

**LAUNCH OF THE 4<sup>TH</sup> EDITION OF THE  
CORPORATE GOVERNANCE PRINCIPLES & RECOMMENDATIONS**

**ADDRESS BY THE CHAIR OF THE ASX CORPORATE GOVERNANCE COUNCIL**

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**27 February 2019**

Ladies and gentlemen, good morning and welcome to the launch of the 4<sup>th</sup> edition of the ASX Corporate Governance Council's *Principles and Recommendations*.

Let me begin by reminding you who is on the Council and provide some context for why the Council decided in May 2017 to commence work on a 4<sup>th</sup> edition of its *Principles and Recommendations*.

The ASX Corporate Governance Council is an independent body that brings together a wide range of business, shareholder and industry groups, each offering their individual insights and perspectives on governance issues. The primary role of the Council is to develop and issue principles-based recommendations on the corporate governance practices to be adopted by ASX listed entities.

The *Principles and Recommendations* derive their force from ASX listing rule 4.10.3, which requires ASX listed entities to benchmark their corporate governance practices against the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why – usually referred to as the 'if not, why not' requirement.

The logos of the 19 Council members are on the screens behind me but in case you can't see them, let me list the 19 members for you:

- Association of Superannuation Funds of Australia
- ASX Limited
- Australasian Investor Relations Association

- Australian Council of Superannuation Investors
- Australian Institute of Company Directors
- Australian Institute of Superannuation Trustees
- Australian Shareholders' Association
- Business Council of Australia
- Chartered Accountants Australia and New Zealand
- CPA Australia
- Financial Services Council
- Financial Services Institute of Australasia
- Governance Institute of Australia
- Group of 100
- Institute of Internal Auditors – Australia
- Institute of Public Accountants
- Law Council of Australia
- Property Council of Australia
- Stockbrokers and Financial Advisers Association Limited

As you can see, the Council is not a group of “left wing activists” or “social engineers” that some of the more histrionic commentators labelled it during the course of the public consultation.

The 19 Council members have unanimously endorsed the 4<sup>th</sup> edition of the *Principles and Recommendations*. It therefore is very much a work of the market, by the market, for the market.

As to the reasons for publishing a 4<sup>th</sup> edition, you may recall that the Council published the 3<sup>rd</sup> edition of the *Principles and Recommendations* in 2014. It was very much focused on the governance learnings from the GFC, particularly in relation to recognising and managing risk. By 2017, however, it was apparent that culture and values were emerging as critical governance issues. We had:

- witnessed a number of incidents where listed entities had engaged in behaviour that fell well short of community expectations;
- the Sedgewick review into banking remuneration;
- the proposal to establish BEAR (the Banking Executive Accountability Regime);
- public pressure for a royal commission to investigate misconduct in the banking, superannuation and financial services industry that ultimately led to the establishment of Hayne Royal Commission; and
- parliamentary reviews looking to reform the laws relating to whistleblowing, foreign bribery and corruption and modern slavery.

Outside of culture and values, there were also calls for changes to boost diversity and a Senate Economics References Committee report calling for more market guidance on the disclosure of carbon risk.

Given these gathering forces, the Council resolved in May 2017 to commence work on a 4<sup>th</sup> edition of the *Principles and Recommendations*. A consultation version of the 4<sup>th</sup> edition was released for public comment in May 2018.

The consultation draft was intended to generate debate and elicit a wide range of views – and it did.

Council received over 100 submissions from a wide variety of interested parties – industry groups, domestic and international institutional investors, listed entities, proxy advisers, government bodies, environmental groups, lawyers, accountants, academics and prominent individuals.

On behalf of the Council, I would like to thank all the organisations and individuals who provided submissions on the consultation draft. The Council reviewed all of them carefully and gave them due deliberation. It found the different perspectives and concerns raised by respondents invaluable in formulating the final version of the 4<sup>th</sup> edition.

The consultation draft also attracted considerable media commentary, not all of it, I might say, fully informed.

Overwhelmingly, the most commented upon and polarising of the issues in the consultation draft was the use of the term “social licence to operate” in parts of the commentary. The Council had used this expression 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 stakeholder groups with which it interacts, something which Commissioner Hayne has recently emphasised in his report.

Almost all investor interest groups, accounting bodies and standards setters strongly supported the concept of “social licence to operate” and the recognition of broader stakeholder accountability. However there were a range of other stakeholders who were troubled by the term “social licence to operate”. They argued it is vague, subjective and elastic. They also pointed out the particular difficulties that it could cause for listed entities legitimately operating in particular sectors that some parts of society are opposed to – such as companies involved in the gaming, alcohol, tobacco, fast food, coal and coal seam gas sectors.

