

**JULY 2018**

## **PIRC RESPONSE TO THE CONSULTATION ON THE ASX FOURTH EDITION OF THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS – RECOMMENDATIONS AND ANALYSIS**



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## ABOUT PIRC

**PIRC provides a variety of corporate governance research, advisory and data analysis services to institutional investors. These include research on governance standards and compliance among listed companies, analysis of general meeting resolutions and proxy voting advice in line with PIRC policies. PIRC also provides customised client templates and interpretation of client policies, outsourced vote execution, reporting on proxy voting activity and auditing of third party actions.**

Since the inception of PIRC's Corporate Governance Service, PIRC has argued that corporate governance best practice has been an important element in reducing the risk of corporate failure and enhancing shareholder returns over the long-term.

PIRC considers that investors have a responsibility to develop consistent, informed and fair corporate governance policies which are relevant to the particularities of the market and promote good practice across it, as well as at individual companies.

## OVERVIEW

In the consultation paper dated 2 May 2018<sup>1</sup>, the Australian Securities Exchange (ASX) expressed special interest in receiving comments concerning:

1. whether stakeholders agree with the nine proposed new recommendations and, if not, why not;
2. whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;
3. specifically, whether stakeholders agree with the Council's proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date;
4. whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7;
5. whether stakeholders agree with Council's proposed changes to box 2.3, setting out the factors relevant to assessing director independence;
6. whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity's values, culture and social licence to operate;
7. whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities;

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<sup>1</sup> 'Review of the ASX Corporate Governance Council's Principles and Recommendations', last accessed 3 July 2018, available at <https://www.asx.com.au/documents/asx-compliance/consultation-paper-cgc-4th-edition.pdf>

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8. whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations; and

9. whether there are any other gaps or deficiencies in the Principles and Recommendations that have not been addressed by the proposed changes in the consultation draft of the fourth edition.

As such the response to the consultation will tackle each of these interests in the order provided.

## **PIRC RESPONSE TO THE CONSULTATION**

### **1. Nine New Recommendations**

The nine new recommendations proposed are largely based on increased disclosure to authorities and shareholders. PIRC welcomes the majority of the new recommendations as a result. However PIRC considers that some of the new recommendations may not be sufficiently challenging, for the maintenance of high corporate governance standards, especially concerning the topics of increased disclosure and director independence.

PIRC's comments on the nine new recommendations are as follows:

**1. Recommendation 2.7:** listed entity with a director who is not fluent in the language in which board or security holder meetings are held or key documents are written should disclose the processes it has in place to ensure the director understands and can contribute to the discussions at those meetings and understands and can discharge their obligations in relation to those documents. PIRC agrees that in the event that a director is not fluent in the language, the company uses in board and security holder meetings or publishing key documents, the process by which the director understands and contributes to the discussion should be disclosed. PIRC also recommends that translation documents should be disclosed alongside meeting minutes. This would give shareholders the ability to hold responsible parties accountable.

**2. Recommendation 3.1:** A listed entity should articulate and disclose its core values.

PIRC agrees that a listed entity should articulate and disclose its core values. This is considered to be of interest for value-based shareholders. Should these core values be subject to a vote by shareholders', PIRC will evaluate them on a case-by-case basis.

**3. Recommendation 3.3:** A listed entity should:

- have and disclose a whistle-blower policy that encourages employees to come forward with concerns that the entity is not acting lawfully, ethically or in a socially responsible manner and provides suitable protections if they do; and
- ensure that the board is informed of any material concerns raised under that policy that call into question the culture of the organisation.

PIRC welcomes the requirement of ASX listed companies to instate a whistle-blower policy. In addition, it would be preferred that issuers were recommended that the whistle-blowing hotline be the responsibility of the audit committee.

**4. Recommendation 3.4:** A listed entity should:

- have and disclose an anti-bribery and corruption policy; and
- ensure that the board is informed of any material breaches of that policy.

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PIRC welcomes the recommendation for a disclosed anti-bribery and anti-corruption policy. PIRC agrees that members of the board should be informed of any breaches. In addition, it is considered that the audit committee (which should preferably consist exclusively of independent members) should be able to start its own investigations on the matters reported to the hotline.

**5. Recommendation 4.4:** A listed entity should have and disclose its process to validate that its annual directors' report and any other corporate reports it releases to the market are accurate, balanced and understandable and provide investors with appropriate information to make informed investment decisions.

