PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

Property Council of Australia
ABN 13 00847 4422

Level 1, 11 Barrack Street
Sydney NSW 2000

T. +61 2 9033 1900
E. info@propertycouncil.com.au

propertycouncil.com.au
@propertycouncil

27 July 2018

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

By email: mavis.tan@asx.com.au

ASX Corporate Governance Principles and Recommendations – 4th edition consultation

Thank you for the opportunity to comment on the draft 4th edition of the ASX Corporate Governance Principles and Recommendations (the Principles and Recommendations).

The Property Council, as a participating member of the ASX Corporate Governance Council (CGC), strongly supports the aims of the CGC which is to encourage good corporate governance practices for ASX listed entities. This is crucial to promoting investor confidence and competing for capital. We welcome the consultative approach taken by the CGC in relation to the review of the Principles and Recommendations.

We support the intended outcomes of the 4th edition to improve and enhance Australia's corporate governance practices and have suggested below areas where the current draft wording, primarily in the commentary of the recommendations, could be re-examined to ensure the language is not overly prescriptive, ambiguous or in conflict with legislative or other statutory rules.

Australia is well regarded for its open and transparent markets, and its high corporate governance standards. As such, whilst we acknowledge that there are emerging governance issues that have arisen in relation to certain public companies, this is not a systemic issue that would warrant a radical overhaul of the existing framework. We also note there are other enquiries and regulatory changes underway that address many of the emerging issues noted in the consultation paper, and therefore care should be taken not to cause overlapping or competing requirements.

The Principles and Recommendations was last updated in 2014 and this review presents an opportunity to refine and improve Australia's corporate governance framework. The Principles and Recommendations should not be seen as a "catch-all" manual for all issues that may impact listed entities – some issues will best be dealt with through legislation or regulation, and some issues will best be dealt with by allowing the market to evolve.

We support the new commentary included in the Principles and Guidance on "how to approach corporate governance disclosures" which encourages the framework to be approached in a holistic and informative way, rather than as a compliance document. However, to ensure this is how ASX listed entities view the document, the Principles and Recommendations should be principles-based rather than overly prescriptive. This allows each organisation to apply the principles to their own organisation and encourages dialogue between the board and senior management on corporate governance. An overly

prescriptive document could effectively become supplementary regulation and viewed as a "compliance manual" where entities default to a box-ticking exercise which would detract from its usefulness.

For the Principles and Guidance to meet its aim of being a holistic and informative document, we note the following concerns for further consideration before finalising the guidance:

- **References to 'social licence to operate' and 'social responsibility' in the principles, recommendations and commentary** – we strongly agree with the observations in the consultation paper that entities should consider a broader range of stakeholders than just their security holders. This is a critical part of any organisation's strategy.

  The 'social licence to operate' is not a concept that lives in a document, it is a form of social acceptance or approval that companies earn through consistent and trustworthy behaviour and interactions with their stakeholders. This is distinct from reputation and other terms used like 'social responsibility' referred to in the draft document. The social licence for a given company is bespoke and difficult to define. It is a judgement by communities about whether a company is a proper and fitting entity that deserves to be part of their community, and this can change over time as community norms and expectations change.

  As such, references to the social licence may not be appropriate for a document of this nature and more readily understood terms which reflect these ideals could be used. A social licence is built on effective stakeholder engagement; the processes an organisation uses to involve people in the decisions that affect them. It is also important that the commentary recognise that directors are ultimately bound by their director duties which includes acting in the best interest of the company as a whole.

- **Balancing the need for guidance whilst not being overly prescriptive** – in addition to the nine new recommendations, the proposed 4th edition includes significant additions in the commentary which are not intended to be binding. However, entities will nevertheless have to analyse the commentary and consider the detailed examples included throughout the Principles and Recommendations. Some of the commentary appears overly prescriptive, while some terms are vague and could give rise to confusion on what is intended. This detracts from the overall aims of the framework which is to encourage a more holistic approach to corporate governance.

