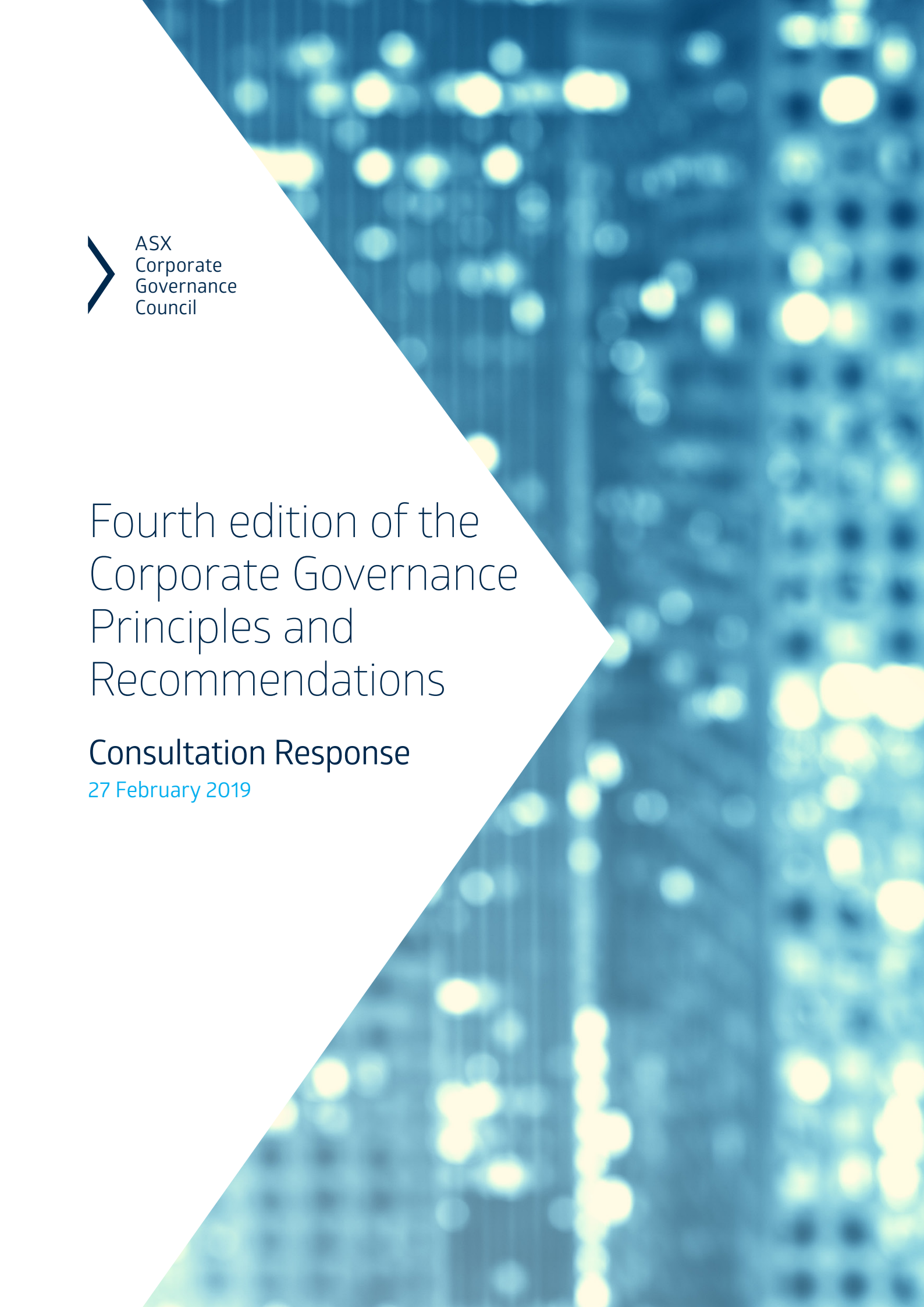

ASX
Corporate
Governance
Council

Fourth edition of the Corporate Governance Principles and Recommendations

Consultation Response

27 February 2019

ASX Corporate Governance Council

Contents

Consultation Response 1

1. Background 1
2. Release of the fourth edition 1
3. New recommendations 1
4. Key changes addressing culture and values 2
5. Other key changes 3
6. Effective date 3

Annexure A / Summary of consultation feedback 4

1. Overview 4
2. Major issues raised in the consultation feedback 4

2.1. Social licence to operate 4
2.2. Level of prescription 5
2.3. Recommendations that only apply to a small number of entities 5
2.4. Transition 5

3. Specific feedback 6

3.1. Recommendation 1.3 (written contracts of appointment) 6
3.2. Recommendation 1.5 (diversity) 6
3.3. Recommendation 1.6 (board performance reviews) 7
3.4. Principle 2 (structure the boardto be effective and add value) 7
3.5. Recommendation 2.2 (board skills matrix) 7
3.6. Recommendation 2.3 (director independence) 8
3.7. Principle 3 (instil a culture of acting lawfully, ethically and responsibly) 8
3.8. New recommendation 3.1 (values) 9
3.9. New recommendations 3.3 (whistleblower policy) and 3.4 (anti-bribery and corruption policy) 9
3.10. Principle 4 (safeguard the integrity of corporate reports) 9
3.11. New recommendation 4.3 (process to verify integrity of periodic corporate reports) 10
3.12. New recommendation 5.2 (copies of announcements to board) 10
3.13. New recommendation 5.3 (investor and analyst presentations) 10
3.14. New recommendation 6.4 (vote by poll rather than show of hands) 11
3.15. Recommendation 7.4 (environmental and social risks) 11
3.16. Proposed new recommendation 8.4 (consultancy arrangements) 12
3.17. Disclosure of key governance policies in full 12

Consultation Response

1. Background

The Corporate Governance Principles and Recommendations ("*Principles and Recommendations*") were first introduced in 2003. A second edition was issued in 2007 and new recommendations on diversity and the composition of the remuneration committee were added in 2010. A substantially re-written and restructured third edition was issued in March 2014 addressing a number of governance issues that came to light during the global financial crisis.

