

Mavis Tan  
ASX Corporate Governance Council  
C/O ASX Limited  
PO Box H224 Australia Square NSW 1215

26 July 2018

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

Dear Mavis,

**Response to ASX Corporate Governance Council consultation on a proposed fourth edition of the Corporate Governance Principles and Recommendations**

Hermes EOS welcomes the opportunity to provide our comments on a proposed fourth edition of the ASX Corporate Governance Council's Principles and Recommendations (the "Principles and Recommendations"). Hermes Investment Management is an asset manager with a difference. With £33.6 billion in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world. Its stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £330.5 billion<sup>1</sup> on behalf of over 40 international institutional investors.

Hermes EOS responds to consultations on behalf of many clients around the world. The views expressed in this letter are those of Hermes EOS and clients who have expressly given their support to this response and do not necessarily represent the views of all clients. Our response to this consultation is explicitly supported by BBC (the United Kingdom), HESTA (Australia), PNO Media (the Netherlands), the Environment Agency (the United Kingdom) and VicSuper (Australia).

We support the proposed amendments to the Principles and Recommendations. The extra focus on diversity, stakeholders, culture and reporting is positive. We believe that this will help encourage boards to discuss in a more holistic fashion how their businesses seek to generate sustainable value for shareholders, and for wider stakeholders.

Please see below our comments on specific sections of the amended Principles and Recommendations. Should you wish to discuss any of these comments further, please feel free to contact Pauline Lecoursonnois at [pauline.lecoursonnois@hermes-investment.com](mailto:pauline.lecoursonnois@hermes-investment.com)

Yours sincerely,



Bruce Duguid  
Head of Stewardship, Hermes Equity Ownership Services



Pauline Lecoursonnois  
Engagement, Hermes Equity Ownership Services

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<sup>1</sup> Assets under management and under advice correct as at 31 March 2018

### **Recommendation 1.5: Diversity**

As members of the 30% Club, we expect boards to have already achieved a minimum of 30% female representation or to demonstrate credible plans to achieve this goal in the near future. We therefore support the proposed amendments requiring entities in the S&P/ASX300 to set an objective of not less than 30% in the composition of the board.

We believe that what gets measured gets managed, and what gets published gets managed even better. The Principles and Recommendations could be further strengthened with reporting guidelines on diversity. The pay gap reporting regulation now in place in the UK is a powerful indicator for gauging a company's wider corporate culture, diversity and inclusion. It has also proved to be a real incentive for companies to assess their practice, beyond their policies, and act upon their identified shortcomings. Disclosure of the gender balance on the Executive Committee and direct reports to the Executive Committee can also be a meaningful indicator.

Ultimately, we believe companies should seek diversity in its broadest sense, taking into account the diversity of society, company's long-term strategic direction, business model, employees, customers, suppliers and geographic footprint. We therefore support the expectation that diversity policies express a commitment to embrace diversity at all levels and in all its facets.

### **Recommendation 2.3: Director independence**

We welcome the addition in the list of factors used to assess the independence of a director of a criteria related to the award of performance based remuneration or the participation in an employee incentive scheme.

### **Principle 3: Instil the desired culture**

We support the new (3.1, 3.3 and 3.4) and amended recommendations (1.1 and 3.1) under this Principle.

#### Stakeholders

We support the acknowledgment that in order to preserve its social licence to operate a listed entity must have regard to the views and interests of a broader range of stakeholders than just its security holders. We believe successful companies not only create sustainable value for their shareholders, but also benefit stakeholders, the wider economy and the societies in which they participate.

