AustralianSuper

An Industry SuperFund

27/07/2018

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Dear Ms. Tan,

RE: AUSTRALIANSUPER SUBMISSION TO THE ASX CORPORATE GOVERNANCE COUNCIL CONSULTATION ON THE REVIEW OF ITS CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS

AustralianSuper welcomes the opportunity to make a submission to the above consultation. We acknowledge the genuine attempt by the Council to move Australian Corporate Governance standards forward on many important but complex issues, such as culture and values. These are issues which we believe can impact on long term business sustainability and value creation and which are therefore important to AustralianSuper as a long-term investor. We believe the proposed fourth edition provides a leading corporate governance standard for Australian listed companies.

About AustralianSuper

AustralianSuper is Australia's largest single superannuation fund and is run only to benefit members. The fund has over 2.2 million members and manages over $130 billion of members' assets. This includes over $30 billion invested in Australian listed equities and as such, we have a strong interest in the maintenance and improvement of corporate governance standards and practices of ASX-listed companies to improve investment outcomes for our members.

Key Points

This submission confirms AustralianSuper's general support of the proposed new recommendations and amendments to current principles, commentary and recommendations as outlined in the above-named consultation paper.

The following key points highlight the instances in which AustralianSuper strongly supports a particular proposal or believes an adjustment to a proposal should be made. The body of the submission further articulates our rationale for these positions.

<u>Diversity</u>

- *Substantial change to Recommendation 1.5*: AustralianSuper agrees with the proposed requirement that ASX 300 companies set a measurable objective to

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have a minimum 30% of directors of each gender on their boards. We also support the Council's encouragement that organisations develop measurable gender diversity objectives for their senior management and general workforce. We believe these changes will support AustralianSuper's efforts, such as our single gender voting policy for ASX 200 companies, to encourage greater board gender diversity which we see as essential to effective corporate governance.

Board Operation

- *Amendments to Recommendations 1.6:* AustralianSuper strongly agrees with the annual timeframes proposed for Recommendation 1.6.
- *Amendments to Principle 2:* AustralianSuper believes that having directors with knowledge of the entity and the industry in which it operates is essential for effective governance and thus supports amendments to Principle 2.
- *Amendments to Recommendation 2.2:* Given the current inconsistent disclosures in board skills matrices of ASX-listed companies, AustralianSuper supports greater guidance on what should be included in a board skills matrix. Further, we provide guidance on the most useful format of board skills matrices from an investor perspective.
- *Amendments to Recommendation 2.3*: Recommendation 2.3 should be adjusted to ensure that remuneration clauses used to define independence stipulate that directors remunerated with options may still be considered independent where those options have no performance hurdles attached.
- *Amendments to Recommendation 2.6:* We welcome the amendments to Recommendation 2.6 regarding director induction and training as a means to achieve greater effectiveness from newly appointed directors sooner.

Core Values of an Entity

- *Substantial changes to Principle 3 and New Recommendations 3.1 and 3.3:* AustralianSuper strongly supports the proposed amendments to Principle 3 and the introduction of new Recommendations 3.1 and 3.3. We welcome the increased focus these bring in relation to how listed companies manage and provide disclosure on their core values which we see as fundamental to long-term business sustainability and investment value creation.

Poll Voting

- *New Recommendation 6.4:* As an actively voting shareholder, AustralianSuper strongly supports the proposal that all shareholder resolutions are decided by a poll rather than a show of hands.

Environment and Social Risk

- *Amendments to Recommendation 7.4:* Company disclosures on the management of environmental and social risks is foundational to our work to integrate environmental and social considerations into investment decisions. Therefore we strongly support amendments to this recommendation which aim

to improve the breadth and depth of those disclosures. Further, we consider the TCFD as the leading climate disclosure framework and therefore endorse the Council's inclusion of the reference to the TCFD framework.

Remuneration

- *Amendments to Principle 8 commentary and Recommendation 8.2:* Commentary regarding the time frames that an organisation should consider when setting remuneration should be amended to emphasise the long term. Further, the suggestion that listed entities should benchmark remuneration against peers to verify that remuneration is not excessive should be accompanied by commentary that this is only one aspect in assessing appropriate pay quantum and cautions that an overreliance on benchmarking can lead to escalating pay outcomes.

