

26 November 2013

Mr Alan Cameron AO  
Chairman  
ASX Corporate Governance Council  
20 Bridge St  
SYDNEY NSW 2000

Dear Mr Cameron

**FSC SUBMISSION – DRAFT THIRD EDITION OF THE CORPORATE GOVERNANCE PRINCIPLES  
AND RECOMMENDATIONS**

Thank you for the opportunity to provide a submission on this paper.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 130 members who are responsible for investing \$2 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to discussing the contents with you. I can be contacted on 02 9299 3022.

Yours sincerely



**ANDREW BRAGG**  
SENIOR POLICY MANAGER



## **INTRODUCTION**

The Financial Services Council welcomes the opportunity to provide feedback on the draft third edition of the Corporate Governance Council's Principles and Recommendations.

FSC's members invest over \$2 trillion dollars on behalf of 11 million Australians. We have been an active member of the Council following its inception and we believe the Principles and Recommendations form a critical component of Australia's corporate governance landscape.

The operation of the Principles and Recommendations through the listing rules provide sufficient strength which is balanced by the effectively self-regulatory nature of the Council. We believe this remains a world-leading model which has continued to evolve with this draft third edition.

Without evolution, this self-regulatory model will come under increased pressure from the many stakeholders with an interest in the governance of Australian listed entities and capital markets generally. There is an increasing interest in capital market structure and policy as our superannuation savings pool increases from \$1.7 trillion today to \$3 trillion by 2020.

Norms, practices and investor expectations have continued to advance, and with this advancement comes the expectation that the Principles and Recommendations should also do so.

It is clear that the Council has adopted a progressive approach in this edition, which as a representative of investors, the FSC strongly supports.

Our comments on the proposed revised principles follow.

### **PRINCIPLE 1 SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT**

Generally these changes are improvements; however we believe there is room for additional detail on the diversity recommendations, in particular, diversity targets and their implications for business performance should be disclosed.

Given the gaps in respect of diversity between the current and desired status, we believe there should be more detailed guidance on how improved performance against diversity targets is being pursued by the entity. This detail should include the governance of the structure of the policy (accountability and outcomes), the business case for gender diversity targets and initiatives and the detail of the initiatives in place to address diversity targets.

## **PRINCIPLE 2 STRUCTURE THE BOARD TO ADD VALUE**

The FSC supports the changes to Principle 2, however we propose that Recommendation 2.5 stipulate that companies should disclose a skills matrix to investors. This would be a document which would already exist within the entity and could easily be disclosed in a simple manner which would not divulge commercially sensitive information.

Disclosure of a skills matrix would enable investors to judge the adequacy of a board (as well as the quality of implementation).

We also believe it would be appropriate for a board to disclose its approach to diversity, in line with our comments under principle 1. Change starts from the top and if a board is not sufficiently diverse, it is less likely the entity (as a whole) will achieve its diversity targets.

In relation to Box 2.1 – the defining characteristics of an independent director, the FSC believes the following are also relevant examples of interests that may cause doubts about the independence of a director and should be included in box 2.1:

- has participated in equity-based remuneration that vests based on performance or continuing service in the capacity of non-executive director;
- has business or other relationships which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

In terms of the text at the bottom of Box 2.1, repeated here for reference:

In each case, the materiality of the interest, position, association or relationship needs to be assessed to determine whether it might interfere, or might reasonably be seen to 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.

The FSC believes the issue of materiality should be removed from this context on the basis that full disclosure of the interest, position, association or relationship to shareholders should be seen as best practice and the emphasis placed on shareholders to judge whether the issue is material or not.

## **PRINCIPLE 3 – PROMOTE ETHICAL AND RESPONSIBLE DECISION-MAKING**

We believe this principle should be reworded to: "A listed entity should actively promote ethical and responsible decision-making and accordingly act ethically and responsibly.

This reflects our desire to emphasise that ethical and responsible decision making go hand in hand with value creation, and when not observed can also lead to significant value destruction over any timeframe. In order to maintain adequate levels of confidence in public companies, ethical and responsible decision-making should not be treated as subordinate to value creation.

We also prefer a stricter expression of recommendation 3.1(b) delete "or a summary of it". In addition, we wish to see the following addition:

*3 (c) disclose the consequences for breaching the code of conduct.*

#### **PRINCIPLE 4 SAFEGUARD INTEGRITY IN FINANCIAL REPORTING**

We are comfortable with principle 4 as proposed.

#### **PRINCIPLE 5 MAKE TIMELY AND BALANCED DISCLOSURE**

The FSC notes that sentiment and other unpredictable factors often drive the price of securities in the short term and note that a reasonable person's expectation of what might impact price / value is not an appropriate test for timely and balanced disclosure.

We therefore do not support confining disclosure obligations to matters that a reasonable person would expect to have a material effect on the price or value of securities. We suggest either retaining the wording of the existing Principle; specifically mentioning long term value; or otherwise referencing the value of the entity instead of the price or value of its securities.

#### **PRINCIPLE 6 RESPECT THE RIGHTS OF SECURITY HOLDERS**

FSC believes that security holders should be entitled to deepen their engagement in investee entities.