- **Potential inconsistencies with, or replication of, other legislative or regulatory requirements** – the inclusion of specific references to whistle-blower and anti-bribery and corruption requirements need to be reviewed carefully to ensure they do not conflict with privacy protections set out under these legislative regimes (which have either been recently enacted or are currently in the process of being legislated). There are also technical footnotes which are out of date or incorrect.

- **Narrow or targeted recommendations** – as noted above, consideration should be given to whether certain recommendations are necessary or could be better dealt with through legislation, the market place or within commentary. The more detail and prescriptive the Principles and Recommendations are, the potentially less effective they become as a strategic tool.

- **Changes relating to externally managed entities** – the proposed changes relating to externally managed entities could cause confusion or give rise to unnecessary disclosures of inconsequential or immaterial matters.

- **Disclosure of information –** the proposed 4th edition notes on numerous occasions the need to disclose policies and procedures to investors, stakeholders and shareholders. While acknowledging

the need for transparency as part of good governance principles, this should be weighed against a company's need for confidentiality of some information to protect staff, executives, board members and shareholders. There may also be legal requirements around privacy protections that need to be balanced. We consider it appropriate that companies should retain the ability to make available summaries of policies, rather than full policies, to satisfy the recommendations.

Implementation date for 4th edition

The substantive nature of changes to the Principles and Recommendations will require sufficient lead time for listed entities to implement the new guidance.

We are concerned that the proposed finalisation and release of the 4th edition by early 2019 will not give sufficient time for entities to start applying the 4th edition for the first full financial year from 1 July 2019 – i.e. a proposed lead time of 4-5 months.

To ensure that listed entities have the necessary lead time to properly implement the 4th edition changes, we recommend the implementation date be moved out to the first full financial year commencing on or after 1 January 2020.

We have set out in the Appendix greater detail in relation the above issues. We are happy to provide further feedback. Please contact Collin Jennings (02 9033 1979) or me (02 9033 1929) to discuss further.

Yours sincerely

Belinda Ngo
Executive Director – Capital Markets

PROPERTY COUNCIL of Australia

Appendix: Detailed submission on 4th edition

Providing clear and concise principles that are easily understood by business is the key to the success of this project. Our overall recommendation is that the current draft wording, primarily in the commentary of the recommendations, be re-examined to ensure the language is not overly prescriptive, ambiguous or in conflict with legislative or other statutory rules.

We have set out below further details of the five critical issues identified:

1. References to 'social licence to operate' and 'social responsibility' in the principles, recommendations and commentary

Principle 3 – inclusion of 'acting in a socially responsible manner"

The proposed amendments in the 4th edition includes a requirement in Principle 3 to acting in a "socially responsible manner". The commentary to Principle 3 and recommendation 7.4 also includes references to "social licence to operate".

We agree with the observations in the consultation paper that entities should consider a broader range of stakeholders than just their security holders.

However, it can be challenging for companies to quantify and report on how it gauges the culture within the organisation. The social licence for a given company is bespoke and difficult to define. It is a judgement by communities about whether a company is a proper and fitting entity that deserves to be part of their community, and this can change over time as community norms and expectations change.

Further, the examples in the commentary for Principle 3 overlap with issues that are subject to legislation – for example, dot point one under the Principle discusses the issues of bonded labour, paying living wages and not engaging with child labour. However, in the period since the release of the 4th edition draft for consultation, both the Federal and NSW state parliaments are discussing and drafting Modern Slavery legislation dealing directly with these issues.

For companies to report on how they are working within a social licence may need greater clarification from the Council on how the Council sees companies reporting on this theme.

Alternatively, and preferably, more readily understood terms which reflect these ideals could include brand, reputation, values and culture, non-financial risks, and the long-term interests of security holders.

Critically, while from a social responsibility standpoint, it would be preferable to hold entities to a standard where their businesses are conducted in a way that leads to an optimal environmental or socially responsible outcome, the primary duty is to ensure that such conduct is compatible with directors' duties to their securityholders, as a whole, and the commentary should acknowledge that constraint.

