Governance Institute of Australia

5 May 2014

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Dear Kerrie

Draft ICGN Global Governance Principles

Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members are all involved in governance, corporate administration and company secretarial within their organisations. They deal on a day-to-day basis with the Australian Securities Exchange (ASX), have primary responsibility for communicating with regulators such as the Australian Securities Investments Commission (ASIC) and have a thorough working knowledge of the operations of the markets, the needs of investors and the listing rules, as well as compliance with the corporations law. Our Members also hold primary responsibility within listed companies for developing governance policies and supporting the board on all governance matters.

Governance Institute of Australia (Governance Institute) welcomes the opportunity to comment on the Draft ICGN Global Governance Principles (Draft Principles) and draws upon the experience of our Members in providing our response.

General comments

There is a preponderance of governance guidelines issued by multiple parties, including intermediaries acting collectively on behalf of asset owners as well as individual asset owners, fund managers, proxy advisers and shareholder groups. We also note that at present the Organization for Economic Co-operation and Development (OECD) is revising its corporate governance principles. While there can be commonality in some areas between these multiple guidelines, they can conflict at times. The approach can also at times be prescriptive.

In Australia, the primary governance document is the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles and Recommendations). The key principle underpinning the guidelines is the 'if not, why not' model. This model is that governance cannot be a 'one-size-fits-all' approach and that if an entity considers a Recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it —- a flexibility tempered by the requirement to explain why. That is, this model provides for other approaches, subject to explanation.

A similar approach is taken in the United Kingdom with the 'comply or explain' model.

The last decade has shown that the approach taken by Council in the Principles and Recommendations is key to the success of the guidelines in being adopted by listed entities as the primary document. The Principles and Recommendations have played a vital role in improving corporate governance in Australian listed companies since the release of the first edition in 2003. Their history is one of practical statements on governance which have brought meaningful change to governance practice.

We recognise that an effort has been made in the Draft Principles to clarify that listed entities have the flexibility to explain why divergence from the ICGN Principles is in the best interests of the company and its shareholders. The Preamble currently states that:

> National codes should reflect local standards and companies and investors are encouraged to explain divergence from the ICGN's Principles against this framework. Members of the ICGN support the flexible application of these standards (comply or explain), and the Principles should be applied in a way that recognises the specific circumstances of individual companies, investors and the market within which they operate.

Notwithstanding this statement, Governance Institute members note that the Draft Principles use the word 'should' throughout, which is prescriptive language. We are of the view that the statement in the Preamble is insufficient to confirm that those using the ICGN Principles to assess governance practices and frameworks in listed entities will not 'mark down' those listed entities that have practices other than those set out in the Draft Principles. We recommend that greater emphasis should be placed on the flexible application of these principles, to avoid any misunderstanding that they are prescriptive in nature.

We also note that, without reference to definitions, which were not included with the draft Principles, it is very difficult to provide comment in some areas, as assumptions as to meaning and interpretations by respondents could differ from what is intended by ICGN.

Another matter is that the Draft Principles have a very strong UK-focus. This is not appropriate for a set of Principles which are meant to apply globally. We recommend that the UK-specific Principles should be modified to ensure that the ICGN Principles accommodate market practices different from those operating in the United Kingdom.

Finally, we note that we seek to provide feedback to ICGN on various ICGN guidance as part of our mission to promote and apply the practice of governance to drive responsible performance for the benefit of organisations and the wider community. To this end, we would in turn appreciate feedback from ICGN on the exposure draft of *Guidelines: Improving engagement between ASX-listed entities and their institutional investors*, which was provided to ICGN at the end of February as part of the public consultation.

We provide detailed comment on the Draft Principles on the following pages.

Yours sincerely

Tim Sheehy
Chief Executive

Section A: Board members

1 Responsibilities

1.2
We note that a definitional issue arises in 1.2 (p 4), which states that 'Board members are collectively responsible for promoting the success of the company and, in fulfilling their role effectively,…'. Without access to definitions, the current wording is ambiguous, as 'promoting' could refer to advertising, which is inappropriate in relation to board oversight.

We also note that the emphasis on the success of the company does not accommodate the reality that, in any organisation, there can be failures along the way, as not every undertaking or activity will automatically result in success. Good risk management practices can not only help to protect established value, they can assist in identifying and capitalising on opportunities to create value, but there is uncertainty attached to capitalising on opportunities.

We are of the view that the list of role responsibilities set out in 1.2 needs to include reference to oversight of the safety of employees, which is currently not mentioned.

We recommend that 1.2(i) would be better worded as also referring to the board's role in appointing and, if necessary, removing the chief executive officer (CEO), which is one of the board's main responsibilities. While we acknowledge that 'executive directors' could include the CEO, without access to definitions it is not possible to confirm if this is so.

1.3
The reference to 'guidance relating to compliance with fair disclosure …' is relevant to the United Kingdom, but not to other jurisdictions, including Australia. In Australia there is a continuous disclosure regime in place.

We recommend that the word 'fair' be deleted before the word 'disclosure', to remove the reference to a specific UK disclosure practice.

2 Leadership and independence

2.6 and 2.7
2.6 We recommend that a better approach to disclosure of independence is to explain why a director is not independent, rather than to require definitions of independence from each listed entity with an explanation of how each director meets that definition.

We refer to the 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, which takes this approach. In Principle 2, Recommendation 2.3 (p 16) requires a listed entity to disclose:

(a) the names of the directors considered by the board to be independent directors;

(b) if a director has an interest, position, association or relationship of the type described in Box 2.3 but the board is of the opinion that it does not compromise the independence of the director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and

(c) the length of service of each director.