PIRC considers that the process to validate a directors' report be as important as the report itself. In addition, PIRC supports the recommendation that companies should have to disclose the process used for validating non-financial information to the same extent as financial information.

**6. Recommendation 5.2:** A listed entity should ensure that its board receives copies of all announcements under Listing Rule 3.1 promptly after they have been made.

PIRC agrees with the recommendation which relates to being aware of, and disclosing any information that a reasonable person would expect to have a material effect of the price or value of the company's securities.

**7. Recommendation 5.3:** A listed entity that gives a new investor or analyst presentation should release a copy of the presentation materials on the ASX Market Announcements Platform ahead of the presentation.

PIRC agrees with the recommendation. In addition, PIRC considers that such announcements should be made publicly available at the latest 28 days prior to the meeting.

**8. Recommendation 6.4:** A listed entity should ensure that all resolutions at a meeting of security holders are decided by a poll rather than by a show of hands.

PIRC agrees with the recommendation and believes that the results of the poll be posted on the company's website as soon as practicable after the meeting.

**9. Recommendation 8.4:** A listed entity should only enter into an agreement for the provision of consultancy or similar services by a director or senior executive or by a related party of a director or senior executive:

– If it has independent advice that:

the services being provided are outside the ordinary scope of their duties as a director or senior executive (as applicable);

the agreement is on arm's length terms; and

the remuneration payable under it is reasonable; and

– with full disclosure of the material terms to security holders.

While the inclusion of increased restrictions on providing directors with additional remuneration for work outside of the director role is welcomed, it is PIRC's view that the recommendation may not be sufficiently far-reaching. PIRC considers that corporate best practice would prohibit the entering into of an agreement with a director or senior executive for consultancy or similar services. Any additional service and accompanying remuneration may affect director independence negatively. On the other hand, executives should not be paid additional remuneration for executive-level services provided to companies. While the requirement for independent advice is also welcomed, PIRC considers simply finding an independent candidate for the role may be in the best interest of better corporate governance of the company.

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## 2. Amended Recommendations

PIRC is generally in favour of the changes made to the recommendations in the fourth edition of the review. Below are the listed amendments and PIRC's opinion on them:

**Recommendation 1.1** (role of board and management) to recommend that a listed entity has a board charter

PIRC welcomes the proposed change. PIRC considers it good corporate governance to have clearly defined roles and responsibilities for the Board and Management. This allows the relevant parties to be held accountable, and prevents consolidation of power into too few hands.

**Recommendation 1.2** (background checks) to recommend that a listed entity undertake appropriate background checks on senior executives, as well as directors, before engaging them

PIRC welcomes the proposed changes. PIRC is in favour of increased focus on director independence and competency. In addition, PIRC considers that recruitment policies for senior executives, including the CEO, should be publicly available.

**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 at least 30% of directors of each gender on its board within a specified period

PIRC generally welcomes the changes, and is in agreement with the principle of the change. However there is some constructive feedback regarding this proposal below (point 3).

**Recommendations 1.6** (board reviews) **and 1.7** (management reviews) to specify that such reviews should take place "each reporting period" (i.e. annually); PIRC welcomes the proposed changes. PIRC is in favour of increased focus on director accountability.

**Recommendation 2.3** (disclose independence and length of service of directors) and the related box 2.3 to:

- simplify the drafting;
- add a further example in box 2.3 covering directors who receive performance based remuneration (including options or performance rights) or participate in an employee incentive scheme; and
- changing the reference to "close family ties" in box 2.3 to "close personal ties"

PIRC welcomes the specific changes proposed. However PIRC has provided some constructive feedback regarding the existing details of the recommendation that can be found below (point 6.)

**Recommendation 2.6** (director induction and professional development) so that it now reads: "[a] listed entity should have a program for inducting new directors and for periodically reviewing whether there is a need for existing directors to undertake professional development to maintain the skills and knowledge needed to perform their role as directors effectively"

PIRC welcomes the proposed changes, and is in favour of increased director competence, which will likely increase added value over time.

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**Recommendation 3.1** (code of conduct) to recommend that the board is informed of any material breaches of a listed entity’s code of conduct by a director or senior manager and of any other material breaches of the code that call into question the culture of the organisation

PIRC generally welcomes the proposed change of having the board informed of any material breaches of a listed entity’s code of conduct, though it is our recommendation that as well as informing the board, any breaches of the policy should be disclosed at the earliest convenience.

