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Dear Elizabeth

ASX Corporate Governance Principles and Recommendations 4th Edition Feedback

Thank you for the opportunity to review and provide feedback on the ASX Corporate Governance Council's proposed 4th Edition of its Corporate Governance Principles and Recommendations (**CG P&R**). We understand that the 4th Edition of the CG P&R will be released early in 2019 for adoption for years beginning on or after 1 July 2019, with early adoption encouraged. We note that there has been significant uptake of previous Editions, even at the proposed stage, given that they represent contemporary thinking in best practice corporate governance.

With public trust in Australian corporates at an all-time low (Edelman Trust Barometer 2018), and more investors asking boards to explain how they are actively engaged in setting and monitoring strategy, we believe that the ASX Corporate Governance Council is to be congratulated in its prescience in preparing the proposed 4th Edition. Its proposed work was well under way before the banking royal commission commenced and APRA's CBA report was released. The Council was already reflecting on and the proposed the 4th Edition as contemporary best practice in corporate governance.

In our view, the ASX Corporate Governance Principles and Recommendations – 4th Edition overall, will be a catalyst for boards and executives to rethink how they report to investors and other key stakeholders to enhance transparency and re-build corporate trust.

The 4th Edition stands to bring Australian corporate governance principles into line with world's best practice. Our feedback has been proposed in this light. Our comments are quite specific and recommend that the substance of the CG P&R be maintained intact.

Overall Themes

KPMG strongly support the proposed amendments which we consider will strengthen the Principles and Recommendations and successfully address a range of contemporary governance concerns. We welcome the Council's proposed improvements in the following topics:

- Social licence to operate;
- Corporate values and culture;
- Whistleblower rules;
- Anti-bribery and corruption policies;
- Improving diversity;
- Corporate reporting; and
- Climate-related disclosures.

The 'if not, why not?' regime of the ASX Corporate Governance Principles & Recommendations continues to work in Australia's interests. A key element of the regime is that every Recommendation brings with it a corporate reporting *opportunity*, or alternatively a corporate reporting *obligation*. The opportunity for companies is for them to proactively bring together in their Corporate Governance Statement a summary of how they have positively responded to each Recommendation, and where they have not adopted a Recommendation, to explain why not.

The best governed, managed and reporting companies will find the proposed changes in the proposed 4th Edition easy to implement, as the matters being introduced are already 'core business' for them. However, this is not the case for many companies, which will need the stimulus of the 4th Edition changes to bring them into line with best corporate governance practices, and so be able to meet the needs and expectations of their investors, and other key stakeholders.

KPMG's key feedback and proposed changes

Principle 3 – Instil the desired culture	• **Code of Conduct and Stakeholders:** The Council should include further guidance to support the development of an organisational culture that appropriately balances the competing priorities of Stakeholders. Additionally there needs to be further guidance on how entities might report on the actions taken to enforce their Code of Conduct. This may be necessary in both instances to prevent simplistic statements that fail to achieve these important objectives.
Principle 4 – Produce corporate reports of high quality and integrity	• **Principles of integrated reporting:** We recommend a small but significant change to Recommendation 4.4 to more specifically recognise that the principles of integrated reporting have been proven to work in practice and have widespread global adoption, and that adoption produces benefits for the reporting organisation which are broader than simply improved corporate reports.
Principle 7 - Recognise and manage risk	• **Framework adequacy review:** With regard to the review of the entity's risk management, we would suggest that the requirement states the need for a review of the risk management framework, and whether it is embedded in the operations and culture of the organisation in order to determine its continuing soundness. Organisations can have a technically sound framework, but can still fail if it is not embedded into the operations of the organisation. • **CRO or executive leadership of risk**: There is no commentary on the appointment of a CRO (or an Executive responsible for risk). This is becoming much more common practice across all industries and would seem to make sense. • **Risk appetite transparency:** The more specific language regarding the role of the board in monitoring the risk appetite of the organisation provides greater clarity and reinforces its responsibilities. There is a question as to whether this goes far enough, and if organisations should provide some public overview which allows them to be transparent over the level of risk they are willing to take (or not take) in line with their strategic objectives. • **Environmental and social risk:** Whilst the additional considerations added to the guidance in this area are relevant, there is an opportunity to provide companies with much greater guidance on what current expectations are from investors and other stakeholders. Approaches used by other members of the Sustainable Stock Exchange (SSE) Partner Exchange initiative, such as minimum expectations or providing/updating additional guidance, would be useful

