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ASIC

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Dear Mavis

**Review of the ASX Corporate Governance Council's Principles and Recommendations  
– Submissions of ASIC**

Thank you for the opportunity to comment on the consultation draft of the fourth edition of the ASX Corporate Governance Council's *Principles and Recommendations* (**Principles and Recommendations**).

The Australian Securities and Investments Commission (ASIC) provides the following comments and would like to suggest an alternative model for reporting under the Principles and Recommendations for consideration.

**Improving standards of governance in Australia and the effectiveness of the Principles and Recommendations**

With this consultation it is timely to consider possible changes to disclosures made under, and the behaviours driven by, the Principles and Recommendations.

ASIC's view is that any set of corporate governance principles or standards should meet the primary purposes of:

- (a) providing investors with clear disclosure of the actual corporate governance practices of an entity; and
- (b) encouraging improvements in those practices.

The following suggestions are aimed at enhancing the ability of the Principles and Recommendations to meet these purposes.

### **Current structure may encourage ‘boilerplate’ disclosure**

ASIC is concerned that corporate governance statements in Australia sometimes lack transparency and do not adequately reflect the actual corporate governance practices of entities. In large part this is because ASX Listing Rule 4.10.3 only requires reporting against the Recommendations, and these are drafted in a way that means that entities are often only required to disclose the *existence* of a governance policy or framework rather than *how* an entity implements that policy or framework. This may lead to inadequate and largely meaningless disclosure – the existence of a policy does not necessarily mean that the policy is being implemented. This can also lead to the corporate governance statement comprising largely ‘boilerplate’ disclosure which is unlikely to change from year to year.

For example, the proposed:

- Recommendation 3.2 states that an entity should have and disclose a code of conduct and ensure the board is informed of certain material breaches of the code. However, it does not specifically require reporting on how compliance with the code is monitored, whether material breaches were drawn to the attention of the board in a particular year and what, if any, action was taken to address those breaches. In other words, it does not require reporting on how the code is implemented in practice.
- Recommendation 5.1 states that a listed entity should have and disclose a written policy for complying with its continuous disclosure obligations. However, it similarly does not require entities to disclose how the entity complies with the policy and whether the policy is effective.

Unless the Principles and Recommendations require entities to set out how a particular policy or framework is applied in practice, there remains a risk that entities will simply state that they comply with the Principles and Recommendations, without actually providing the market with meaningful disclosure on the substance of its governance practices.

Boilerplate and ‘tick the box’ approaches to corporate governance disclosure detract from the objectives of driving improvements in practices or even of setting an effective baseline standard of governance for larger listed entities.

### **Example: Commonwealth Bank of Australia (CBA)**

CBA's 2017 Corporate Governance Statement states that CBA "has followed the recommendations set out in the third edition of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations".

However, the April 2018 report by APRA after its prudential inquiry into CBA revealed significant shortcomings in CBA's governance, particularly in relation to the management of non-financial risk.

In this example, although CBA's Corporate Governance Statement stated that it followed the Principles and Recommendations, this description did not provide sufficient transparency regarding the actual practices of CBA as identified in the APRA report. It illustrates the risk of a 'form over substance' approach that entities may take to the Principles and Recommendations, limiting their effectiveness.

The Principles and Recommendations could be more effective if they encouraged more transparent and practical reporting, which follows a process of objective analysis. This would also significantly improve the value of disclosures made by the listed community, which ASIC would expect to have a follow-on impact on tangible governance practices adopted by entities.

### **Suggested alternative disclosure model for consideration**

ASIC suggests that the following alternative manner of disclosing against the Principles and Recommendations, which would provide investors with disclosure about the effectiveness of an entity's actual governance practices without increasing the length of disclosures that need to be provided to investors on an annual basis.

This model involves the presentation of material to be disclosed under the Principles and Recommendations in two separate places:

- 1. Standalone document describing corporate governance framework** – this document would include information that would not necessarily change or need to be updated on an annual basis in one separate standalone document which is readily accessible by investors in a central place (for example on the entity's website). A reference or link to this document could be included in the entity's corporate governance statement.

We expect that this document would include many of the disclosures that are currently provided to evidence compliance with the Principles and Recommendations – for example, whether an entity has a policy or framework in place and a summary of that policy or framework. It should not simply contain links to relevant codes or policies set out in disparate places on a website. It should provide investors with a readily accessible overview of an entity's governance framework.

It is important for investors to have access to this information as it provides them with insight into the entity's corporate governance framework. However, given the often static nature of this information, we do not expect that it needs to be replicated in full in the disclosure provided to investors on an annual basis. In fact, its inclusion could add unnecessary length to the disclosure and detract from an entity providing information regarding how its corporate governance framework has been implemented over the past year. The corporate governance statement or annual report would then be able to focus on what the entity has done in practice in any given year.