**Recommendation 6.2** (investor relations program) so that it now reads “[a] listed entity should have an investors relations program that facilitates effective two way communication with investors”

PIRC welcomes the proposed change. PIRC is in favour of increased shareholder oversight, and the availability of information is an important aspect of shareholder oversight. It is further considered that companies should disclose annual engagement with shareholders and other representatives of the investment community, as well as the discussed matters of such engagement.

**Recommendation 6.3** (participation at meetings of security holders) so that it now reads: “[a] listed entity should disclose how it facilitates and encourages participation at meetings of security holders”

PIRC welcomes the proposed change. PIRC is in favour of increased shareholder oversight, and shareholder meetings are an import means of exercising this oversight.

**Recommendation 7.2** (annual risk review) elevating the commentary in the third edition that a board should satisfy itself that the entity is operating with due regard to the risk appetite set by the board so that it forms part of the recommendation;

PIRC welcomes the proposed change.

**Recommendation 7.4** (sustainability disclosures) to refer to “environmental and social risks” rather than “economic, environmental and social sustainability risks”.

PIRC welcomes the proposed change. It is important for companies to focus on environmental and social risks rather than economic when considering a company’s “social licence to operate.”

### **3. Recommendation 1.5: S&P/ASX 300 30% of Each Gender on the Board**

PIRC welcomes the increased gender diversity goals. In addition, PIRC considers that companies not in line with such target should report on their efforts towards diversity (on a comply-or-explain basis). It is considered, in such cases, that the Nomination Committee should disclose a diversity policy or how diversity is taken into account when recruiting executive and non-executive directors.

### **4. Recommendation 1.6 and Recommendation 1.7: Annual Timeframe for Board and Management Reviews**

PIRC is in agreement with the proposed changes to the recommendations. It is considered good practice to have annual performance reviews for the Board and Management, as well as disclosing the results to shareholders.

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## **5. Recommendation 2.3: Factors for Assessing Director Independence**

PIRC is generally in favour of the guidelines set out in recommendation 2.3. PIRC considers director's non-independent in the event they are, or are associated with a significant beneficial shareholder (holding more than 3% of the voting power), a current or prior employee of the company, have personal or family ties with members of the company or have a material relationship (supplier, auditor) with the company.

Outside of what is recommended in this review, PIRC recommends also considering that a director receiving remuneration outside the scope of their role from the company to be a reason for classification as non-independent.

The Fourth edition of the review also suggests that companies review the independence of directors that have been on the board over ten years, due to the potential to have become too close to management or a substantial security holder. The review also states that directors should not be considered non-independent solely due to having a longer tenure. It is PIRC's recommendation that a Director that has been a member of the board for over nine years should be considered non-independent for the reasons stated in the review.

## **6. Recommendation 3: Corporate Entities' Values, Culture, and Social Licence to Operate**

PIRC is in agreement with the proposed change to the recommendation. Should the corporate values be put forward at a meeting, PIRC will assess them on a case-by-case basis.

## **7. Compliance Burdens**

PIRC does not see any issues regarding compliance burdens. The recommendations are largely in line with corporate governance best practice, in the opinion of PIRC, it is therefore the listed entities obligation to meet these guidelines, regardless of perceived burdens.

## **8. Level of Guidance**

PIRC considers that the level of guidance is sufficient.

## **9. Gaps or Deficiencies in the Principles and Recommendations that have not been addressed**

Leaving aside previously made comments on gender, independence and director tenure (see points 2 and 5) PIRC considers there is one additional deficiency in the fourth edition of the ASX Corporate Governance Principles and Recommendations review, regarding the independence of board committees.

The review advocates for an audit and risk committee of at least three members, with a majority being independent. PIRC welcomes this policy, and the policy is in line with most countries market practice. However in the interest of best practice, PIRC considers that audit and remuneration committees should consist of a minimum of three members, and be wholly independent. It is the view of PIRC that having a security holder, executive or other non-independent members on the board committees represents a serious conflict of interests, and is not representative of good corporate governance.

For more information relating to the content of this document, or to request a copy of PIRC's shareholder voting guidelines, please email [info@pirc.co.uk](mailto:info@pirc.co.uk).

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