information”.

Page 5

I do not know what is meant by “a holistic (sic) ... explanation”. Holistic could mean complete and exhaustive. I would delete the phrase. The phrase “an informative explanation” is perfectly adequate.

In the same sentence, I suggest substituting the word “policies” for “framework”. The word framework is less clear than “policies”. It is over-used throughout the draft, and in almost all cases the word “policies” or the phrase “policies and practices” would be plainer English.

I believe footnote 10 is superfluous.

Page 6

The example given in the new wording is inconsistent with the first sentence. The example makes no reference to the adoption of a suggestion in the Commentary. I would be in favour of deleting all of the new words in this paragraph as being unnecessarily detailed and prescriptive.

The new wording also raises an important question of policy and principle. This is the issue of whom the Principles are intended to serve. The words on Page 2 state that the recommendations are to serve investors “and other stakeholders”. The issue is: are the disclosures recommended for listed companies for the benefit of investors or for the benefit of a wider range of stakeholders? If so, what is the definition of “other stakeholders?” The purpose of the Principles and Recommendations has always been to provide appropriate information to shareholders. These disclosures are made public

documents and, therefore, available for all the world to read. This ensures that “the market” is appropriately informed on listed company governance. If the redrafted document is intended to serve other objectives or other stakeholders, this should be explicit and should be explained up front in relation to the Purpose section on page 2. I strongly believe that the Guidelines should not set out to serve “other stakeholders”.

Page 8

I suggest that the phrase “core values” should be changed to “values”. It is not clear what distinction is being drawn between “core” and “non-core” values. I note the word “values” is used elsewhere in the document (for example in the seventh and twelfth dot points on this page itself). Is it intended that those references are to values other than “core values”?

In the seventh dot point the phrase “business model” is used. This is jargon and should be avoided. In most cases the phrase “business”, “business plans” or “business objectives” would be better plain English drafting.

In the twelfth dot point, the word “policies” would be better than “framework”. Also, the word “ensuring” should where possible be avoided in documents such as this as it is usually interpreted at law as meaning “guaranteeing”. I suggest reverting to the previous wording on this dot point.

Page 9

The first paragraph on this page is inconsistent with the accountability model adopted by most companies. Normally the board delegates to the Chief Executive the responsibility for the matters outlined in this paragraph, not to the “senior executive team” as a whole. Individual executives are then assigned accountability by the CEO for specific objectives. This paragraph assumes a completely collective accountability for the matters delineated. This is inappropriate. I suggest the paragraph be reworded.

In the second paragraph, the phrase “any material misconduct that is inconsistent with the values ... of the entity” is poorly expressed. It implies that

some misconduct may be consistent with the values of the entity. This is surely not intended. Perhaps what is meant is “any conduct that is inconsistent with ...”

Page 10

I would recommend deleting the phrase “and the outcome of those checks”. If there were adverse outcomes, it is unlikely that a board would be proposing the candidate. It would be highly risky for a board to ignore adverse findings. Confirmation that appropriate checks have been conducted implies without more an absence of adverse findings.

Page 12

There is a problem with Recommendation 1.5(b)(ii). Management cannot and should not be involved in implementing gender diversity policies in relation to the composition of the board. This issue requires rewording. The same problem infects paragraph (b)(iii).

Moreover, gender diversity targets for boards should in my view relate only to non-executive directors. Boards have a fiduciary duty to appoint the very best candidate as CEO/Managing Director, regardless of gender, whereas the board’s ability to appoint NEDs to casual vacancies is not so constrained.

Page 13

I submit that the final paragraph of Recommendation 1.5 should be removed from the Recommendations and moved into the Commentary. This is because the paragraph and its stated target is exhortatory rather than an enduring principle. I believe it will become out-of-date relatively quickly as more companies achieve or exceed the 30 percent target for female directors. Also, limiting this recommendation to the S&P/ASX 300 is an arbitrary cut-off. All listed companies should be encouraged to improve the gender diversity of their boards. Nowhere else in the Principles and Recommendations are the recommendations directed at a sub-set of listed companies unless this is mandated by the ASX Listing Rules. I believe it is

desirable as a matter of principle for the Guidelines to apply to all listed companies unless otherwise required by the Listing Rules.

I believe the second sentence of the Commentary is misconceived. All companies should have a non-discriminatory employment policy, but this is a very different thing from a policy to explicitly “embrace” (a vague term!) such “facets” as “gender identity”, “physical abilities” and “cultural backgrounds”. I believe this paragraph is unworkable in practise. For example, it would be an invasion of privacy for a company to require employees to disclose their religious beliefs, describe their cultural backgrounds or their socioeconomic circumstances. How then could a company have a meaningful policy to “embrace” these features of its workforce?