For example, we recommend that the commentary in Recommendation 7.4 be amended to the following effect:

> *"the licence can be lost or seriously damaged if the entity conducts its business in a way that is not environmentally or socially responsible and is inconsistent with the board's duties to the entity and its securityholders' as a whole", acknowledging the primary duties owed by directors under Australian law at present.*

Recommendation 3.2 code of conduct
We agree that codes of conduct provide both markets and the public assurance that organisations are being mindful of good corporate governance and the integrity of the company. We also agree that codes of conduct should be reviewed as a matter of course by entities to ensure that the conduct of the company is in line with both its own culture and community expectations.

However, as with social licence, internal requirements of conduct can vary depending on the company. It may be overly prescriptive to lock in determined time frames for review as conduct policies can shift and change depending on their organisation's needs.

Understanding the obligations of a company's code of conduct is an important part of a company's governance. This can be achieved from the outset, either through employment contracts or through induction processes, and can also be part of ongoing training. Rather than mandating formal training (as currently proposed), each organisation should be allowed to determine the best way to ensure their code of conduct is understood and reinforced across the organisation. The commentary should focus on the objective – i.e. ensuring a company's code of conduct is understood – rather than the way this is achieved.

Ensuring that a company's code of conduct is enforceable and actions can be taken for breaches of a company's code is also good governance practice and we agree with the direction that the CGC is taking in advising companies to ensure that conduct of the highest levels are maintained in listed entities.

However, reporting on what actions a company *has* taken in relation to breaches of the code may be too sensitive and part of internal operations that should not be disclosed publicly. What actions a company *could* take in relations to a breach should be sufficient to ensure public confidence in the code.

2. Balancing the need for guidance whilst not being overly prescriptive

Commentary on Recommendation 1.1 – board charter
The commentary for Recommendation 1.1 is unclear and in some instances overly prescriptive. It is unclear, for example, how a company can measure whether a Board has overseen management instilling values. Additionally, the recommendation's language around "Management should draft, and the board should approve, an entity's statement on core values" is seen as being too prescriptive.

Boards focus on strategy and, generally, do not focus on overseeing the implementation by management of the business model. If the aim of the recommendation is to create a more values-based environment, then further clarity in the commentary is required.

Commentary on Recommendation 1.3 – appointment of directors
Footnote 24 suggests directors who have a personal services company may be perceived as engaging in "preferential treatment".

This is highly concerning as there can be legitimate reasons for the use of personal services companies and it does not seem appropriate to include a footnote in the Principles and Recommendations that would infer otherwise.

Commentary on Recommendation 1.5 – Diversity
The Property Council is committed to building a diverse and inclusive industry – this includes establishing and funding the Property Male Champions of Change who are working to achieve a significant and sustainable increase in the number of women in senior leadership positions in the property industry.

We welcome the direction taken in the 4th edition to consider other forms of diversity beyond gender and note the following observations:

- While the commentary acknowledges the importance of diversity in terms of not only gender, but ethnicity, age, socio-economic background, sexual orientation etc are all important, the majority of the commentary continues to focus only on gender diversity. We suggest the commentary or recommendation could be reframed to focus on achieving diversity in general.
- There can be practical challenges in measuring and reporting on other forms of diversity. This does not detract from the importance of having appropriate policies in place to encourage diverse and inclusive workplaces, and it is important for the recommendation and commentary to balance this overall goal whilst not being overly prescriptive or requiring entities to disclose matters which may be confidential.

We note the proposed 4th edition requires entities in the ASX 300 to have a measurable objective of no less than 30% of its directors of each gender within a specified period. Many of our affected members are already at or above this target, and we acknowledge that setting benchmarking targets are an important part of ensuring that companies are meeting both public and market expectations. However, we query whether the proposed benchmark is appropriate to include in the recommendation given the breadth of sectors covered by the ASX 300.

