Law Council
OF AUSTRALIA
Business Law Section

Ms Mavis Tan
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Via email: mavis.tan@asx.com.au

18 November 2013

Dear Ms Tan

Proposed Third Edition of the ASX Corporate Governance Principles and Recommendations and proposed related Listing Rule amendments

Attached is the submission of the Corporations Committee of the Business Law Section of the Law Council of Australia ('the Committee') in response to the proposed Third Edition of the ASX Corporate Governance Principles and Recommendations and proposed related Listing Rule amendments.

The Committee draws your attention in particular to the following:

(a) The relationship between tenure and independence is not straightforward and for the range of reasons explained in our submission, the Committee does not support the introduction of a 9 year period of tenure as an indication that a director may not be independent.

(b) The Committee supports the notion that there should be a Risk Committee, particularly because it can be combined with the Audit Committee.

(c) The Committee is not supportive of the proposed new disclosure requirements in Listing Rule 3.19B relating to on market acquisitions of securities under the terms of director or employee incentive plans. There are a range of reasons for this, including that there does not appear to be any mischief or material concern that this new requirement is intended to remedy, or that would warrant this additional administrative burden and regulation.

(d) For Listing Rule 10.1, the Committee supports the adoption of the section 12, Corporations Act definition rather than the definitions in sections 13 to 17. However, the Committee does not support the inclusion of the last sentence of the proposed definition of "associate" in Listing Rule 19.12, which includes the related parties of directors and officers on a blanket basis. In our view this is likely to be too broad in some cases.

(e) The Committee does not support replacing the term “associate” in Listing Rule 10.14 with the term “related party” because "related party" is too broad. In the Committee’s view the term "associate" should remain but the definitions in sections 13 to 17 should be replaced with the definition in section 12.

If you would like further information, in the first instance please contact either Byron Koster on (02) 8274 9550 or the Committee Chair, Marie McDonald, on (03) 9679 3264.

Yours sincerely,

Frank O’Loughlin

Proposed third edition of the Corporate Governance Principles and Recommendations
Corporations Committee of Business Law Section ('BLS') comments (by exception)

Key proposed changes	Comments
Disclosure in the annual report or on the company website	• Supportive
Director independence – Box 2.1	• The Committee agrees that length of tenure may be relevant in assessing independence but does not support a requirement to report against a specific period of service. • Despite the flexibility afforded by "if not why not", and acknowledging that a non-executive director may still be a board member even if not independent, a requirement to report against a specific period of tenure is likely to result in fewer directors exceeding that period. The benefits longer tenure brings in terms of experience and corporate memory mean that specifying too short a period could be seriously detrimental. Given that, the adoption of a 9 year period by other codes does not provide sufficient justification, without more, for this measure. In addition, there has, in the Committee's view, been no event or development that would justify a change to the approach from that adopted in the First Edition of the Principles and Recommendations. • The relationship between tenure and independence is not straightforward, see for example: Sterling Huang, 'Zombie Boards: Board Tenure and Firm Performance' (2013) INSEAD Business School, 17 http://efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2013-reading/phd/Board%20Tenure%20and%20Firm%20Performance.pdf Sterling Huang states in his article that: "Given that many proposals for governance reform explicitly stress the importance of limiting tenure on the board, this paper shows that board tenure has an inverted U-shaped relation with both firm value and corporate decisions, and that these relations vary across industries and firm characteristics, suggesting that a 'one size fits all' regulation may not be appropriate."

Key proposed changes	Comments
	In addition, while longstanding directors may sometimes develop relationships that reduce their independence, equally, new directors' relative lack of familiarity with the company's history or business may make it difficult to exercise independence effectively. • Tenure needs to be balanced across the entirety of a board, as with skills and experience. For example, it is appropriate to have some longer serving directors with greater corporate memory as well as newer directors bringing fresh ideas and perspectives. (The Council could consider including a reference to "tenure" in the commentary for the proposed Recommendation 2.4 in the context of evaluating the "balance" of skills, experience, independence and knowledge of a board.) • The approach to tenure also needs to recognise that finding suitably qualified new directors may be difficult. • A longer tenure may be appropriate in the case of a Chair, given that a person will typically serve as a director before assuming the role of Chair and it is appropriate to require additional experience for that role. (The Committee notes that several other codes permit this: the UK Code recognises that the test of independence is not appropriate in relation to the Chair after appointment (see fn 5), and the Singapore and Hong Kong codes do not require an independent Chair. • If, despite the Committee's submission, reference to a specified period of tenure is considered necessary, the Committee suggests: o including it in the commentary, rather than in Box 2.1; o acknowledging that a longer tenure may be appropriate for the Chair; and o recognising that the approach to tenure should be considered in the context of average tenure across the board and the need for orderly succession and renewal. • The Committee notes that the inclusion of "close family ties" in Box 2.1 may work against achievement of diversity objectives for the Board (for example, if eligible female candidates are more likely to have spouses/partners in senior positions than male candidates). It may be appropriate to acknowledge that family ties with persons in less material positions should not be permitted to unduly obstruct the achievement of diversity objectives.