I also strongly recommend deleting footnote 29. It cites only one amongst many studies on this subject, not all of which support the conclusions drawn by the KPMG study. Many studies contradict the KPMG conclusions on what is a very fraught and difficult analysis when done with statistical rigour. The KPMG study appears to commit the fallacy that correlation proves causation. Moreover, I note also that this particular KPMG report seeks to draw conclusions over the financial results of companies over a single year without normalising for sector and industry business cycles. Quite frankly this is laughable for any reader familiar with sound quantitative analysis principles. Also, the footnote draws conclusions based on revenue growth. This is not always a good guide to company profit returns. The footnote is reminiscent of the errors of Emma Alberici. Retention of this footnote will, I believe, damage the credibility of the Guidelines.

Page 14

The new words in the top paragraph on this page are redundant. They do nothing more than restate the Recommendation.

The first full paragraph is also redundant. It states the obvious.

I believe the three paragraphs after the three dot points are unduly prescriptive and could be deleted without in any way diminishing the import or impact of this section of the Commentary.

The Commentary on gender diversity is excessively long. This puts undue emphasis on the importance of gender diversity (important though it is) as distinct from other important considerations in composing a board with valuable cognitive diversity, diversity of business and industry backgrounds and diversity of life experience. I suggest more concise wording for this section of the Commentary.

Page 16

I would delete the phrase “for each reporting period” in Recommendation 1.6(l). This is unduly prescriptive. The previous wording is preferable. I do not object to that phrase as used in Recommendation 1.7 as this accords with normal corporate practice.

Page 20

The fifth, sixth and seventh paragraphs in this page are of little value. They are also grammatically awkward and overly prescriptive. I suggest more concise rewording.

Page 21

I would delete the word “affiliation” in the third paragraph and elsewhere as this is a vague term and not clearly defined.

In Box 2.3, the phrase “close personal ties” is unduly vague and I suggest reverting to the previous wording.

The second dot point in Box 2.3 creates difficulty for small and start-up companies where directors are often (of necessity due to shortages of cash) given options or performance share rights in lieu of cash directors fees. This should not disqualify the director from being independent, any more than

owning shares in a company (which is encouraged!) should impugn independence unless the equity interest is substantial.

Page 22

The phrase “based on family, friendship or other social or business connections” is unduly broad and vague. I suggest deleting this paragraph entirely.

Page 23

I would delete the new paragraph for the reason that it seriously waters down the strong principle that a listed company board should have a majority of independent directors. It is up to each company to justify departure from Recommendation 2.4.

Page 24

I consider footnote 38 regarding the Centro judgement to be sufficiently important that it should be incorporated in the Commentary itself, rather than footnoted.

The second paragraph on this page is superfluous and repetitive.

I believe Recommendation 2.7 is misconceived. It is highly questionable whether a director can be effective if he or she is not fluent in the language of the company. Directors are called upon to make fine and nuanced judgements about language, in the context of market disclosures, corporate reports, financial accounts and in many other circumstances. It is, therefore, highly risky for the board and, indeed, for the individuals involved if directors are not fluent in the language of the company. The lack of fluency would be no excuse at law to a charge of negligence or breach of duty by a director of a public company. I suggest, therefore, that Recommendation 2.7 be deleted in its entirety.

I have already stated my objections to the phrase “in a socially responsible manner” in Principle 3. I have the same concern about the use of the phrase “social licence to operate” in the Commentary.

The fact that the draft puts the phrase “social licence to operate” in parentheses (though I note not uniformly throughout the draft) indicates the slipperiness of this concept. It is at best a metaphor for a company’s brand or reputation in the community. It would, therefore, be better to frame this Commentary in terms of “the importance of culture to the preservation and enhancement of a company’s brand and reputation which are important sources of value and competitive advantage”. This would avoid the open-ended, vague and controversial notion that companies have a “social licence” as distinct from legal licences to operate.

The second paragraph of this Commentary implies that the board should seek out the views of a wide range of “stakeholders” including regulators, taxpayers and “consumers” (is this different from customers?). I find this entire paragraph to be poorly conceived and poorly drafted. It would be better to comment simply that “the board and management of a listed entity should have regard to the impact of the company’s operations on all affected parties and on the communities in which the company operates”.