Mindful of its role to ensure that the *Principles and Recommendations* remain contemporary and continue to reflect local and international expectations around corporate governance, the ASX Corporate Governance Council ("Council") agreed in May 2017 to commence work on a fourth edition of the *Principles and Recommendations*.

In May 2018, Council released for public comment:

- a communique
- a consultation paper entitled *Review of the ASX Corporate Governance Council's Principles and Recommendations*
- a consultation draft of a proposed fourth edition of the *Principles and Recommendations*
- a mark-up of the consultation draft against the third edition of the *Principles and Recommendations*

Council invited written comments from all interested stakeholders by Friday, 27 July 2018.

As part of the consultation process, a number of presentations were held over the consultation period, including public presentations in Melbourne (1 June), Sydney (4 June), Perth (6 June), Adelaide (7 June) and Brisbane (13 June).

Council received a total of 102 submissions in response to its consultation paper: 92 non-confidential and 10 confidential submissions. Copies of the non-confidential submissions are available on the ASX website at: www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm.

Council would like to express its gratitude to each respondent who took the time and trouble to send a written submission. Council has found the feedback provided by respondents invaluable in understanding the perspectives and concerns of various stakeholders.

2. Release of the fourth edition

Along with this document, Council is today releasing:

- the final version of the fourth edition of the *Principles and Recommendations*;
- a mark-up comparing the final version of the fourth edition to the consultation version; and
- a mark-up comparing the final version of the fourth edition to the third edition.

The fourth edition maintains the same flexible, non-mandatory "if not, why not" approach to disclosure as in the third edition. It also has the same structure – eight core principles, supporting recommendations, and commentary with guidance on implementing the recommendations.

3. New recommendations

Council is proceeding with all but one[1] of the nine new recommendations proposed in the consultation draft of the fourth edition, but with a number of drafting changes reflecting feedback received in the consultation.

One of the new recommendations proposed in the consultation draft, as well as an existing recommendation in the third edition,[2] are being moved to a separate section of the *Principles and Recommendations* that only applies to a small subset of listed entities. A third new recommendation has been added to this section dealing with matters previously included in the commentary to another recommendation in the consultation draft.[3]

As a result of these changes, the fourth edition has 35 recommendations of general application, seven of which are new:

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

Recommendation 3.3: A listed entity should:

(a) have and disclose a whistleblower policy; and

(b) ensure that the board or a committee of the board is informed of any material incidents reported under that policy.

1 The one recommendation in the consultation version of the fourth edition that Council is not proceeding with is recommendation 8.4 relating to consultancy arrangements.

2 Recommendation 4.3 in the third edition will be moved to section 9 in the fourth edition and become recommendation 9.3; "A listed entity established outside Australia, and an externally managed listed entity that has an AGM, should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit."

3 Recommendation 9.2 in the final version of the fourth edition was previously addressed in the commentary to recommendation 6.3 of the consultation version. It now reads: "A listed entity established outside Australia should ensure that meetings of security holders are held at a reasonable place and time."

Recommendation 3.4: A listed entity should:

(a) have and disclose an anti-bribery and corruption policy; and

(b) ensure that the board or a committee of the board is informed of any material breaches of that policy.

Recommendation 4.3: A listed entity should disclose its process to verify the integrity of any periodic corporate report it releases to the market that is not audited or reviewed by an external auditor.

Recommendation 5.2: A listed entity should ensure that its board receives copies of all material market announcements promptly after they have been made.

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

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

The two new recommendations that only apply to a small subset of listed entities are:

Recommendation 9.1: A listed entity with a director who does not speak the language in which board or security holder meetings are held or key corporate 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.

Recommendation 9.2: A listed entity established outside Australia should ensure that meetings of security holders are held at a reasonable place and time.

4. Key changes addressing culture and values

Culture and values were front and centre in the consultation version of the fourth edition of the *Principles and Recommendations*. Council's proposals in this regard responded to the various commissions and enquiries over recent years highlighting governance issues arising from poor conduct or culture. Council considers it vital that these issues are addressed to help arrest the loss of trust in business.

The final version of the fourth edition includes all of the key changes around culture and values proposed in the consultation draft, although there are some drafting changes reflecting feedback received in the consultation.

Key in this regard are the changes to principle 3,[4] which will now read in its abbreviated form as *"instil a culture of acting lawfully, ethically and responsibly"* and in its longer form as *"a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly"*.

Principle 3 will be underpinned by new recommendations 3.1 (values), 3.3 (whistleblowing policy) and 3.4 (anti-bribery and corruption policy) mentioned in the preceding section, as well as an addition to recommendation 3.2[5] (code of conduct) that a listed entity's board or a committee of the board should be informed of any material breaches of the entity's code of conduct.

In addition, the commentary to recommendation 1.1 (role of board and management) has been amended to add to the list of usual responsibilities of the board of a listed entity:

- defining the entity's purpose;
- approving the entity's statement of values and code of conduct to underpin the desired culture within the entity;
- satisfying itself that the entity has in place an appropriate risk management framework that covers both financial and non-financial risks;
- satisfying itself that an appropriate framework exists for relevant information to be reported by management to the board;
- whenever required, challenging management and holding it to account;
- overseeing management in its implementation of the entity's strategic objectives, instilling of the entity's values and performance generally; and
- satisfying itself that the entity's remuneration policies are aligned with the entity's purpose, values, strategic objectives and risk appetite.

The commentary to recommendation 1.1 has also been amended to make it clear that the senior executive team is responsible for providing the board with accurate, timely and clear information on the entity's operations to enable the board to perform its responsibilities and that this is not just limited to information about the financial performance of the entity, but also its compliance with material legal and regulatory requirements and any conduct that is materially inconsistent with the values or code of conduct of the entity.

These changes are directed to setting "the tone from the top" and ensuring that the board of a listed entity is provided with the information it needs to monitor the culture of the entity.

4 In the third edition, principle 3 read in its abbreviated form as *"act ethically and responsibly"* and in its longer form as "a listed entity should act ethically and responsibly".