Key proposed changes	Comments
	• The Committee supports the absence of a three-year look back in relation to family ties. It would appear, however, that there is an indirect look back in respect of current family ties to those caught by the three-year look back in "the categories described above". The Committee submits that this will be difficult and time consuming to apply and is not appropriate. • The Committee submits that, given the need to report against Box 2.1, several of the new categories are too broadly cast, and will lead to unnecessary expense investigating non-material connections. For example, the Committee suggests: o inserting "material" before all references to "related entities"; and o confining the second new bullet to "substantial" shareholders and "material" professional advisers/consultants. • For completeness, the Committee notes that APRA has adopted the existing Box 2.1 relationships as mandatory (CPS 510 Governance, 510.15), rather than if not why not, and it is reasonable to anticipate that APRA will adopt any amendments to Box 2.1. The standard allows an ADI to consult if there is "doubt about a director's independence" (510.16). There is no specific provision for an exemption as such, although APRA has been willing to allow transitional arrangements. However, without APRA intervention, if tenure is introduced in Box 2.1, this is likely to mean for APRA purposes that a person exceeding the "if not, why not" ASX tenure, will not be independent. Among other things, it means that they cannot be Chair (510.20) – which is contrary to the note above, that a longer tenure may be appropriate in the case of a Chair.
Diversity reporting	• Supportive, however, note that the WGEA reporting is imperfect in some respects. For example, gender pay equity is shown across an organisation as a whole rather than on a like for like role basis. • Also, the Committee understands that WGEA may be amending their form of reporting and developing a uniform definition of "senior executive". It may make sense to harmonise these changes with the proposals by WGEA.
Risk management	• Supportive, particularly, that Risk Committee can be combined with the Audit Committee. Audit and risk are

Key proposed changes	Comments
committee	often hand and glove. • APRA regulated entities are already required to have an Audit Committee that looks after risk management (see Prudential Standard CPS 510). To avoid duplication, such entities should be exempted from compliance with the ASX requirements provided that the APRA prudential requirements are met and disclosed. Alternatively, the ASX requirements should be harmonised as much as possible with the APRA requirements.
"Clawback" policy	• Given the recent change in Federal Government, this should be deferred to see whether the Federal Government decides to regulate for it. • Again APRA entities already have clawback requirements. If the requirements are introduced by the Federal Government, the ASX requirements should be harmonised with the APRA requirements as much as possible.
Flexibility for smaller listed entities	• Generally supportive. • It makes sense that smaller entities are not placed under undue burden. However, there needs to be balance as the general governance practices may not be as strong because of lesser awareness and available resources.
Elevating existing commentary into Recommendations	• Generally supportive. • In relation to recommendation 1.4 concerning the Company Secretary having a direct reporting line to the Chair, this relationship would be better described as one involving direct "access and accountability" (i.e. the Chair can directly access the Company Secretary for advice and the Company Secretary can directly access the Chair to raise governance matters and concerns, and the Company Secretary is accountable to the entirety of the board). • "Reporting lines" typically connote a broader relationship, including taking responsibility for performance reviews, remuneration, career development and welfare. A Chair may well provide feedback into these processes but should not be expected to contribute the considerable time required to be responsible for these matters which are more executive in nature. • These issues are even more profound where a Company Secretary fulfils other executive roles (e.g. general counsel, financial control, risk, compliance etc). • It should also be made clear that a Company Secretary can continue to report to executives in the business,

Proposed Changes to ASX Listing Rules and Guidance Note 9
(By exception only)

Key proposed changes	Comments
New LR 3.19B	The Committee is supportive of the current policy, as restated in the "Purpose of Amendment" section, that LR 10.14 should not apply to securities purchased on-market under the terms of certain director or employee equity schemes. As stated, these are more appropriately regulated under legislation and accounting standards relating to remuneration matters, and they do not involve dilution of existing security holders. (Some additional comments on the proposed changes to LR 10.14 are set out below.) The Committee is not supportive, however, of the proposed new disclosure requirements in LR 3.19B relating to such acquisitions of securities on-market. The key reasons for this submission are: • there does not appear to be any mischief or material concern that this new requirement is intended to remedy, or that would warrant this additional administrative burden and regulation. The Purpose of Amendment section only says that "concerns have been raised", and does not refer to any proper underlying basis for the concern. Further, it does not outline why the information that would need to be disclosed would be particularly useful to investors. For example, if acquisitions are required to be "on-market" in any event, why is the average price for all purchases (which would reflect publicly available market prices) useful? • the acquisitions would not dilute existing shareholders, and they would not affect the issued share capital (unlike new share issues). • in respect of directors and their notifiable interests, any increase in their shareholding already has to be notified