I also believe some of the dot points given as examples are misconceived. For example, there is no legal requirement for a company to “pay a living wage”. The very fact that this phrase is in parentheses indicates how ill-defined it is. (What is a living wage for a part-time casual employee?). Similarly, there is no legal requirement for a company to offer employment to socially disadvantaged groups, or to avoid engaging in tax minimisation strategies. (What, by the way, is the difference between aggressive and non-aggressive tax minimisation strategies?). Moreover, the phrase “human conflict” is vague and subjective. Should this be “armed conflict”? Even that expression would be unduly vague and broad.

I have already expressed my view on the phrase “core values”.

I suggest reverting to the previous wording of Recommendation 3.1 in the interests of clarity.

Page 27

I would delete the second full paragraph in its entirety. Amongst its other shortcomings, use of the phrase “the Council would encourage ...” is not in my view wise. Is this different from “should” as used elsewhere in the Guidelines? Either way, I believe that the proposed disclosures may be impracticable (given legal constraints) and would more often than not be against the interests of investors.

The fourth dot in Box 3.2 contains a double negative and should be rephrased to say “act in an ethical manner”.

I have elsewhere expressed my concern about the phrase “socially irresponsible manner”.

I do not believe Recommendation 3.3 is necessary in its entirety. There are now well-established laws relating to whistleblower policies and there is no reason to single out for a specific Recommendation these particular legal responsibilities from all other legal responsibilities governing listed companies.

In addition, I question whether the phrasing of paragraph (a) is technically correct. Whistleblower concerns mostly relate to individuals acting unlawfully or unethically rather than the “entity” doing so.

Page 28

I have the same objection to Recommendation 3.4. Again, there are well-established laws in this area and there is nothing to be gained but excessive reporting boilerplate requiring companies to disclose these policies in detail.

Page 30

The term “validate” requires clearer definition. Is it materially different from the previous word “verify”? If so, the distinction should be made clearer.

I would delete the second sentence of the first paragraph under Commentary. I have already expressed my concerns about the phrases “a reasonable understanding” and “business model”.

Page 33

Recommendation 4.4 raises difficulties of implementation. The requirement to “validate” is incompatible with a report being “balanced and understandable”. The board and not third parties should take full responsibility for balanced and clear reporting. Recommendation 4.4 should in my view be rephrased as follows:

“A listed entity should disclose its process for achieving corporate reports that are accurate, balanced and provide investors with appropriate information to make informed investment decisions.”

The first paragraph under Commentary states that “forward looking information” is usually included in a director’s report. This is not always the case. I suggest that this paragraph could be deleted without loss.

Footnote 53 is an inadequate definition of what constitutes balanced reporting. It should be deleted or rewritten.

Page 34

This paragraph could be deleted as it is superfluous.

Page 35

Principle 5 says all that needs to be said about timely and balanced corporate reporting. I submit that it makes Recommendation 4.4 superfluous.

Page 36

Recommendation 5.2 should relate only to all material announcements. Many companies release miscellaneous and less-significant news by way of ASX announcements. It is not necessary for the board to receive all of these. Companies should make their own policies in this regard.

Page 44

I believe that the phrase “social risks” is vague and should be deleted. The definition provided in the Glossary is fraught with subjectivity, including phrases such as “accepted community standards” which is highly subjective and inevitably contentious.

I repeat my misgivings about the phrase “social licence to operate”.

Page 46

I have previously expressed my concerns about the phrase “over the short, medium and longer-term”. I repeat my concern about the phrase “social licence to operate”, and accordingly, suggest deleting the third dot point and retaining the existing wording on the fourth dot point.

In the following paragraph, I suggest finishing the second sentence after the word “peers”. Benchmarking is often very complex and involves nuanced judgements. It does not automatically verify that pay is “not excessive”.

Footnote 74 and the sentence to which it relates, read together, are quite convoluted. Rewording is suggested.

Page 50

Recommendation 8.4 should have a materiality test so that independent advice and full disclosure of terms are not required for minor arrangements.

Page 55

In the definition of environmental risks, I recommend deleting the words “or perceived impact”. Logically, if there is no actual impact, there can be no

negative consequences. Also, the term “impact” is neither negative nor positive. Accordingly, the phrase should be “negative impact on the natural environment”.

I make this submission with the aim of helping the Council arrive at revisions, where needed, that will enhance rather than detract from the usefulness and workability of the Guidelines. Naturally I would be happy to expand of any of these suggestions if required.

Graham Bradley AM

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