5 This was previously recommendation 3.1 in the third edition.

5. Other key changes

Other key changes proposed in the consultation version that have been incorporated into the fourth edition (in some cases with drafting changes) include:

- expanding recommendation 1.5 (diversity) to state that the board of a listed entity should set measurable objectives for achieving gender diversity not only in the composition of its board but also in its senior executive ranks and its workforce generally;
- adding to recommendation 1.5 a statement that if a listed entity was in the S&P/ASX 300 Index at the commencement of the reporting period, the measurable objective for achieving gender diversity in the composition of its board should be to have not less than 30% of its directors of each gender within a specified period;
- amending Box 2.3 (the indicators of director independence) to:
  - extend "material business relationships" to include relationships as professional advisers and consultants;
  - change "close family ties" to "close personal ties", along with the inclusion of commentary that these ties may be based on "family, friendship or other social or business connections"; and
  - clarify that the reference to "independence" having been compromised by long tenure refers to independence from management and substantial holders;
- providing additional guidance in the commentary to recommendation 2.3 (disclose independence and length of service of directors) that where a director falls within one or more of the examples in Box 2.3, the board should rule the director not to be independent unless it is clear that the interest, position or relationship in question is not material and will not interfere with the director's capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity as a whole rather than in the interests of an individual security holder or other party;
- removing the reference to "economic sustainability risks" and changing "environmental sustainability risks" and "social sustainability risks" to "environmental risks" and "social risks" respectively in recommendation 7.4 (environmental and social risks);
- adding to the commentary to recommendation 7.4 a reference to the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD"); and
- modifying the recommendations relating to the disclosure of relevant governance policies to state that the policies should be disclosed in full rather than permitting a summary to be disclosed.

In addition, having listened carefully to the feedback provided by stakeholders, Council has shortened and re-drafted some parts of the commentary to make it clearer that it is guidance only and not intended to be prescriptive. It has also replaced the references in the commentary to "social licence to operate" – for which there was considerable support from many stakeholders but opposition from others – with references to "reputation" and "standing in the community". Council regards these concepts as synonymous.

More detail about the submissions received, and Council's response, can be found in Annexure A.

6. Effective date

All ASX listed entities are required to report against the recommendations in the *Principles and Recommendations* on an annual basis under the ASX Listing Rules.

The fourth edition of the *Principles and Recommendations* **will take effect for an entity's first full financial year commencing on or after 1 January 2020.** Accordingly, entities with a 31 December balance date will be required to report against the fourth edition starting with the financial year beginning 1 January 2020 and ending 31 December 2020. Entities with a 30 June balance date will be required to report against the fourth edition starting with the financial year beginning 1 July 2020 and ending 30 June 2021.

As with previous editions, Council encourages listed entities to adopt the fourth edition earlier, if they wish.

Annexure A /

Summary of consultation feedback

1. Overview

Generally speaking, there was overwhelming support for the changes proposed in the consultation version of the fourth edition from the investor community, accounting firms and standards setters, but significant opposition to some aspects of the changes from the business, director, company secretary and legal communities.

On the whole, stakeholders representing investor interests believed the changes proposed in the consultation version would successfully address a range of contemporary governance concerns and would provide them and other stakeholders with improved insight into the robustness and effectiveness of the governance arrangements of the entities they invest in. They also commended the greater transparency that the new recommendations would provide.

Some stakeholders queried the need for a fourth edition, arguing that governance standards in Australia are already high ("there are no systemic issues"). Some also questioned the wisdom of responding to the governance issues identified in recent commissions and enquiries when some of those enquiries (including notably the Hayne Royal Commission) were still in progress.

2. Major issues raised in the consultation feedback

This section summarises the major issues raised by stakeholders in relation to the consultation version of the fourth edition and Council's response.

2.1. Social licence to operate

The proposed introduction of the term "social licence to operate" ("SLTO") into the *Principles and Recommendations* was unquestionably the most polarising issue addressed in the consultation feedback.

The term SLTO was used in the consultation draft of the fourth edition as shorthand to convey the notion that a listed entity's long term sustainable success is dependent on maintaining the trust and goodwill of the various social groups with which it interacts. This was proposed to be reinforced in the consultation draft by proposed commentary to principle 3 (act lawfully, ethically and in a socially responsible manner) and recommendation 7.4 (environmental and social risks) referencing the need for a listed entity to have regard to a broader group of stakeholders than just its security holders, including employees, customers, suppliers, creditors, regulators and the local communities in which it operates.

Almost all investor groups, accounting firms and standards setters supported the concept of SLTO and the recognition of broader stakeholder accountability.

A couple of submissions noted that the inclusion of SLTO reflects an evolution of the term from its original usage in the mining industry and is now more broadly associated with concepts of trust, credibility and community acceptance. A number also referred to the well-publicised opinion by Noel Hutley QC and Sebastian Hartford-Davis on directors' duties relating to climate risk. These submissions contended that this opinion could be extrapolated to suggest that directors who do not take into account wider stakeholder interests may breach their duties by failing to predict what impact a decision made purely on the basis of advancing shareholder wealth may have on a corporation's reputation (or SLTO).

Those who opposed the introduction of SLTO into the fourth edition argued that the term is vague and subjective, that it could mean different things to different stakeholders, and that its reach would likely vary over time. They noted that it could be confused or conflated with community opposition, which in turn might expose listed entities to "social engineering agendas and objectives" that are not necessarily concerned with good corporate governance. Further, the notion of broader stakeholder accountability inherent in SLTO might actually conflict with the duties of directors, as they have been espoused by the courts and are traditionally understood in Australia.

A number of respondents raised concerns about the application of SLTO to entities involved in industries that raise particular social issues, such as gaming, alcohol, tobacco and fast food.

Recognising these issues, Council has decided to replace all references to SLTO in the fourth edition with references to "reputation" and "standing in the community". Council regards these concepts as synonymous. However, the modified terminology is more likely to be better understood and more consistently applied by listed entities, their boards and other stakeholders.

Council has added to the commentary under recommendation 3.1 in the fourth edition a statement that:

"In formulating its values, a listed entity should consider what behaviours are needed from its officers and employees to build long term sustainable value for its security holders. This includes the need for the entity to preserve and protect its reputation and standing in the community and with key stakeholders, such as customers, employees, suppliers, creditors, law makers and regulators."