To that end, in some markets we have been supportive of proposals aimed at bringing stakeholder views more prominently into governance structures. For example, in our response<sup>2</sup> to the FRC consultation on a proposed revision to the UK Corporate Governance Code we have supported the creation of an independent advisory stakeholder committee to the board or the representation of employees on company boards. We are particularly sympathetic to the idea of strengthening the role of employees within governance arrangements and specifically giving the workforce a greater voice in boardrooms. Employees are the providers of human capital on which companies depend. Fostering a closer partnership between management and the workforce is desirable and should support greater employee engagement and morale, which should lead to higher productivity. From our experience engaging with companies we have noted good, and bad, practices irrespective of the governance system. We have heard much positive anecdotal feedback from those directors who sit on boards which include employee representation, with many citing the different perspective as a positive contribution to a more holistic board discussion. Of course we have also heard critiques although these most notably stem from circumstances, as in Germany, when the employee representation becomes too dominant an element on the board and results in a confrontational board discussion as opposed to a culture of collective responsibility - this is something which would need to be guarded against. We would encourage the ASX Corporate Governance Council to consider such governance arrangements.

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<sup>2</sup> <https://www.frc.org.uk/getattachment/0b5352ab-6bec-4ae9-a410-86a28369b04f/Hermes-Equity-Ownership-Services-Ltd.aspx>

### Corporate purpose, values and culture

We support adding the articulation of the entity's purpose in the list of usual responsibilities for the board, and the greater emphasis on values and culture. We believe boards should ensure that the company's culture, strategy and major decisions are guided by a stated corporate purpose.

### Whistleblower policy

We support the introduction of a requirement for listed entities to have and disclose a whistleblower policy. This is an important element of good corporate governance. It is important to note that the success of such policies will rely on the organisation's culture which must encourage people to speak out and support those who do.

### **Recommendation 4.4: Reporting**

We strongly encourage companies to adopt integrated reporting. Through this exercise, we believe companies can provide a more holistic view of their performance and prospects. The merits of integrated reporting have been acknowledged by both practitioners and academics<sup>3</sup>. While it is true that the validation of information is one of the biggest barriers to integrated reporting, the necessary software and internal controls are improving. Each year, the integrated report should get better. We therefore agree that companies should disclose the processes in place to "validate that the report is accurate, balanced and understandable and provides the market with appropriate information to make informed investment decisions". Ultimately, we believe that an integrated report should have an integrated assurance opinion.

### **Recommendation 6.4: Voting at shareholder meetings**

We believe that all votes should be taken on a poll and the approach of voting by show of hands should be abandoned. It is a historic anachronism which reflects the origins of AGMs in the 18<sup>th</sup> and 19<sup>th</sup> Centuries when the bulk of shareholders did attend the AGM in person. Now that the bulk of shareholders are absent, seeing resolutions approved solely by those in the room - which is what voting by show of hands implies - risks giving the impression that AGMs are unrepresentative, and particularly that they are unresponsive to the wishes of international shareholders. The technology to effect this is available and already used at a number of company meetings.

### **Recommendation 7.4: Disclosure of material environmental and social risks**

We agree that listed entities should identify any material exposure to environmental or social risks and disclose how those risks are or will be managed. Public companies, as their name suggests, ultimately need a social licence to operate.

In their reporting, companies should also report how they define "materiality". We would point out that in relation to human rights the UN Guiding Principles Reporting Framework recommends using the concept of salience. This concept uses the lens of risk to people, not the business, as the starting point. Companies should conduct human rights impact assessments using saliency not financial materiality, and should report accordingly on the most salient human rights risks they face even if they are not considered as financially material. The timeframe chosen by the company may also affect the identification of material environmental or social risks. Climate change is a great illustration of a risk which may vary depending on the timeframe used by the company, and we strongly support the reference to the TCFD recommendations which provide a useful framework for reporting on climate-related risks and opportunities.

Ultimately, long term performance depends on the social and environmental resilience of the societies listed entities operate in. In that respect, the Principles and Recommendations could also encourage listed companies to demonstrate how their strategy aligns with the Sustainable Development Goals.

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<sup>3</sup> Professor Bob Eccles, an expert on integrated reporting, notably developed the idea of an annual board of directors 'Statement of Significant Audiences and Materiality'.  
<https://arabesque.com/2016/08/12/insights-into-integrated-reporting/>