Rationale and commentary to support key points

Diversity

Substantial change to Recommendation 1.5

AustralianSuper believes that gender diversity at board level is essential to effective corporate governance. Further, we believe that gender diversity on boards, in workforces and management has the potential to impact long-term value and the investment outcomes of our members.

To support these beliefs, and encourage gender diversity at board level, we introduced AustralianSuper's Single Gender Voting Policy in January 2017 in which we made a commitment to vote against the most senior director up for re-election at ASX 200 companies which had single gender boards. In 2018, we have extended this policy to cover ASX 300 companies. As such, AustralianSuper agrees with the proposed change to Recommendation 1.5, that entities in the ASX 300 set a measurable objective to have a minimum 30% of directors of each gender on their boards by a specific date. Further, we believe that this change will support the current industry-wide efforts underway to improve gender diversity at ASX 300 boards.

We also strongly support the Council's inclusion of changes to Recommendation 1.5 which encourage the development of measurable gender diversity objectives targeted at achieving gender diversity in the composition of a company's senior management and workforce. In particular, disclosing outcomes and actions taken as a result of gender benchmarking will help investors understand the extent to which companies are committed to diversity.

Board Operation

Amendments Recommendation 1.6

AustralianSuper strongly agrees that companies should evaluate board performance annually. In addition, we believe that the Council could consider extending this

recommendation in the future to seek that a company articulates how it incorporates results of board evaluations. This would help investors better understand how evaluations are undertaken and the responsiveness of companies to action the results. We believe good examples of how to encourage boards to disclose insights from board performance evaluation can be found in both the UK and France's revised Corporate Governance Codes.

Amendment to Principle 2

AustralianSuper believes that having directors with knowledge of the entity and the industry in which it operates is essential for effective governance. There are instances in which ASX-listed companies lack industry-specific knowledge on their boards and AustralianSuper seeks to engage with companies in such instances to address these skills gaps. We believe that the amendment to Principle 2 supports our engagement efforts to ensure that industry-specific knowledge forms a core part of the composition of all ASX-listed company boards.

Amendments to Recommendation 2.2

Board skills matrices are an increasingly important tool in our assessment of appropriate board composition and performance. In our experience, there is a lack of consistency and comparability of board skills matrices across ASX-listed companies. Further, many companies are open to improving their board skills disclosures but may be unsure how to do so. Therefore, AustralianSuper welcomes the Council's attempt to provide greater guidance on what should be included in a board skills matrix.

We note that the Council states there is no prescribed format for a board skills matrix. However from an investment perspective, we believe that the most useful format for a board skills matrix is one which:

i) Identifies relevant skills;
ii) Clearly articulates the board's definition of each identified skill;
iii) Identifies the presence or absence of that particular skill on a director by director basis and,
iv) Discloses the criteria a director must meet to be considered to have that skill.

In addition, as a long-term investor we are concerned about new and emerging issues that companies will need to manage for business sustainability, maintaining a social licence to operate and long-term value creation. Therefore we strongly agree with the Council that it is important and appropriate for a board to regularly review its skills matrix to make sure it covers the skills needed to address existing and emerging business, governance and other issues relating to a company's social licence to operate, and to include these in the board skills matrix.

Amendments Recommendation 2.3

AustralianSuper notes that the Council identified a number of factors relevant to assessing the independence of a director in Box 2.3 and suggests, with some

caveats, that where a director falls into one of the examples, the board should consider that the director is *not* to be independent. We believe that the wording in Box 2.3 as it relates to performance-based remuneration, should be amended to specify that where a director receives options without a performance hurdle, that this is an insufficient basis to deem that director is not independent. We note that many smaller ASX-listed companies opt to remunerate their directors with options without an exercise price for justifiable reasons. To ensure alignment with shareholders, we typically expect directors to hold company stock and we therefore believe that being remunerated with zero-exercise price options should not be considered to impact a director's independence.

Amendment to Recommendation 2.6

We welcome the amendment to Recommendation 2.6 and agree that a listed entity should have both a program for inducting new directors and have a periodic review of the need for existing directors to undertake additional professional development. In our engagements with ASX-listed companies, it is common to hear that it takes a period of time for new directors to become fully effective in their new role. Therefore any recommendation to help directors become more effective in their roles sooner, is positive for shareholders.