The Council saw the force in these arguments. Consequently, the Council has replaced the references in the commentary to “social licence to operate” with references instead to “reputation” and “standing in the community”. The Council regards these concepts as essentially synonymous with “social licence to operate”, in the sense in which that term was used in the consultation draft. However, this modified terminology is more likely to be better understood and therefore more consistently applied by listed entities, their boards and other stakeholders.

So what is in the 4<sup>th</sup> edition?

I am not proposing today to go through in detail the differences between the consultation draft and the final version. For those of you who would like a more detailed explanation of the changes the Council has made, I would encourage you to read the consultation response that the Council released this morning. Copies of the 4<sup>th</sup> edition and the consultation response are

available on the table by the door. Please feel free to take a copy. Electronic copies of the 4<sup>th</sup> edition and the consultation response are also available on the Council's page on the ASX's website.

Suffice to say, the changes in the 4<sup>th</sup> edition are evolutionary not revolutionary. The 4<sup>th</sup> edition maintains the same flexible, non-mandatory "if not, why not" approach to disclosure as in earlier editions. It also has the same structure – 8 core principles, supporting recommendations, and commentary with guidance on implementing the recommendations.

The 8 core principles are set out on the screen behind me.

The Council is proceeding with all but one of the 9 new recommendations proposed in the consultation draft of the 4<sup>th</sup> 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 3<sup>rd</sup> edition, 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.

As a result of these changes, the 4<sup>th</sup> edition has 35 recommendations of general application, 7 of which are new. It also has 3 recommendations that only apply to a small subset of listed entities, 2 of which are new.

Culture and values were front and centre in the consultation version of the 4<sup>th</sup> edition of the *Principles and Recommendations* and they retain that position in the final version of the 4<sup>th</sup> edition. The Council considers it imperative that listed entities align their culture and values with community expectations to help arrest the loss of trust in business.

Accordingly, the final version includes all of the key changes around culture and values proposed in the consultation draft, with some drafting changes reflecting feedback received in the consultation.

Key in this regard are the changes to principle 3, 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), as well as an addition to recommendation 3.2 (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.

The 4<sup>th</sup> edition also contains additional guidance on the role of board and management in the commentary to recommendation 1.1. The list of usual responsibilities of the board of a listed entity has been expanded to include:

- 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.

Having listened carefully to the consultation feedback, Council has shortened the commentary and made changes to make it clearer that it is guidance and not intended to be prescriptive.

On diversity, as was proposed in the consultation draft, recommendation 1.5 has been expanded 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. It also specifies 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.

As requested by the Senate Economics References Committee, the 4<sup>th</sup> edition contains greater guidance on climate risk. There is now additional commentary in recommendation 7.4 covering the types of risks associated with climate change and encouragement that listed entities assess if they have a material exposure to climate change risk by reference to the recommendations of the Task Force on Climate-related Financial Disclosures.

The last issue I would like to touch on are the transition arrangements for moving from the 3<sup>rd</sup> to the 4<sup>th</sup> edition. A number of submissions raised a concern that listed entities would not have sufficient time to make the necessary changes to their corporate governance frameworks to meet the 1 July 2019 deadline originally proposed in the consultation version.

To address these concerns, the Council has decided to defer the effective date for the 4<sup>th</sup> 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 4<sup>th</sup> 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 4<sup>th</sup> edition starting with the financial year beginning 1 July 2020 and ending 30 June 2021.

As with previous editions, Council would encourage listed entities to early adopt the 4<sup>th</sup> edition if they are able to do so.

That concludes all that I would like to say this morning about the content of the 4<sup>th</sup> edition.

All that remains for me to do is to thank all of the organisations on the Council and their members for the tremendous contribution they have made to the 4<sup>th</sup> edition and to the continuing elevation of corporate governance standards in Australia. In my view the 4<sup>th</sup> edition is a high quality, balanced and sensible document that has benefited enormously from the feedback provided in the consultation process.

I would especially like to acknowledge the hard work of the Council's drafting committee:

- Louise Davidson from ACSI
- Louise Petschler and Christian Gergis from AICD
- Judith Fox and Fiona Balzer from ASA
- Catherine Maxwell from the Governance Institute of Australia
- Quentin Digby from the Law Council, and
- Kevin Lewis and Mavis Tan from ASX

who prepared the consultation draft and then distilled the consultation submissions into the final draft of the 4<sup>th</sup> edition for consideration and debate by the Council.

Ladies and gentlemen, thank you all for attending. I'll now hand over to Kevin to say a few brief words on what the ASX is doing next to help listed entities to transition to the 4<sup>th</sup> edition. Please do stay a while and enjoy some refreshments.