Principle 8 – Remunerate fairly and responsibly	We generally support the proposed changes to Principle 8. However, we make the following observations: • **Composition of executive pay:** The alignment between executive pay and the company's *'circumstances, purposes, strategic goals, values and risk appetite'*, as well as *'short, medium and longer term performance objectives'*, are important considerations for the overarching executive remuneration structure (rather than just for setting performance targets). In light of this, we would suggest moving this commentary to be under the heading 'Composition', rather than limiting this to the setting of performance targets. • **Quantum & benchmarking:** While benchmarking and market data can serve as a useful reference point when setting and assessing remuneration levels, the Council should also emphasise the importance of looking to a broader set of qualitative factors (such as a company's size, operations and forward looking strategy, as well as an individual's tenure, skills and experience). A focus solely on 'benchmarking to the median' risks the counter-intuitive effect of ratcheting up pay.

Further commentary and additional context for the above proposed changes is provided in **Appendix 1.**

Concluding remarks

KPMG welcomes the Council's proposed update of the CG P&R to ensure that they remain relevant, reflect today's challenging business environment and current better practice in corporate reporting, and will make a positive contribution to Australian business and capital markets. We will be following the progress of the consultation with interest.

Thank you for the opportunity to provide feedback and we would welcome the opportunity to provide further feedback or support should you require.

Yours sincerely

Alison Kitchen
Australian Chairman

Appendix 1 – Detailed Commentary and support for ASX Principles and Recommendations 4th Edition - KPMG's response to the proposed new and amended principles and recommendations in the proposed 4th Edition.

Principle 1 and in particular recommendation 1.5 (diversity) to achieve better gender diversity outcomes, including a new provision recommending that an entity in the S&P/ASX 300 have as a measurable objective of at least 30% of directors of each gender on its board within a specified period;

KPMG is broadly supportive of this significant change to the existing recommendation 1.5, boosting its impact and increasing accountability with measurable gender diversity commitments. While it is generally acknowledged that boards must identify the best skill sets for their requirements, it makes good sense for a board to reflect the diversity of its stakeholders, and it is noted that Australian boards have been slow to react, boards are failing to leverage the greater innovation, more rigorous questioning and the improved bottom lines that come from a diverse board.

KPMG supports the measurable objective, however we recognise that the 30% target may not be possible, in the short term, for smaller boards. Our observations, from working extensively with boards are:

- Sameness is the most dangerous thing around a board table, particularly in times of change, digital innovation and fluidity;
- Raising the diversity of the board aligns with global expectations and increases the resilience of the board. Fairness and equity are also considerations;
- There is significant data supporting the performance benefits derived from having access to the variety of unique perspectives, expertise and knowledge of 50 per cent of the talent base; and
- Chairs who have met the 30% target note the improved decision-making capacity of their diversified group and the ability to discuss issues from various angles.

KPMG strongly supports the amendments to Recommendation 1.5, including:

- The requirement that entities in the S&P/ASX300 set a measurable objective to have a minimum of 30 per cent of directors of each gender on their boards by a specified date; and
- Guidance in the commentary that boards of listed entities should have regard to other facets of diversity, in addition to gender, when considering their make-up. Having directors of different ages and ethnicities, and from different cultural or socio-economic backgrounds, can help bring different experiences and perspectives to bear and avoid 'groupthink' in decision making.

Proposed revisions

- No proposed revisions.

Principle 3: Instil the desired culture and in particular 3.3 – Whistleblowing

KPMG strongly supports the move from calling this Principle “Act ethically and responsibly” to “Instil the Desired Culture” as it shifts the focus from how individuals should act to how an organisation should maintain a culture which is appropriate. This is aligned with the focus on culture of both ASIC and APRA, and recognises that a listed entity should have regard to its social licence to operate (SLTO). In order to maintain this licence, the entity needs to act lawfully, ethically and in a socially responsible manner. The re-drafting of Principle 3 seeks to address recent governance issues that have arisen from poor culture and conduct in listed entities. It is also encouraging to note that Tax Governance is raised as an example of what might impact SLTO.