Council has also included in a footnote in the fourth edition the comment by Commissioner Hayne in his Interim Report (Volume 1, at pages 54-55) that:

"As [a commercial enterprise], [a listed] entity... rightly pursues profit. Directors and other officers of the entities owe duties to shareholders to do that. But the duty to pursue profit is one that has a significant temporal dimension. The duty is to pursue the long term advantage of the enterprise. Pursuit of long term advantage (as distinct from short term gain) entails preserving and enhancing the reputation of the enterprise. And, lest there be any doubt, it also entails obeying the law. But to preserve and enhance a reputation ... the enterprise must do more than not break the law. It must seek to do 'the right thing'."

2.2. Level of prescription

A significant number of consultation submissions expressed concern about the level of detail and prescription in the commentary to the consultation version of the fourth edition. They observed that this was a departure from previous editions and from the widely accepted objective of having a principles-based corporate governance framework. They also commented on what they saw as the over-use of "should" and "ensure" in the commentary and, in a number of cases, the perception that the commentary set a higher bar for action rather than serving as explanatory guidance to the recommendations.

There were also concerns expressed that many larger listed entities treat the commentary as if it were part of the recommendation and therefore more prescriptive commentary increased the compliance burden for listed entities.

Some submissions argued that a higher level of prescription would discourage listed entities from exploring how best to meet the spirit of the recommendations and could encourage boiler-plate disclosures.

To address these concerns, Council has made a number of changes in the fourth edition, including:

- removing the commentary under principles 2, 3, 7 and 8, on the basis that the principles, as high level normative statements, should be able to stand on their own without further elaboration;
- removing self-evident or exhortatory statements;
- removing some duplicative text – for example, in the introductory commentary under "How to approach governance disclosures", additional guidance has been provided:

  "This includes not only outlining the governance arrangements it has in place but also explaining how they are being implemented in practice. For example, where a recommendation calls for a particular policy to be in place, it will aid transparency and promote investor confidence for the entity to disclose, where appropriate, whether there have been material breaches of the policy during the reporting period and how they have been dealt with. Similarly, where a recommendation calls for a matter to be reviewed or evaluated, (as is the case for example in recommendations 1.6 (board performance reviews) and 7.2 (annual risk review)) investors will find it helpful for the entity to disclose, where appropriate, any material insights it has gained from the review or evaluation and any changes it has made to its governance arrangements as a result."

  This eliminates the need to repeat this guidance in the commentary to each recommendation that references a policy or calls for a listed entity to conduct a particular review or evaluation;
- deleting some of the guidance on board skills matrices, including the suggestions for possible formats, following feedback that the commentary was too detailed and prescriptive; and
- streamlining the commentary accompanying recommendation 1.5 (diversity).[6]

2.3. Recommendations that only apply to a small number of entities

A number of submissions questioned the inclusion in the consultation version of the fourth edition of recommendations that apply only to a small subset of foreign incorporated or other listed entities. This was particularly the case with the new recommendation dealing with directors who do not speak the language in which board or security holder meetings are held or key corporate documents are written.[7]

Council believes that it is important that these recommendations appear somewhere in the *Principles and Recommendations*, in view of the increasing number of cross-border listings on ASX, but recognises that they should not "clutter" the body of the *Principles and Recommendations*.

To address these concerns, Council has decided to create a separate section 9 in the *Principles and Recommendations*: "Additional recommendations that apply only in certain cases." This section contains new recommendations 9.1 and 9.2 mentioned in section 3 of the Consultation Response. Former recommendation 4.3 in the third edition (external auditor available at AGM) has also been moved to this section and renumbered as recommendation 9.3.

2.4. Transition

Lastly, there were a number of concerns raised that there would be insufficient time for entities to make the necessary changes to their corporate governance frameworks to transition over to the fourth edition by the 1 July 2019 deadline originally proposed in the consultation version.

6 A number of consultation submissions pointed out that the commentary on diversity was disproportionately long compared to the commentary on other recommendations.

7 Proposed new recommendation 2.7 in the consultation version of the fourth edition but now new recommendation 9.1 in the final version of the fourth edition.

To address these concerns, Council has decided to defer the transition date for the fourth edition to the first full financial year commencing on or after 1 January 2020. In other words, entities with a 31 December balance date will be required to report against the fourth edition starting with the financial year beginning 1 January 2020 and ending 31 December 2020. Entities with a 30 June balance date will be required to report against the fourth edition starting with the financial year beginning 1 July 2020 and ending 30 June 2021.

3. Specific feedback

This section summarises some of the main feedback received on specific changes proposed in the consultation version of the fourth edition and Council's response. To the extent that an issue has already been covered in the body of the Consultation Response or in section 2 of this annexure, it is not repeated below.

3.1. Recommendation 1.3 (written contracts of appointment)

In the consultation version of the fourth edition, Council proposed adding a footnote to recommendation 1.3 clarifying that when this recommendation refers to a listed entity having a written agreement with each director and senior executive setting out the terms of their appointment, this means an agreement with the director or senior executive personally rather than with an entity supplying their services.

Council was asked to clarify that it did not intend this change to apply to contract company secretarial services provided through a professional services firm, which is not an unusual arrangement for smaller listed entities. To address this issue, Council has added new commentary to clarify that:

"With one exception, the agreement in question should be with the director or senior executive personally rather than an entity supplying their services. This is to ensure that the director or senior executive is personally accountable to the listed entity for any breach of the agreement.

The one exception is where an entity is engaging a bona fide professional services firm to provide the services of a CFO, company secretary or other senior executive on an outsourced basis. In that case, it is acceptable for the agreement to be between the entity and the professional services firm."

3.2. Recommendation 1.5 (diversity)

In the consultation version of the fourth edition, Council proposed a number of changes to recommendation 1.5 and the related commentary. This included a requirement that the board or a committee set measurable objectives for achieving gender diversity not only in the composition of its board, but also in its senior executive ranks and its workforce generally. There was no specific dissent to this change.