- 2. Annual statement describing implementation of corporate governance framework –** this statement would describe how these policies or frameworks described in the standalone document above are being implemented and how they actually were implemented over the last year. The frequency and location of this disclosure would be no different to the requirements regarding the Principles and Recommendations at present (so these disclosures would be made annually and likely be made in the corporate governance statement or annual report).

This disclosure would provide investors with an insight into the effectiveness of the corporate governance framework. The removal of the material regarding the actual content of the framework from the corporate governance statement or annual report would ensure that entities would be required to analyse the way the framework had been implemented over the year, so they could provide this disclosure.

In preparing this disclosure, entities could be guided by the commentary to the Principles and Recommendations which contains references to actual governance practices and their effectiveness. Entities could have reference to those matters in the commentary that are relevant to them in preparing this disclosure on implementation and where relevant include references to the person or group within the entity who has particular responsibility for that function.

ASIC is not proposing prescriptive disclosure against every matter mentioned in the commentary, but rather suggesting that the commentary should be considered as a prompt to entities when considering disclosure of their actual practices. It may be that the entity needs to refer to matters outside of the commentary to clearly illustrate the implementation of a particular framework.

For example, in relation to the disclosures under proposed Recommendation 3.2 regarding the code of conduct referred to above, the disclosure about whether the company has a code of conduct and what it says could form part of the standalone document. The information that could be provided to investors on an annual basis would be how compliance with the code was implemented and monitored during the year,

whether there were any material breaches, whether these were brought to the attention of the board, and what was done to address the breaches.

### **Monitoring disclosures**

For the Principles and Recommendations to be effective, ASIC considers that there needs to be active monitoring and assessment by the ASX of disclosures made under the Principles and Recommendations. This should help to increase the effectiveness of the Principles and Recommendations by identifying where companies may be simply providing boilerplate disclosures which do not accurately reflect their current governance practices. If alternative model above is adopted, this monitoring could identify where entities are not providing an adequate level of reporting on their actual governance practices (and instead either referring to or repeating the information that would otherwise form part of the standalone document).

Active monitoring of corporate governance disclosure is in line with practices in peer markets<sup>1</sup>.

### **Application of Principles and Recommendations to larger listed entities**

ASIC is also of the view that the Principles and Recommendations could perform the additional function of setting a minimum level of corporate governance practices that should be adopted by larger listed entities. This expectation is consistent with the degree of attention given to recent governance failures by these entities highlighted by the Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry and APRA's inquiry into CBA and the need for larger listed entities to be held to a higher standard of conduct.

To improve corporate governance standards, we encourage the Council to consider whether some or all of the Principles and Recommendations should be mandatory for larger listed entities. It may be that this is facilitated by elevating particular recommendations into the ASX's Listing Rules (as was the case with share trading policies which are now in Listing Rules 12.9-12.11).

Larger listed entities are already subject to higher expectations in terms of corporate governance in the Listing Rules, with Listing Rules 12.7 and 12.8 imposing higher standards on ASX 300 entities with respect to audit and remuneration committees.

ASIC suggests the ASX Corporate Governance Council might include strong encouragement of compliance with all the Principles and Recommendations by larger listed entities (say

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<sup>1</sup> The 2017 OECD Corporate Governance Factbook notes that 28 of 46 jurisdictions have established a formal mechanism to periodically analyse and report on how listed firms disclose matters relating to corporate governance codes and whether they provide adequate explanations for non-compliance.

within the ASX 200) and for the disclosures made by these entities to be monitored accordingly.

### **Further comments in response to the consultation**

ASIC's submissions in this letter have focussed on a proposed alternative model for disclosure. Should the ASX Corporate Governance Council be minded to nevertheless retain the existing framework, we would be happy to provide further submissions in response to the specific questions set out in the consultation paper and in relation to specific Recommendations. Please contact us if that is the case.

### **Conclusion**

The Principles and Recommendations should represent 'best practice' and facilitate transparency of the actual governance practices of listed entities. They should be drafted and administered in a manner which aims to raise and maintain the standards of governance within listed entities. For larger listed entities, compliance with the standards should be generally seen as the minimum standard of governance.

ASIC suggests that a system with less emphasis on formal disclosure of policies and more on how governance is implemented with appropriate monitoring is worthy of serious consideration.

Such an approach would reinforce Australia's reputation internationally as a jurisdiction that is well regulated with strong corporate governance.

### **Further information**

If you would like to discuss any of ASIC's comments further, please contact Suneeta Sidhu on (02) 9911 2327.

Thank you again for the opportunity to comment on the consultation draft of the Principles and Recommendations.

Yours sincerely



John Price  
Commissioner