We also note that there has been considerable expansion of the commentary under Recommendation 1.5 and note the following two additional concerns:

- The proposed commentary recommends the linking of remuneration to achieving diversity KPIs. We suggest this should be left to each organisation to determine how they will implement the gender diversity initiatives contemplated by Recommendation 1.5.
- The proposed commentary also suggests disclosure of "insights" from annual reviews – we agree that the reporting of key metrics is important to ensure transparency and accountability, however, any insights from annual reviews could contain sensitive information. We would suggest this could be caveated to ensure the requirement to disclose does not result in breaching of confidentiality or require the disclosure of sensitive information insights.

Commentary on Recommendation 1.6 – board evaluation process

Recommendation 1.6 deals with board evaluation processes and the proposed commentary removes the previous reference to disclosures being provided "where appropriate".

It is possible that certain findings could be sensitive and mandating disclosure may result in less openness in these processes making them less effective and reducing the potential for positive change.

We would suggest the caveat re "to the extent appropriate" should be retained.

Commentary on Recommendation 2.2 – skills matrix

While recommendation 2.2 has not changed substantively, the commentary has been expanded extensively.

The revised commentary appears to confuse the skills a company has and the skills a company needs. The skills should reflect the board as a whole rather than focussing on individual directors. It should also be up to the board to identify the critical skills needed for the organisation (in keeping with principle 2 around board composition).

A critical component in the formation of a board is the wide-ranging knowledge that the board has. While we agree that awareness of emerging governance issues such as cyber security, climate change and digital disruption is critically important for board members, the commentary should be cautious about

encouraging the appointment of 'subject matter experts' in these areas who may lack the other requisite skills to oversee a company's affairs. Issues like cyber security will be more relevant in some organisations than others – it should be left to each organisation to determine what specialist skills are required and what generalist skills are required. Agile and responsive boards will ensure that the knowledge of emerging topics is handled by the board as relevant and as required.

Paragraph three of the commentary seems to place too greater an emphasis on emerging issues and distracts from what appears to be the intent of the recommendation, that boards provide investors and stakeholders with information regarding the skills and knowledge of the board in relation to their obligations as board members.

It is recommended that paragraph three of the commentary be removed so that companies can examine the skills that the board has a whole rather than the individual and which are relevant to that entity.

Commentary on Recommendation 2.3 – director independence
Industry does not dispute the fundamental importance of director independence and ensuring any conflicts are identified and appropriately managed.

In relation to the proposed addition to Box 2.3 ("Factors relevant to assessing the independence of a director") to cover directors who receive performance based remuneration (including options or performance rights) or participate in an employee incentive scheme, it should be clarified whether the reference to an 'employee incentive scheme' is intended to capture (or exclude) a contribution-style plan or salary sacrifice plan, which allows a non-executive director to gain exposure to the entity's securities via regular contributions (at cost to the director).

Contribution-style plans (as compared to plans featuring zero cost performance rights which vest over a short to medium-term period, or options with a favourable exercise price) do not give rise to the same independence and governance concerns for non-executive directors.

As such, contribution-style plans do not give rise to the same independence and governance concerns for non-executive directors and should not be captured.

Commentary on Recommendation 2.6 – professional development
The expanded commentary refers to directors requiring training if they do not have "accounting skills". We do not consider it appropriate to include this in the Principles and Recommendations given there is substantive case law that requires directors to have sufficient financial literacy and skills to understand an entity's financial statements and it is the responsibility of individual directors to ensure they maintain these requisite skills. If the commentary is to remain, we suggest that the Council consider using the term "financial literacy" rather than "accounting skills" for consistency with the case law.

The commentary in the third edition, that the Board assesses gaps and has programs to ensure that it can govern the operations of the listed entity effectively, would appear to be more appropriate.

The commentary on board briefings should be reworded to allow the briefings to be given to a director, board or committee as appropriate.

Commentary on Recommendation 3.1 – core values
The commentary in 3.1 includes examples of core values which is a matter for the organisation to determine and is seen as unnecessary – while they may be intended as examples, the mere inclusion of a list could be viewed as a prescriptive set of requirements.