We support the expansion of the ability of shareholders to submit to companies for inclusion on the AGM agenda non-binding resolutions. Recently we have seen instances in relation to both climate change disclosure (Woodside Petroleum) and electronic gaming machines (Woolworths), where resolutions which might otherwise had been put to shareholders as non-binding resolutions instead had to be put as constitutional amendments. Aside from requiring a greater portion of shareholders to pass (75% as opposed to a simple majority) constitutional amendments are not the most appropriate medium for achieving change in areas like these.

We do not believe allowing non-binding resolutions could blur the distinction between the role of the board and that of the general meeting, diminish director accountability, or be equivalent to the company being run through 'shareholder plebiscite' because these concerns have not been realised in the introduction of non-binding resolutions related to executive pay.

To the contrary non-binding resolutions in relation to executive pay have proved a valuable tool for shareholders to express concerns over remuneration practices without causing broader unintended consequences for the company (as per a constitutional amendment) and importantly has increased the level and quality of director engagement with shareholders on remuneration practices.

Coupled with changes to threshold tests, particularly in relation to minimum holding periods, broadening the scope for non-binding shareholder resolutions has the potential to provide a new and important tool for shareholder engagement with companies on issues of interest to long term shareholders, particularly as they relate to the long term sustainability of the company. The coupling of these mechanisms could (as part of a broader package of reforms) prevent some of the negative impacts of short-termism identified by the Kay Review in the UK in relation to the in UK equity markets.

Accordingly we would support a recommendation under principle 6 which provided for entities to offer a non-binding shareholder advisory vote.

Further, we believe that recommendation 6.2 or the explanatory notes should be reworded to make clear that communications programs should include both company management and the board and emphasise the importance of two way communication.

## **PRINCIPLE 7 – RECOGNISE AND MANAGE RISK**

We are very supportive of the revised recommendations under principle 7. In particular we believe that proposed recommendation 7.4 now reads represents a progressive step forward in Australian corporate governance. It now reads:

### ***Recommendation 7.4:***

*A listed entity should disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks.*

### ***Commentary***

*How a listed entity conducts its business activities impacts directly on a range of stakeholders, including security holders, employees, customers, suppliers, creditors, consumers, governments and the local communities in which it operates. Whether it does so sustainably can impact in the longer term on society and the environment.*

*Listed entities will be aware of the increasing calls globally for the business community to address matters of economic, environmental and social sustainability<sup>30</sup> and the increasing demand from investors, especially institutional investors, for greater transparency on these matters so that they can properly assess investment risk.<sup>31</sup>*

*Entities that have, or aspire to have, institutional investors on their register should consider making more detailed disclosures about their approach to economic, environmental and social sustainability, including the benchmarks they use to measure performance on issues of sustainability and their achievements against those benchmarks.*

We strongly support the sentiment – but we do believe that recommendation 7.4 or the explanatory notes should be clearer about what is expected from these disclosures. The FSC/ACSI guide of ESG disclosure for listed companies provides a good reference point for this, but ideally we would like to see

- o an explanation of the process for identifying material issues including stakeholder engagement,
- o an explanation of the process(es) for prioritising and integrating sustainability factors (including measuring performance) into the business; and
- o approach to reporting and disclosure

We believe there should be disclosure of the approach to these risks, in order to understand the processes for managing them. This recognises that risk-seeking is legitimate business behaviour, but requires frank disclosure of it so that investors can opt in / out of ownership.

The principles refer to the integrated reporting framework as needing to be ‘much better developed’ before companies should be expected to report to that standard. This understates how much progress has been made with the framework and the FSC believes in the long-term importance of moving towards integrated reporting to more holistically capture corporate performance.

As a result we believe the wording should be changed to state:

The CGC continues to monitor developments in integrated reporting but is not seeking to require a move to integrated reporting at this stage. However, the CGC recognises that the integrated reporting initiative is currently the leading effort in evolving corporate reporting standards and is well supported by a range of standard setting organisations, leading companies

## FSC SUBMISSION

and investors. Consequently the GCC expects that integrated reporting will continue to gain prominence and acceptance.

GCC considers it reasonable for companies to use the integrated reporting framework as a reference document to help them frame their responses to the principles and better prepare for shifts towards integrated reporting in future. This would be particularly relevant for responses to principles four and seven.

As the Principles and Recommendations may not be redrafted for a considerable time, we suggest that companies be encouraged to refer to integrated reporting guiding principles to identify opportunities to evolve current reporting practices toward IR.

### **PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY**

The FSC broadly agrees with the heading of Principle 8, though would like to draw attention to the inclusion of the word “motivate”.

Research indicates that pay in itself is not a “motivator”. The word “motivate” has become linked to incentive pay and it may be inferred from the way Principle 8 is worded that investors prefer listed entities to offer incentive pay.

While the FSC believes there is a role for incentives and other forms of variable pay, the culture of providing incentives to “motivate”, regardless of business, sector, or the specific conditions of a company, has led to increasingly complex remuneration plans, which in themselves have delivered questionable outcomes.

We therefore suggest Principle 8 be reworded to “a listed entity should structure remuneration for executives and directors that supports the long term creation of value. Remuneration should be sufficient and reasonable, paying due regard to generally accepted human capital management principles.”