Balancing stakeholder interests

An emerging challenge for the development of organisational culture is the need to balance often competing stakeholder interests. An organisation’s stakeholders are defined as “more than just its security holders, including employees, customers, suppliers, creditors, regulators, consumers, taxpayers and the local communities in which it operates”. The Council could include further guidance to support the development of an organisational culture that appropriately balances competing priorities, through appropriately targeted incentive and accountability mechanisms. International Accountability Standard AA1000 provides guidance regarding actively monitoring the material concerns of your material stakeholders.

We have concerns over the proposal “To improve transparency and promote investor confidence, the Council would encourage a listed entity to disclose in general terms the actions it has taken to enforce its code of conduct (recognising that legal and other constraints may prevent it disclosing specific details of any individual action)”. There is a danger that this may just create some simplistic statements such as “We have taken the necessary action where it has been determined that employees have acted outside of our code of conduct”. If this potentially is the outcome, then the recommendation will have created a further reporting burden for little value.

Whistleblowers

We recognise that whistleblowing programs have an increasingly important role to play within corporate governance frameworks in Australia but, we suggest that Recommendation 3.3 is more closely aligned with the *Treasury Laws Amendment (Whistleblowers)* Bill 2017 (the Bill). We note that:

- The bill requires all public companies and large private companies to have and disclose a whistleblower policy before 1 January 2019, or risk facing financial penalty. We note that the policy must be made available to all those working within an organisation including employees, officers and contractors.

Accordingly, we are of the view that Recommendation 3.3 should be expanded to include “officers”; and

- Any material concerns reported to the board will need to be carefully managed, in light of the new confidentiality provisions in the Bill which carry pecuniary penalties of $200,000 for individuals and $1 million for corporations. This should be reflected in recommendation 3.3 so as not to conflict with the Bill.

Proposed revisions

- The Council could include further guidance to support the development of an organisational culture that balances competing priorities through appropriately targeted incentive and accountability mechanisms. International Accountability Standard AA1000 provides guidance regarding actively monitoring the material concerns of your material stakeholders.
- Expand Recommendation 3.3 to include “officers”.
- Ensure that Recommendation 3.3 reflects the new confidentiality provisions in the *Treasury Laws Amendment (Whistleblowers)* Bill 2017
- The guidance to Recommendation 3.3 be broadened to incorporate the following:
- A ‘better practice whistleblower policy should include a range of communication channels (both internal and external) by which concerns can be raised with senior management and/or the board. The channels should include procedures to protect anonymity in instances where the discloser wishes not to disclose their identity.

Principle 4 – Produce corporate reports of high quality and integrity

The 4th Edition is driving change for the good, in line with modern modes of value creation – strategies, business models and governance practices - and societal expectations.

Businesses will have an opportunity to revisit their approach to communicating the way in which they harness the power of their innovation, intellectual property, technology and talent to improve the experience of their customers, employees and members, to give them a competitive edge in the marketplace, and so meet the needs of their investors and other key stakeholders (e.g. customers, employees, regulators and governments).

Integrated reporting is focused on providing insight on **how** value is created in the short, medium and long term. Value is often manifested in broader outcomes in advance of the ultimate financial outcomes.

While being primarily directed to investors, integrated reports provide information of interest for **all** key stakeholders. For example, how does an organisation's investment in its training drive improved employee engagement, reduced turnover, and so enhance organisational capacity to execute its strategy?

Adoption Momentum & Evidence of Adoption Benefits

Momentum for the adoption of integrated reporting principles around the world is growing strongly. Adopting businesses attest to the benefits of adoption. Australia, has lagged behind, although Australian adoption is gathering pace.

Investors are increasingly demanding good integrated reporting. Highly respected academic evidence now attests to good integrated reporting being positively associated with better business performance, and that is being reflected in investor estimates of future cash flows, assessments of firm value, and higher stock liquidity.

Key Australian capital markets institutions, the AICD, G100, ASIC, FRC and ACSI have recently affirmed positive policy positions on the principles of integrated reporting.