Additionally, the example of "commitment by the entity to complying fully with its legal obligations and to acting ethically and in a socially responsible manner" is not really a core value but something that could be included in a code of conduct.

We suggest the commentary confirm that an entity could meet these disclosure requirements through the company's code of conduct, which follows common market practice.

Principle 4 Produce corporate reports of high quality and integrity
The commentary within this principle requiring corporate reports to 'give the reader a reasonable understanding of the entity's business model, strategy, risks and opportunities, remuneration policies and practices and governance frameworks as well as its financial performance', is unclear as to what is a corporate report. The wording of the commentary needs to be qualified to be relevant to the corporate report.

New Recommendation 4.4 – validating market information
This is a new recommendation which has caused confusion on what will be required to be undertaken to satisfy the requirement.

Under section 295A of the Corporations Act, certificates are provided by the Managing Director and Chief Financial Officer around the preparation of accounts.

It is unclear whether the recommendation requires disclosure of the process by which this information is validated or is imposing additional compliance requirements (eg line by line verification as per prospectuses). The more an entity discloses around its internal processes the more exposure there can be if there is a delay in those processes on a one-off basis. An example of this is where there might have been a transposition error for a number in the financial report which was not picked up in the internal verification process.

The Corporations Act also requires that entities disclose information that members of the listed entity would reasonably require to make an informed assessment of the operations of the entity, the financial position and the business strategies and prospects of an entity. The recommendation requires listed entities to provide investors with 'appropriate information to make investment decisions'. This could be viewed as potentially being in conflict with the existing Corporations Act requirements, and also brings in additional subjectivity as to what may be viewed as 'appropriate'.

We do not expect this is the level of detail required by Recommendation 4.4, and recommend clarity is provided in the commentary that this recommendation is satisfied where entities disclose the process by which they verify information. Further, we suggest that an entity satisfies this recommendation if it considers it has complied with the Corporations Act.

New Recommendation 6.4 Resolutions by poll rather than show of hands
We are supportive of the move from a show of hands for resolutions at a meeting of security holders, to polling.

We note that this can create some procedural issues for companies and may place pressure on larger companies to move to electronic voting, which is more expensive, especially when physical attendances at AGMs can be small in comparison to the number of shareholders.

The Corporations Act does deal with issues of resolutions and additional commentary may overlap with the Act.

Greater guidance around proper management of meetings to accompany this recommendation, for example a reference guide, would be beneficial.

Commentary on Recommendation 7.4 – integrated reporting and social risks
We acknowledge the addition in the 4th edition to 'integrated reporting' as a possible way of satisfying Recommendation 7.4. This is welcome as many entities are starting to move to integrated reporting. However, as this is a significant project, we support the optionality of satisfying the reporting requirement by *either* having a sustainability report or integrated report.

We also query the expansion to include social risk under Recommendation 7.4. This recommendation has historically focused on environmental issues. Social risk can mean a variety of issues and it is unclear from the wording whether the proposed changes are referring to social risk in relation to the effects of environmental risk (eg climate change and other sustainability issues) or whether there is a broader view of social risk. It would be preferred if the commentary was clarified to replace references to social risk with these more specific issues.

In the event the reference to social risk is retained, the lack of guidance on 'social risk' in recommendation 7.4 also gives rise to difficulties on how entities are expected to meaningfully benchmark themselves, particularly as social risks can vary significantly even amongst peers within the same industry if they are operating in different geographical locations. In comparison, benchmarking of environmental risks can be more easily quantified by using global benchmarks which have a uniform assessment criteria such as the Global ESG Benchmark for Real Estate (GRESB) and the Dow Jones Sustainability Index.

3. Potential inconsistencies with, or replication of, other legislative or regulatory requirements

Recommendation 3.3 Whistle-blower policy
While we agree that all organisations should have a whistle blower policy, we query the need to have a specific recommendation on this issue given the existing legislative framework (see further comments below). In the event the recommendation is retained, we would suggest that the wording is reviewed to ensure it does not conflict with the law.