Key proposed changes	Comments
	within 5 business days under LR 3.19A/Appendix 3Y. • the disclosure of matters relating to remuneration is the subject of the Corporations Act, including in relation to the content of the Remuneration Report, the non-binding advisory vote and the ASX Corporate Governance Council recommendations. This area has already been through extensive review and consultation processes in recent years. • the matter of the cost to the listed entity of acquiring those shares should be a matter for accounting standards and remuneration disclosure. • insider trading and market manipulation laws already apply, and have potentially very serious consequences if breached - presumably the proposed new rule is not intended to augment that regulation. Further, securities trading policies as they affect directors and employees are already required to be published on ASX and (in the case of directors) they already have to disclose if a trade occurred in a closed period. If the ASX nevertheless wishes to introduce such a requirement: • if the concerns that have been raised primarily relate to directors, why would it be necessary to disclose the aggregate information for all directors and employees under proposed LRs 3.19B.1 and 3.19B.2? Further, sometimes securities are acquired as part of an unallocated pool in a separate employee share trust, and it is not known at that time if they will ultimately be allocated to a director - that would not be known until the relevant options or rights vest and are exercised (after which the Appendix 3Y and the remuneration report would provide disclosure); and • why would it be necessary to disclose this information within 5 business days after each purchase? Some companies might do a significant number of small trades, and the disclosure after each purchase would be less meaningful than aggregate information in relation to (say) each half year. Perhaps it could be a disclosure in connection with half year and full year results announcements in respect of the preceding half year period.

Key proposed changes	Comments
Amendment to LR 10.14	• Supportive of removing the ss13-17 definition of "associate". However the reference to "related parties" is too broad. For example, it is not clear to the Committee why an adult independent child of a director (or their spouse) who is employed by the company should be denied the opportunity to receive (without shareholder approval) a general grant of shares to employees on the same terms as all other staff. Instead the Committee would support the s12 definition of associate in LR 10.14.2 (see below). • The exception to LR10.14 should be further clarified so that it not only applies to securities purchased on market but also to the issue of securities (such as performance rights and options) which will, in accordance with the terms of the scheme, be satisfied by the transfer of securities that were purchased on market.
Amendments to LR10.1, LR 14.11 and Associate definition	• Supportive of the definition of "associate" adopting the s12 definition rather than the ss13-17 definition. (The Committee submits that the second sentence should preferably, begin "Section 12 is to be applied as if the ASX Listing Rules were listed in paragraph 12(1)(a) and on the basis…", or alternatively refer to "Chapter 6, 6A, 6B or 6C".) • The Committee does not support inclusion of the last sentence of the proposed definition of "associate" in LR19.12, which includes related parties of directors and officers on a blanket basis. This is likely to be too broad in some cases at least, potentially creating requirements that (1) are unacceptably onerous to satisfy (2) result in unnecessary uncertainty as to satisfaction/validity or (3) are likely to operate unfairly eg by unnecessarily restricting transactions that are not in fact objectionable. Any global amendment of this nature would require a detailed analysis of its impact in each rule. • For example, votes cast on a resolution to approve the issue of securities to a Managing Director for the purpose of LR 10.14 would need to be disregarded if cast by entities controlled by a de facto spouse of a child/parent of a non-executive director where the non-executive director is eligible to participate in an employee incentive scheme of the entity (see LR 14.11.1). The Committee queries whether this is necessary in circumstances where those entities are not otherwise associates of the director (which means there is no relevant agreement or acting in concert). More importantly, the Committee queries whether any benefit obtained by extending the definition in this way justifies the difficulty and cost of investigating all potential "related parties" of directors.

Key proposed changes	Comments
	• In addition, by including "related parties", the Listing Rules would go further, in some respects, than analogous Corporations Act restrictions (eg s200E(2A)). • The Committee submits that ASX should, instead: (a) delete the last sentence of the proposed definition of "associate" in LR19.12; (b) if necessary, include a specific narrow extension, in addition to associates, in particular rules (or specified items of the table in LR 14.11.1) but only where that is justified and not unduly onerous; and (c) if necessary, add other less onerous "anti-avoidance" provisions where appropriate eg power for ASX to deem that a person should be treated as an associate (or should not be permitted to vote). • An example of a rule where inclusion of related parties may be less problematic is LR10.16, since in the case of that rule there are not likely to be many potential underwriters and accordingly ascertaining their related parties should not be unduly onerous. However, even in that case, the Committee does not see any policy justification for the change (particularly if the amended associate definition is applied) and so do not support it.