Council also proposed that boards charge management with designing, implementing and maintaining programs and initiatives to help achieve the entity's measurable diversity objectives and review with management at least annually the entity's progress towards achieving those objectives and the adequacy of its diversity programs and initiatives. In the end, Council decided not to proceed with this change based on feedback that it was too prescriptive and, as one submission pointed out, management should not be involved in implementing gender diversity policies in relation to the composition of the board.

Council additionally proposed that if a listed entity was in the S&P/ASX 300 Index at the commencement of the reporting period, its measurable objective for achieving gender diversity in the composition of its board should be to have not less than 30% of its directors of each gender within a specified period. This proposal received significant support in the consultation feedback, although there were some dissenters.

Supporters of the 30% target for the S&P/ASX 300 noted that skilled and suitably diverse boards make for better governed listed entities; encourage diversity of thought in decision making and best use of talent; and bring different perspectives and ways of thinking about risks, opportunities and strategic issues. Some submissions expressed concern with the lack of progress in achieving gender diversity on boards, particularly among ASX 201-300 listed entities, and noted that targets are becoming increasingly common and are preferable to mandatory quotas. A number of submissions supported the 30% target on the basis of the precedent set by ACSI and AICD's 30% Club.

Notably some stakeholders believed that a 30% target was too low ("not a stretch target") and should be 40% or in one case 50% ("women make up 50.7% of the Australian population").

One respondent did not agree with the application of the target to S&P/ASX 300 entities only and saw it as an arbitrary cut-off. In its view, all listed entities should be encouraged to improve the gender diversity of their boards. It noted that no other recommendation in the *Principles and Recommendations* is directed at a sub-set of listed entities and that it would be desirable as a matter of principle for the *Principles and Recommendations* to apply to all listed entities unless otherwise mandated by the Listing Rules.

One stakeholder argued that the 30% target should apply only to non-executive directors.

Those opposed to the 30% target did so for a range of reasons: the recommendation may breach discrimination laws; the best candidate may not be selected; it could trigger the exit of high-performance incumbent directors; and the target may not be appropriate given the breadth of sectors covered by the S&P/ASX 300. One suggested that the target should be moved to commentary as the stated target is "exhortatory rather than an enduring principle" and would become out-of-date relatively quickly as more entities achieve or exceed the 30% target for female directors.

Council has decided to proceed with the 30% target. In relation to the arguments in dissent, Council notes that recommendation 1.5 has been in operation since 2010 and no-one to date has challenged it as a breach of discrimination laws. There have also been no serious suggestions that it has caused a flight of high performance directors from boards.

On other matters, a number of submissions called for recommendation 1.5 to address other aspects of diversity apart from gender. They pointed to commentary acknowledging the importance of diversity in terms of ethnicity, age, socio-economic background, sexual orientation etc. Another referred to a report[8] that provided the business case for having ethnically diverse teams and the significant under-representation of cultural diversity in senior leadership roles in Australia.

Council did propose in the consultation version of the fourth edition to insert additional commentary to recommendation 1.5 that entities *"have regard to other facets of diversity in addition to gender when considering the composition of the board. In particular, having directors of different ages and ethnicities and from different cultural or socio-economic backgrounds can help bring different perspectives and experiences to bear and avoid "groupthink" in decision making".*

Council received overwhelming support for this guidance from investor and advisory groups and professional bodies, although a number of submissions argued for the commentary to be deleted as it implies a requirement for broad diversity that is impractical and constrained by optimum board size.

Council has decided to retain this as guidance in the commentary to the fourth edition, but with some minor drafting changes so that it now reads that boards of listed entities "*consider*" other facets of diversity instead of "*have regard to*" other facets of diversity. Otherwise, Council considers that the focus for the time being of recommendation 1.5 should remain on gender diversity and that there would likely be practical difficulties in extending the recommendation to cover other facets of diversity.

A small number of submissions suggested that recommendation 1.5 should address gender pay inequality by requiring gender pay audits or the disclosure of gender pay gaps. Noting that the *Principles and Recommendations* apply to approximately 2,300 listed entities of various sizes and circumstances, Council considers that this change would be too prescriptive at this point in time.

3.3. Recommendation 1.6 (board performance reviews)

In the consultation version of the fourth edition, Council proposed changing recommendation 1.6 to require board evaluations to be undertaken annually, rather than "periodically". This was an important issue for, and supported by, investor groups. They argued that it provides increased focus on director accountability, supports board effectiveness and negates the risk of "free riders".

A number of submissions, largely from the director and company secretary community, were not in favour of the change in time frame. These submissions argued that an annual evaluation would be too prescriptive, particularly for smaller entities; was not in line with current practice as most entities phase their evaluation over a three year triennium with a more detailed focus on the different groups (the board, committees and individual directors) each year; and while it is not unusual for a board to review its performance and that of its members each year, entities do not always evaluate their board committees every year given how infrequently some of them meet.

In light of the submissions received, Council has decided to revert to the current wording of recommendation 1.6(a) in the third edition that a listed entity *"have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors"* but has included a suggestion in the commentary that such reviews preferably take place annually.

Council has also reinstated the wording in recommendation 1.6(b) of the third edition with a minor drafting change and amended recommendation 1.7(b) (management performance reviews) to be consistent.

3.4. Principle 2 (structure the board to be effective and add value)

In the consultation version of the fourth edition, Council proposed to amend principle 2 to refer to the board of a listed entity having *"knowledge of the entity and industry in which it operates".* There was considerable support for the intention underpinning the change but the submissions opposing the change took the view that the reworded principle implied that each director should have that knowledge. This would have the effect of precluding the appointment of people with other desirable skills and restrict the pool of suitable director candidates.

That was not Council's intention and so Council has modified principle 2 to refer to the board "*collectively*" having knowledge of the entity and the industry in which it operates.

Principle 2 now reads: *"The board of a listed entity should be of an appropriate size and collectively have the skills, commitment and knowledge of the entity and the industry in which it operates, to enable it to discharge its duties effectively and to add value."*

3.5. Recommendation 2.2 (board skills matrix)

In the consultation version of the fourth edition, Council proposed adding new commentary suggesting that boards give consideration to whether they have the necessary skills to deal with existing and emerging business and governance issues such as those around culture, conduct risk, digital disruption, cyber-security, sustainability and climate change.