Core Values of an Entity

Substantial changes to Principle 3

AustralianSuper believes that a foundation of business sustainability and long-term value is an entity's core values and the manner in which these are instilled and reinforced throughout the operation of the organisation. As such, we strongly support the substantial changes to the language of Principle 3; the proposed language shifts focus from the idea that an organisation should act ethically and responsibly, to the idea that culture underpins the extent to which an organisation behaves ethically and responsibly. Thus we agree that instilling culture, and reinforcing culture across an organisation, is key to an organisation acting lawfully, ethically and in a socially responsible manner.

Further, we believe the erosion of an organisation's social licence to operate poses a significant investment risk. Therefore, we strongly support the Council's focus on the concept of a social licence to operate which we believe has been neglected by some companies.

New Recommendation 3.1 and amendment to Recommendation 1.1

In reference to our support for the changes to Principle 3, we believe that the proposals to introduce Recommendation 3.1 and amend Recommendation 1.1 are necessary practical actions for an organisation to achieve Principle 3. Further, as a long-term investor, an organisation's management of values and culture is a key investment risk for AustralianSuper. Therefore, the disclosure of core values is important information for us as an investor.

New Recommendation 3.3

Similar to the disclosure of core values, the disclosure of an organisation's whistle-blower policy can be a relevant consideration when assessing investment risk. Although we recognise that the culture of an organisation can have a material effect on value, it is often difficult for investors to judge the culture of an organisation. A whistle-blower policy can provide insight as to how an organisation instils and reinforces its core values. Therefore we strongly support the introduction of Recommendation of 3.3.

Poll Voting

New Recommendation 6.4

AustralianSuper actively exercises the rights and responsibilities of being a shareholder. The objective of our stewardship activities is to effectively communicate our long-term investment interests to improve returns for our members. Voting is one of our core stewardship activities and we believe in the fairness of a system of one share, one vote. 'Show of hands' voting arrangements pose a risk to the efficacy of this system being an imprecise and inaccurate mechanism to capture the views of shareholders. As such, we strongly support the introduction of Recommendation 6.4 that an organisation should ensure that all resolutions at a meeting of security holders are decided by a poll rather than by a show of hands. We also believe that poll voting should be elevated to a mandatory regulatory requirement.

Environmental and Social Risk

Amendments Recommendation 7.4

AustralianSuper believes that environmental, social and governance factors can affect the value of investments. Company disclosures on the management of environmental and social risks is a foundation to our work to integrate environmental and social considerations into investment decisions. Therefore we strongly support amendments to Recommendation 7.4 which aim to improve the breadth and depth of those disclosures. In particular, we welcome the suggestion that entities that believe they do not have any material exposure to environmental and social risks, should carefully consider their basis for that belief. We believe all companies are exposed to some material environmental and/or social risks and therefore any organisation which considers that it does not have such exposures should be asked to assess the veracity of that belief.

Further, AustralianSuper welcomes the inclusion of the reference to the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) framework. We consider the TCFD as the leading framework for organisations to consider the materiality of climate risk to their operations and to disclose the management of such risks to investors.

Remuneration

Amendments to Principle 8 commentary and Recommendation 8.2

In our observation from assessing ASX-listed company remuneration reports, developing long-term objectives and remuneration plans which sufficiently link to these objectives, is a difficult and potentially the least well established aspect of typical remuneration structures. We also note the recent trend of many ASX-listed companies to move away from specific long-term incentive elements into a 'combined' variable pay structure which we believe risks losing focus on the long-term in remuneration structures. As a result, we believe that amendments to Principle 8 and Recommendation 8.2 should be adjusted to emphasise the long-term aspect of remuneration.

We also appreciate the concept of excessive remuneration quantum being covered in the proposed amendments to Principle 8 and accompanying recommendations. However, while we agree with the Council that peer benchmarking can be used as a proxy for excessive remuneration, we recommend that the Council caution against an overreliance on benchmarking. Indeed, peer benchmarking itself can lead to escalating remuneration and/or pay that may still be too high, albeit in line with peers. Therefore it should be considered as only one aspect of what constitutes reasonable pay quantum. We believe this should be made clear as part of the amendments to Principle 8 and associated recommendations.

If you have any questions of us or would like further information please do not hesitate to contact Claire Heeps on 03 8648 3848 or cheeps@australiansuper.com in the first instance.

Yours sincerely

Andrew Gray
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