As noted in the covering letter, public trust in Australian corporates is at an all-time low. Integrated reporting offers an important part of the solution, as a vehicle to improve transparency and in so doing assist in rebuilding trust. Australia needs a good practice stimulus to accelerate the pace of adoption of integrated reporting principles. Principle 4, and Recommendation 4.4 in particular, provides the right local stimulus, at the right time. Accordingly, KPMG endorses the proposed Recommendation 4.4.

Corporate Governance Statements

Many companies have relocated their corporate governance statement to their websites, without then providing any discussion in their annual report on the key areas of board focus and action or other important governance changes. Many entities' corporate governance statements have also remained 'boilerplate', particularly on the mandatory obligation to report why a recommendation has *not* been followed. The 2018 changes offer an opportunity to introduce a concise and meaningful summary on those key areas of board focus and what an organisation has done or changed in the year in relation to each Principle and Recommendation.

That concise summary will be more meaningful if it explains how the board has exercised 'active governance' throughout the year. That is, what have been the changes in governance practices and why? What have been the areas in which the board has focused its attention and added or protected value? How has the board performed in these focus areas?

Operating & Financial Reviews

Through Recommendation 4.4 and associated commentary, integrated reporting offers Australian directors a proven framework to support their claims of high quality corporate reporting. Companies can apply integrated reporting principles in their Operating & Financial Reviews (OFR) to better explain how they create and preserve value, whilst as noted above, providing a short 'active governance report' (linked to the on-line CGS) explaining their responses across all of the Recommendations. They can obtain assurance on the disclosure processes selected to validate what line(s) of defence[1] they rely on to ensure that their OFR is '*accurate, balanced and understandable*'. Such reporting will provide investors with credible information, and so confidence in making informed investment decisions.

The alternative of explaining why Recommendation 4.4 has *not* been adopted is a scenario that most boards would not wish to contemplate.

Recommendation 4.4 is a 'process-based' Recommendation

Many companies still have a way to go to have governance, processes, systems and controls over non-financial information which are equivalent to those over financial reporting and sustainability reporting. It will take time for many to be able to make a *positive* statement under the process-based element of Recommendation 4.4.

[1] From management, internal or external audit

Enhancing Transparency – A significant contributor to restoring trust

Transparency is pivotal in rebuilding corporate trust. Companies have a significant opportunity to restore trust by enhancing transparency in responding to Recommendation 4.4.

Early adoption of the 4th Edition is encouraged, an opportunity for companies to start *now* in thinking about their first formal response to Recommendation 4.4. Early adoption of the 4th Edition makes sense, as the proposed 4th Edition is about driving strong business and communication practices, as well as best corporate governance. Early adoption will enable companies to make a 'progress-oriented' disclosure in their corporate reporting in years beginning on or after 1 July 2018.

Proposed revision

- We recommend the following changes to the wording of Recommendation 4.4:

  ~~Some entities use~~ ~~t~~The principles of "integrated reporting" ~~as~~ are a useful framework for preparing operating and financial reviews to provide the market with information about a listed entity's future prospects, risks and opportunities, strategy and business model. Although not required, s~~S~~ome entities prepare annual reviews using the principles of integrated reporting. Other entities are required under the Listing Rules to prepare quarterly activity reports and quarterly cash flow reports that are not typically subject to audit or review by the entity's external auditor. Some also release to the market other corporate reports, such as a "sustainability report", to provide insights into other aspects of their operations.

Principle 7 - Recognise and manage risk

Overall we are supportive of the changes to Principle 7 and the wider inclusion of risk considerations in the other principles. The revisions are more reflective of leading risk practices and provide greater impetus to the embedding of risk into an organisation's wider operations, rather than being treated as a silo activity.

Proposed revisions

In this light we have outlined some further suggestions for consideration as we believe the embedding of risk management practices into entity's culture and operations, and their effectiveness, is central to the successful management of risk.

- **Framework adequacy review:** With regard to the review of the entity's risk management, we would suggest that the requirement states the needs for a review of the risk management framework, **and whether it is embedded in the operations and culture of the organisation** in order to determine its continuing soundness. Organisations can have a technically sound framework but can still fail if it is not embedded into the operations of the organisation. This also supports the ISO31000:2018 premise of focusing on achieving good risk management outcomes through the framework, rather than following processes.