8 McKinsey & Co's report found that companies with the most ethnically diverse executive teams (in both absolute representation and also in ethnic mix) are 33 % more likely to outperform their peers on profitability. In addition, there is a penalty for not being ethnically diverse: those in the fourth quartile of ethnic diversity for their executive teams are 29 % more likely to underperform their peers on profitability. McKinsey's findings indicate that the correlation between ethnic diversity and profitability may be even higher than that between gender diversity and profitability.

This was an important point for investor groups, who expect boards to be able to demonstrate these skills.

On the other hand, some submissions argued against the inclusion of such a list of skills as it implied that boards would need to be comprised of subject matter experts, when they should be more concerned with broader strategic issues and could engage specialist executives or outside advisers or consultants to deal with these issues. There were also concerns expressed that any list of emerging business and governance issues would change over time. Some noted that boards are also constrained in acquiring these additional skills given the diversity issues they have to address.

Council was persuaded by these arguments and has instead referred to these risks in the commentary to recommendation 7.2.

3.6. Recommendation 2.3 (director independence)

In the consultation version of the fourth edition, Council proposed a number of changes to recommendation 2.3 and the related commentary. These included:

- Replacing references to "association" with "affiliation", on the basis that the term "association" has a very technical meaning under the Corporations Act. A number of respondents opposed this on the basis that, without a definition, the term "affiliation" is of unclear scope. After further consideration, Council has decided simply to delete all references to "association" as the existing references to "relationships" are sufficiently generic to capture both "associations" and "affiliations".

  Recommendation 2.3 now reads *"if a director has an interest, position or relationship of the type described in Box 2.3..."*

- Extending the example in Box 2.3 regarding a person who has "close family ties with any person who falls within any of the categories described above" to a person who has "*close personal ties*", along with the inclusion of commentary that these ties may be based on "*family, friendship or other social or business connections*".

  A couple of submissions noted that there are practical difficulties in capturing the meaning of "close personal ties" in a policy relating to director independence. Further, it may not be practically possible to obtain such information from the director (and may not in fact be known to the director) given the broad scope of "material business relationships" and there were concerns with the subjectivity associated with what close personal ties mean.

  Council did not agree with these views. It is up to the board of each entity to assess the independence of its directors applying judgment and common sense. Boards should be able to form a view as to whether a particular director has close personal ties to someone that calls into question his or her independence. If they are in doubt, it is appropriate to regard the director as not independent.

- Additional guidance in the commentary to recommendation 2.3 that where a director falls within one or more of the examples in Box 2.3, the board should rule the director not to be independent unless it is clear that the interest, position or relationship in question is not material and will not interfere with the director's capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.

  A greater number of submissions supported this reversal of onus on the basis that the benefits of a narrow definition of director independence far outweigh the risks. Therefore if an interest, position or relationship potentially threatens a director's ability to serve objectively, it is in the best interests of the listed entity and its security holders to presume, absent strong evidence otherwise, that the director's independence is compromised.

  Arguments against the change said that the case has not been made nor evidence provided to justify the reversal of onus. There was an assertion that such a change would give greater paramountcy to the prescriptive criteria in Box 2.3.

  Council has decided to proceed with this change. As noted above, it is up to the board of each entity to assess the independence of its directors applying judgment and common sense.

- A more detailed explanation in the commentary why a director who is or represents a substantial holder should not be considered independent. The handful of submissions that addressed this issue were equally balanced for and against the change.

  Council has decided to proceed with this change and include further clarification that this point also covers professional advisers. The commentary now reads: *"a director who represents, or is or has been within the last three years an officer or employee of, or professional adviser to, a substantial holder is likely to have a bias towards the individual interests of that substantial holder rather than the interests of security holders generally".*

A number of submissions asked for additional guidance on when independence has been compromised by tenure, eg after 9, 10 or 12 years on the board. On balance, Council is comfortable with the way in which this issue is currently addressed in the *Principles and Recommendations* and is not proposing any changes on this score in the fourth edition.

3.7. Principle 3 (instil a culture of acting lawfully, ethically and responsibly)

In the consultation version of the fourth edition, Council proposed changing principle 3 from *"a listed entity should act ethically and responsibly"* to *"a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner".*

There was considerable support from investor groups for this change. Supporters believed that it would meet investor expectations about the need to improve corporate culture and help address the declining trust in business. A number welcomed the insertion of "lawfully" into the principle as it was "clear from recent events" that to act "ethically and responsibly" did not appear to be specific enough to include officers and employees acting lawfully.

A sizable number of submissions disagreed with the change from acting "responsibly" to acting "in a socially responsible manner" on the basis that social responsibility is difficult to define and subject to shifting community expectations. It could also be challenging for entities involved in industries that raise particular social issues, such as gaming, alcohol, tobacco and fast food. Council saw the merit in these arguments and their linkage to the discussion of SLTO and decided not to proceed with this change.

A number of respondents did not agree with the focus on culture: "the Principles and Recommendations should not attempt to prescribe culture" and "the focus of regulation should be on behaviour and not culture". As mentioned previously, Council sees the changes in the fourth edition around culture and values as fundamental and is proceeding with them.

Council has therefore redrafted principle 3 so it now reads *"A listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly."*

3.8. New recommendation 3.1 (values)

In the consultation version of the fourth edition, Council proposed a new recommendation requiring a listed entity to articulate and disclose its core values. This was overwhelmingly supported by, and an important issue for, investor groups. One submission described this as "a critical addition. A governing purpose or objective, being a statement of what the entity is fundamentally trying to achieve, is essential for good corporate governance. If the only goal is to maximise shareholder wealth, there is no guidance on how to assess the entity's decision making in balancing its allocation of resources and consideration of stakeholder interests."

A contrary view was that there is "no empirical evidence to suggest that articulating 'core values' would improve corporate governance and that simply having a statement of core values facilitates tick a box compliance. Believing and living these values cannot be mandated and is not 'regulate-able'".

Council believes that the introduction of this recommendation is fundamental to the changes in the fourth edition regarding culture and values and is proceeding with recommendation 3.1, with a minor drafting change to refer to *"values"* rather than *"core values"*.