The Corporations Act (and draft legislative reforms in this area) prohibits certain disclosures of a whistle-blower's identity or information likely to lead to the identification of the whistle-blower circumstances, by the recipient of a whistle-blower report.

Any reporting processes to the board or senior management need to be structured and managed in a way that does not breach this prohibition.

We suggest that limb (b) of the new recommendation be de-elevated to the commentary and be subject to words to the effect of 'to the extent permitted by law' (rather than being a recommendation giving rise to a 'comply or explain' obligation, noting the sensitive legal issues companies need to manage within their whistle-blower reporting structures).

New Recommendation 5.3 - Release of investor/analyst presentations

The issue of continuous disclosure is already addressed in detail by Chapter 3 of the ASX Listing Rules and ASX Guidance Note 8. All listed entities are already required to comply with those requirements and therefore this recommendation is not required. Reporting against this requirement would essentially be asking companies to confirm that they have complied with the Listing Rules which we don't consider to be within the spirit or intent of the Principles and Recommendations.

Footnote 26 misquotes section 204D of the Corporations Act
Footnote 26 within Recommendation 1.4 states: *"Listed companies established in Australia should note Section 204D of the Corporations Act which requires the appointment of a company secretary to be formally resolved, rather than simply approved by the board."*

However, section 204D of the Corporations Act simply states: *"A secretary is to be appointed by the directors."* Section 204D does not, in its direct words or notes, dictate how the secretary is to be appointed.

Whilst it may be good governance to have the company secretary appointed by a resolution of the board, and, it can be a recommendation of the ASX that company secretaries are appointed in this manner, it is not a prescription determined by the Corporations Act.

4. Narrow or targeted recommendations

Recommendation 2.7 language fluency
Requiring a separate process for directors who are not fluent in the relevant language appears to be targeted at a small section of the ASX.

To avoid an overly lengthy list of recommendations, this could perhaps be dealt with through commentary. Alternatively, there could be a separate section of the Principles and Recommendations dealing with entities that have directors who are not fluent in the language in which board meetings are held (for example, similar to the separate section that currently exists for externally managed entities).

Recommendation 3.3 whistleblower policy and 3.4 anti-bribery and corruption policy
We strongly support the need for entities to have whistleblower and anti-bribery and corruption policies and comply with any legislative requirements in this area.

However, we query the need to have this included as specific recommendations given there are various other types of misconduct that are not specifically addressed (for example, competition and consumer law, workplace health and safety laws, modern slavery). Referring to some legal requirements and not others could result in confusion as to the purpose of the Principles and Recommendations.

To the extent this is considered necessary because there are entities on the ASX that are not Australian incorporated, we would suggest consideration could be given to having a separate section in the Principles and Recommendations for non-Australian incorporated entities (for example, similar to the separate section that currently exists for externally managed entities).

Recommendation 8.4 consultancy agreements with directors
This is relatively uncommon within companies and, similar to other recommendations, seems more targeted at a very small sector of the ASX, and could be more appropriate if this recommendation was entered in as commentary under Recommendation 8.2.

5. Changes relating to externally managed entities

Commentary to alternative recommendation 1.1 for externally managed listed entities
The proposed change requires disclosures where there has been outsourcing of any aspects of the management of the listed entity.

This disclosure obligation should not extend to inconsequential or immaterial matters or arrangements, which may serve to confuse investors or do not relate to management functions (by way of example, arrangements with registry service providers or custodians).

If the responsible entity has made past disclosures in relation to outsourcing of management functions which remain current, we suggest the commentary indicate that it is acceptable to cross-refer to such past disclosure.

Glossary definition of externally managed entity

The definition of 'externally managed entity' has caused much confusion for many organisations with listed funds. The words "externally managed" has led many organisations to believe that they are not covered by the "externally managed listed entity" definition because the listed fund has an internal responsible entity. The significance being that, where covered by the definition, the entity will disclose against modified principles and recommendations.

We would recommend that the wording be refined to include parameters for those entities where the responsible entity may be internal to the company.