- **CRO or executive leadership of risk:** There is no commentary on the appointment of a CRO (or an Executive responsible for risk). This is becoming much more common practice across all industries and would seem to make sense. APRA, for example, requires a senior person with risk responsibilities.

- **Risk appetite transparency:** The more specific language regarding the role of the board in monitoring the risk appetite of the organisation provides greater clarity and reinforces its responsibilities. It should support the risk appetite becoming far more of a foundational element of the risk framework and the general operations of the business. There is a question as to whether this goes far enough and if organisations should provide some public overview which allows them to be transparent over the level of risk they are willing to take (or not take) in line with their strategic objectives. This would support the investor transparency sought.

- **Broader consideration of risk:** The link to the 'social licence to operate' is helpful along with the focus on environmental and social risk. This does help reinforce the conduct risk that is so prevalent at present. This could perhaps be further reinforced in Principle 7, although the reproposed of Principle 3 may already satisfy that need.

  The specific call out of 'carbon risk' is interesting given the breadth of environmental factors at play. The specific inclusion of this versus other environmental (or social) risks may require further justification or consideration.

  We would welcome specific reference to other key risk areas which are fundamental to modern organisations' operations including culture, people, technology (cyber) and data. The intention is not to be prescriptive but to acknowledge the significance of these risks to all listed organisations. This would also assist in providing greater transparency to investors and other stakeholders.

- **Link of risk and strategy:** The inclusion of commentary outlining the link of risk with strategy and the business model is a good step forward. The strategic objectives of the organisation would provide an anchor point to a number of the principles (as well as the vision and values). This will assist the organisation to give a more balanced view of its risks, and may assist it in differentiating itself from others in its industry, and therefore help to mitigate a contagion effect from risks being experienced by other industry players.

- **Clarity of definitions:** Definitions for materiality and timeframes (short, medium and longer-term) should be more clearly defined. Consideration of these in conjunction with the risk appetite of the organisation, should be included in the reporting. For example an organisation may take on a short-term material risk (which is outside of the risk appetite) in order to achieve a longer-term benefit. The consciousness of the decision is what needs to be understood.

- **ISO 31000:2018 definition of risk should be adopted:** Given most corporate governance standards point to ISO 31000 as a guide to support organisations in meeting any risk management requirements, we would suggest that Principle 7 adopts its definition for risk management, namely: "Create and protect value in organisations by managing risks, making decisions, setting and achieving objectives and improving performance." We recognize this may be a timing issue given that ISO 31000:2018 has only recently been released.

- **Integrated reporting:** The observation regarding the ability of an integrated report to deliver the requirements of recommendation 7.4 is sensible. We are supportive of an integrated report providing a holistic view of the risks an organisation faces as part of its content. When aligned with a strategic overview, the holistic view of risk could provide a clear anchor point for readers and investors.

- **Environmental and social risk**: Whilst the additional considerations added to the guidance in this area are relevant, there is an opportunity to provide companies with much greater guidance on what current expectations are from investors and other stakeholders. According to the Global Sustainable Investment Alliance, 26% of all global funds under management now have some level of environmental, social, and governance (ESG) screening in their investment decision making. Recently, the Responsible Investment Associated Australasia (RIAA) showed this to be even higher in Australia. The ability and quality of ESG screening by investors depends on the information being available, often from companies themselves. Approaches used by other members of the Sustainable Stock Exchange (SSE) Partner Exchange initiative, such as minimum disclosure expectations or providing/updating additional guidance, would be useful.

Principle 8 – Remunerate fairly and responsibly

The Council is proposing several amendments to Principle 8, which provides guidance to listed companies on appropriate senior executive and non-executive director remuneration practices.

Changes to this Principle are particularly topical in the current climate, given the ongoing revelations of remuneration governance failures by a number of prominent Australian boards coming out of the Banking Royal Commission; APRA's Prudential Inquiry into the Commonwealth Bank (**CBA**) and the broader review of the remuneration practices of large financial institutions; as well as the heightened scrutiny of executive pay packets following the introduction of the Banking Executive Accountability Regime (**BEAR**).