3.9. New recommendations 3.3 (whistleblower policy) and 3.4 (anti-bribery and corruption policy)

The new recommendations in the consultation version of the fourth edition to report material whistle blower incidents and material breaches of an entity's anti-bribery and corruption policy to the board were overwhelmingly supported by, and an important issue for, investor groups. One respondent in particular noted that strong whistle blowing protections are important in helping listed entities detect poor culture or business practices before these compromise an organisation.

Dissenters noted the impending law reform in these areas and argued that there should be no duplication in the *Principles and Recommendations* of legislative requirements in case they end up imposing conflicting obligations.

Notably, the Attorney General's Department wrote in support of the inclusion of the anti-bribery and corruption provisions and made the point that proposed recommendation 3.4 would enhance and complement, rather than conflict with, any new anti-bribery legal requirements.

Council considers that the second limb of recommendations 3.3 and 3.4 (ie that the board or a committee of the board is informed of any material incidents reported under the whistleblowing policy or material breaches of the anti-bribery and corruption policy) is fundamental to the board receiving the information it needs to monitor the culture of the organisation. Council is therefore proceeding with these new recommendations, with some minor drafting changes.

3.10. Principle 4 (safeguard the integrity of corporate reports)

In the consultation version of the fourth edition, Council proposed to replace the words *"independently verify and safeguard the integrity of its corporate reporting"* in principle 4 with *"validate the quality and integrity of its corporate reporting"*. Relatively fewer submissions addressed this change but a number that did were concerned with the term "validate". One submission argued that "validity is more about the quality of being logically or factually sound. It is a standard that often implies a scientific rigour that is difficult to apply to general descriptions, future statements or opinions".

Council agreed with these submissions and has redrafted principle 4 so that it now reads: *"A listed entity should have appropriate processes to verify the integrity of its corporate reports".*

3.11. New recommendation 4.3[9] (process to verify integrity of periodic corporate reports)

In the consultation version of the fourth edition, Council proposed a new recommendation 4.4 that: *"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".*

Proposed recommendation 4.4 was overwhelmingly supported by, and an important issue for investor groups. Investor groups believed that disclosure of the process for validating such reports will provide them with greater confidence regarding the quality of these reports.

Stakeholders opposed to this recommendation argued that there are already provisions in the Corporations Act to require that reasonable steps are taken when preparing information being given to the market so as to avoid it being false and misleading in a material respect (ss1308 and 1309).

Other submissions were concerned that the requirement to disclose such processes could expose the entity and others to potential liability in the event of an inadvertent material misstatement and ultimately lead to more assurance being undertaken by the entity's external auditor. This would increase the cost of corporate reporting for the vast majority of entities without, in their view, adding to the quality of reporting. Relatedly, some argued that recommendation 4.4 would act as a disincentive for entities to produce reports which are not legally mandated but are otherwise useful, such as a sustainability report. There were additional concerns about the scope of coverage of "corporate reports"; the practical difficulties in assessing if reports were "understandable"; and that "appropriate information" could mean different things to different people.

More generally, a couple of submissions pointed out that the reference to *"and provide investors with appropriate information to make informed investment decisions"* is also covered in s299A(1) of the Corporations Act. They were concerned that the overlap may create confusion as to what is required, particularly as s299A does not use the phrase "informed investment decisions" but instead refers to "an informed assessment of... the operations of the entity reported on; the financial position of the entity reported on; and the business strategies, and prospects for future financial years, of the entity reported on".

One submission further argued that the phrase "informed investment decisions" imposes fresh obligations beyond existing legislative and ASX Listing Rule requirements and may encourage class action claims.

Lastly, there were also concerns with the drafting of recommendation 4.4, in particular with the use of the term "validate" as this potentially connotes prospectus level processes. Alternative terms suggested included "support" or "verify".

Based on the feedback received, Council has decided to retain recommendation 4.4 (renumbered to be recommendation 4.3 in the fourth edition) but with significant amendments so that it now reads: *"A listed entity should disclose its process to verify the integrity of any periodic corporate report it releases to the market that is not audited or reviewed by an external auditor."*

To provide greater clarity on the scope of this recommendation, "periodic corporate report" has been defined in the glossary to mean *"an entity's annual directors' report, annual and half yearly financial statements, quarterly activity report, quarterly cash flow report, integrated report, sustainability report, or similar periodic report prepared for the benefit of investors".*

3.12. New recommendation 5.2 (copies of announcements to board)

In the consultation version of the fourth edition, Council proposed a new recommendation 5.2 that a listed entity should ensure that its board receives copies of all announcements under listing rule 3.1 promptly after they have been made.

Submissions in support of this new recommendation believed that directors should be fully apprised of all announcements made to the market and approve those of a material nature. This would also promote accountability of the board as a whole.

The fewer number of submissions that did not support the introduction of this recommendation said that this practice is already suggested in ASX Listing Rules Guidance Note 8 and they saw little merit in elevating it to a recommendation.

Council has decided to proceed with this recommendation with a drafting change to remove the reference to listing rule 3.1, so that it now reads: *"A listed entity should ensure that its board receives copies of all material market announcements promptly after they have been made."*

3.13. New recommendation 5.3 (investor and analyst presentations)

In the consultation version of the fourth edition, Council proposed a new recommendation 5.3 that 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.

9 Recommendation 4.4 in the consultation draft.

Submissions in support of this new recommendation were of the view that it is important for making sure that the market is fully informed on an equal basis and therefore particularly important for retail investors. Those who did not agree believed that these practices are already covered in ASX Listing Rules Guidance Note 8 and can be better dealt with in commentary.

Council has decided to proceed with this recommendation, but qualifying it so that it refers to new and substantive presentations. Further commentary has been added recognising that listed entities may give a series of presentations to analysts and investors over a short period that contain materially the same information but have been tailored for each audience. The new commentary clarifies that Council would not regard the second and subsequent presentations in such a series as "new" presentations for these purposes and, provided they do not contain any new market sensitive information, would not expect them to be published on the ASX Market Announcements Platform.