We generally support the proposed amendments to Principle 8, which reflect key themes prevalent in the executive remuneration landscape, including the:

- continued community concern around the quantum of executive remuneration;
- alignment between executive pay, strategy and the long term interests of shareholders;
- importance of ensuring executive remuneration supports the company's risk appetite and culture;
- focus on a company's social licence to operate; and
- need for greater transparency and accountability in the remuneration governance framework.

We set out below some specific suggestions for the Council to consider with the intention of ensuring that the revised Principle 8 continues to sets a high benchmark for remuneration practices in Australia.

Summary of proposed revisions

Quantum

To verify that remuneration is not excessive, the Council has suggested that companies look to '*benchmark their remuneration… to that paid by their peers*'.

In our view, while market data can certainly serve as a reference point, we caution against 'chasing the median' or a particular percentile ranking when setting remuneration levels. For example, we note that the BEIS Select Committee of the House of Commons recently identified that remuneration consultants looking to 'benchmark from the median' was a contributing factor to the 'ratcheting up of pay' in the United Kingdom.

The Council should also note the importance of companies looking to a broader set of qualitative factors beyond market data (including the company's forward looking strategy, size and complexity of operations), as well as individual factors (such as tenure, skills and experience) when setting remuneration levels.

In addition, the Council has included a comment that '*no individual director or senior executive should be involved in deciding their own remuneration.*' As we would expect remuneration decisions to be approved by the board (as a matter of good governance), we do not think this comment is necessary.

Company culture, purpose and values

The '*Guidelines for executive remuneration*' (set out in the commentary to Recommendation 8.2) now include a reference that performance targets in respect to executive pay be set in-line with the company's '*purpose, strategic goals and values'*.

This commentary is consistent with the renewed focus on the interaction between performance-based pay and corporate culture. In practice, we are seeing increased consideration of whether remuneration frameworks are incentivising the right behaviour and a move by several companies to introduce non-financial, culture related LTI measures.

However, we note that alignment between executive pay and the company's '*circumstances, purposes, strategic goals, values and risk appetite'*, as well as '*short, medium and longer term performance objectives'* are important considerations for the overarching executive remuneration structure (rather than just for setting performance targets). As such, this commentary may be more appropriate under the heading '*Composition*'.

Oversight, transparency and trust

The commentary now states that a company's remuneration framework should not '*reward for conduct that is contrary to the entity's values or risk appetite'*. This change reflects the increased scrutiny of boards. For example, APRA's Prudential Inquiry into CBA identified a perceived lack of rigour applied to the oversight of incentives, accountability frameworks and the interaction between risk and remuneration.

We suggest that the Council also note in the section addressing '*Performance-based remuneration*' in the '*Guidelines for executive remuneration'*, that boards should explicitly identify that any performance conditions attaching to any element of executive remuneration are subject to discretion (and are not 'hard-wired' to any financial or other outcome).

Consultancy or similar arrangements with directors or senior executives (or their related parties)

We support the inclusion of the new Recommendation 8.4. In the current climate, this aligns with the expectations around improving the transparency, oversight and rigour to be applied to all aspects of the remuneration framework.

However, we query the practicality of the recommendation that 'independent advice' should be sought to verify whether the provision of such services are appropriate each time such an arrangement is proposed. For example, we are cognisant that these type of arrangements are often entered into ad-hoc as and when there is a need for a director or senior executive's particular expertise to assist with matters outside of the ordinary day-to-day business. We therefore caution that requiring independent advice on every such arrangement could be unduly onerous for some organisations.

At Principle 2, we also note the inclusion of additional examples listed in '*Box 2.3 - Factors relevant to assessing the independence of a director*' which are to be used as guiding factors in determining whether or not a director is to be considered independent. One of these factors is whether '*the director is, or has been within the last three years, in a material business relationship (e.g. as a supplier, professional adviser, consultant or customer)…*' The arrangements contemplated by the new Recommendation 8.4 clearly fall within this example, and we therefore see an opportunity here to clarify the linkage between Recommendations 2.3 and 8.4, either in the form of additional guidance to each of the commentaries (or cross-referencing the commentary of each Recommendation to the other).