3.14. New recommendation 6.4 (vote by poll rather than show of hands)

In the consultation version of the fourth edition, Council proposed a new recommendation 6.4 that 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.

This proposal was overwhelmingly supported by, and an important issue for, investor groups. Some submitted that this would ensure transparency; preserve the integrity of the voting process as it also takes into account proxy votes; and is particularly important if the outcome of the resolution is expected to be close. Others noted that with improvements in technology, voting by poll is now easy to implement and that the benefits outweigh the costs involved. A few submissions said that voting by poll should be made mandatory.[10]

Those who did not agree said that the new recommendation should only apply to material and contested resolutions and not to procedural resolutions. Others were concerned that it would be onerous for smaller listed entities, given the additional costs associated with voting by poll.

Council decided to proceed with the recommendation on the basis that Australia lags behind other countries on this issue. Further, smaller entities that want to have the flexibility to vote by show of hands can do so with an "if not, why not" explanation.

Council has amended recommendation 6.4 so that it now reads: *"A listed entity should ensure that all substantive resolutions at a meeting of security holders are decided by a poll rather than by a show of hands"*. Council has also added commentary noting that whether a poll is called on a procedural resolution is generally a matter for the chair of the meeting.

3.15. Recommendation 7.4 (environmental and social risks)

In the consultation version of the fourth edition, Council proposed amending recommendation 7.4 to remove the reference to "economic sustainability risk", as the inclusion of this term had been confusing for many listed entities.

This change was supported by the majority of submissions. One respondent who did not agree said that the current wording has market acceptance and is well understood and that all risks should be considered together.

There was considerable support for the additional guidance given in the consultation version on carbon risk and the commentary encouraging entities to consider whether they have a material exposure to climate change risk by reference to the recommendations of the TCFD.

One respondent commented that any guidance on climate risk provided by Council should be aligned to ASIC's so as to avoid confusion.[11]

Council did make some drafting changes to the commentary regarding the TCFD to better align it with the TCFD's recommendations and to take in some suggestions provided by ASIC.

Council has decided it should amend the definition of environmental risk to address a point raised in a number of submissions that the impact of a listed entity on the environment is only one aspect of environmental risk. Another aspect is the impact of the changing environment on the listed entity, eg through climate change, water scarcity and material resource scarcity.

Council has therefore amended the definition of "environmental risk" in the glossary to mean:

"the potential negative consequences (including systemic risks and the risk of consequential regulatory responses) to a listed entity if its activities adversely affect the natural environment or if its activities are adversely affected by changes in the natural environment. This includes the risks associated with the entity polluting or degrading the environment, adding to the carbon levels in the atmosphere, or threatening a region's biodiversity or cultural heritage. It also includes the risks for the entity associated with climate change, reduced air quality and water scarcity."

Similarly, Council has amended the definition of "social risk" in the glossary to mean:

10 This would require a change to the Corporations Act (the Listing Rules can only make this binding for Listing Rule resolutions).

11 Council notes that ASIC has also endorsed the TCFD (see ASIC Report 593).

"the potential negative consequences (including systemic risks and the risk of consequential regulatory responses) to a listed entity if its activities adversely affect human society or if its activities are adversely affected by changes in human society. This includes the risks associated with the entity or its suppliers engaging in modern slavery, aiding human conflict, facilitating crime or corruption, mistreating employees, customers or suppliers, or harming the local community. It also includes the risks for the entity associated with large scale mass migration, pandemics or shortages of food, water or shelter."

3.16. Proposed new recommendation 8.4 (consultancy arrangements)

In the consultation version of the fourth edition, Council proposed a new recommendation that listed entities 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 had 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;
- the remuneration payable under it is reasonable; and

with full disclosure of the material terms to security holders.

Submissions in support of this proposal noted that disclosures of these arrangements would assist with the assessment of related party transactions, conflicts and director independence.

Those not in favour believed that the conflicts addressed in the recommendation are already covered in legislation; that there are very clear laws on related party transactions, conflicts, and disclosure of interests that already require such contracts to be on arm's length terms and that remuneration be reasonable and that severe penalties apply to breaches of those laws.

One submission offered another perspective as to why Council should not proceed with this recommendation – that directors should not be allowed to provide any paid consultancy services as the accompanying remuneration may affect their independence and senior executives likewise as they should not be paid additional remuneration for providing executive level services.

A number of submissions argued that there would be practical problems in obtaining independent advice on consultancy arrangements in the absence of any "bright line" test in any of the three limbs set out in the recommendation. It was noted that a legal opinion alone would not be capable of opining on all three limbs, given the issues may require detailed market and remuneration analysis. There were also concerns that independent advice could be costly, burdensome and result in delays.

Council saw the force of these arguments and has decided not to proceed with this new recommendation.

3.17. Disclosure of key governance policies in full

In the consultation version of the fourth edition, Council proposed changes to the applicable recommendations requiring a listed entity to disclose its diversity and continuous disclosure policies and code of conduct in full, and to remove the ability for a listed entity to disclose only a summary of these policies. The new recommendations around whistleblower and anti-bribery and corruption policies were couched in the same terms.

The option for a listed entity to disclose a summary of its key governance policies rather than the full policy originated when these disclosures had to be included in the entity's annual report. Brevity was therefore a virtue. With the changes made in the third edition of the *Principles and Recommendations* to allow an entity to make its governance disclosures on its website, Council believes it is now much easier for listed entities simply to disclose the full policy on its website and include a link to the relevant webpage, rather than go to the trouble of preparing a summary. Disclosing the full policy also promotes transparency and removes the possibility of an inadvertent omission of material information if only a summary is provided.

To address concerns that policies may contain confidential information, a footnote was added in the consultation draft that an entity may redact from the disclosed copy of its key governance policies personal or confidential information such as the names and contact details of individual staff involved in administering the policy.

A submission received in support of the proposal noted that there is potential for distortion of a policy/code of conduct when a summary is provided. Submissions opposed to the proposal raised confidentiality concerns, ie that these policies frequently contained internal management operational material or commercially sensitive information.

Council has decided to proceed with this change. The ability to redact private staff details should address most of these confidentiality concerns.