Box 2.3 (p 16) then sets out factors relevant to assessing the independence of a director as follows:

Examples of interests, positions, associations and relationships that might cause doubts about the independence of a director include if the director:

- is, or has been, employed in an executive capacity by the entity or any of its child entities and there has not been a period of at least three years between ceasing such employment and serving on the board;
- is, or has within the last three years been, a partner, director or senior employee of a provider of material professional services to the entity or any of its child entities;
- is, or has been within the last three years, in a material business relationship (eg as a supplier or customer) with the entity or any of its child entities, or an officer of, or otherwise associated with, someone with such a relationship;
- is a substantial security holder of the entity or an officer of, or otherwise associated with, a substantial security holder of the entity;
- has a material contractual relationship with the entity or its child entities other than as a director;
- has close family ties with any person who falls within any of the categories described above; or
- has been a director of the entity for such a period that his or her independence may have been compromised.
- 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.

2.7 We note that 2.7 includes an example of tenure in 2.7(g) of nine years. We recommend that an example of specific years not be included, as this by default sets nine years as the appropriate limit for director tenure.

Governance Institute is of the view that open-mindedness to new ideas is a central tenet of independence of judgment, rather than any indicator, including tenure, applied in isolation. Tenure also speaks to diversity as much as to independence, as the interests of a listed entity and its shareholders are likely to be well served by having a mix of directors, some with a longer tenure with a deep understanding of the entity and its business and some with a shorter tenure with fresh ideas and perspective.

We recommend that the ICGN Principles delete the reference to nine years and change the example to note that there is no firm threshold for when the length of a directorship affects independence and that it should be assessed on a case-by-case basis.

Retaining a tenure limit in the ICGN Principles also retains the UK focus currently evident in the Draft Principles, given that there is a tenure limit included in the UK governance code. We note that there has been considerable reflection on the focus on and causes of short-termism in the United Kingdom, and that there has been discussion of how best to provide for long-term decision-making on boards, including providing for corporate memory and deep industry experience. However, in Australia, while a tenure limit had been included in the Exposure Draft of the 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (released in 2013 for public consultation) no consensus was reached by stakeholders on the inclusion of a tenure limit and therefore the tenure limit was deleted in the final version of the 3rd edition which published in March 2014.

3 Nomination, election and evaluation

3.1
The UK-centric focus of the Draft Principles is again apparent in this section, which calls for annual election of directors. The United Kingdom is the only jurisdiction to have implemented this requirement, and a UK requirement should not be applied to Principles that are intended to be applied globally.

3.3
Governance Institute is of the view that it is entirely appropriate for shareholders to have the right to nominate candidates for election to the board, but we are equally strongly of the view that it is entirely inappropriate to require nomination committees to consider candidates proposed by investors for election as directors.

There are a number of reasons why this requirement is poor governance.

- Corporations legislation, in Australia and other common law countries, is very clear as to the division of responsibilities in companies. The business of a company is to be managed by or under the direction of a board of directors appointed by and accountable to the shareholders, and the directors exercise all powers of a company except those that are required to be exercised in a general meeting. At no point has corporations legislation either here or overseas contemplated shareholder participation in the management of listed and broadly held companies on a day-to-day basis. Requiring the board to consider investor-nominated candidates and the nomination committee to enter into a dialogue with investors as to their nominated candidates blurs this division of responsibilities, as it involves investors in board decision-making.
- Investors have different timeframes, risk appetites and expectations and they do not have a fiduciary duty to act in the best interests of the company. They can act purely out of self-interest, which cannot be assumed to be the best interests of the company. There is no accountability of investors in relation to director candidate nominations, other than the exercise of a vote by shareholders in a general meeting. This is why it is appropriate for shareholders to have the right to nominate candidates for election to the board, but also why accountability would be entirely absent if investors are able to nominate directors by proposing candidates for consideration by the nomination committee.

Shareholders do not operate under a fiduciary duty to the company and, given that their interests diverge, directors need to engage with shareholders and consider their views but ultimately make decisions that are in the best interests of the company.

3.4
Governance Institute strongly supports board committees which can provide focus on key aspects of a board’s oversight responsibilities. However, we are of the view that provision needs to be made for the different circumstances of listed entities, not all of which will have the requisite board size or numbers of independent directors to populate separate board committees.

We note that the 3rd edition of the ASX Corporate Governance Council’s *Corporate Governance Principles and Recommendations* specifically acknowledges this by including commentary in relation to the recommendation on the nomination committee to the effect that a listed entity:

> if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the

> appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.

For example, a listed entity may not form a separate nomination committee, but may close a board meeting and then convene a meeting of the nomination committee, comprised of all board members, with a separate meeting agenda and minutes.

We recommend that the ICGN Principles include similar commentary.

3.6
This needs to also address the fact that not all listed entities will be able to form a separate nomination committee. We recommend that the wording be amended to state 'The nomination committee or other committee or the board …'.

We have strong concerns in relation to the requirement for nomination committees to disclose specific and measurable targets for achieving appropriate representation from ethnic minorities in senior management and on boards. In Australia it is inappropriate in recruitment processes to record ethnicity, as this could form the basis of a discrimination action.

We refer to the approach taken in the 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, which focuses in Principle 1, Recommendation 1.5 on gender diversity, but which includes commentary (p 12) that:

> It should be noted that while the focus of this recommendation is on gender diversity, diversity has a much broader dimension and includes matters of age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity. To garner the full benefits of diversity, an entity should ensure that its recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered and that there are no conscious or unconscious biases that might discriminate against certain candidates.

4 Integrity, ethics and conflicts

4.3
We note that this section should clarify that any training on mitigating the risk of bribery and corruption or other malfeasance should extend to the board.

4.7
Governance Institute does not agree with the requirement that a separate committee of independent directors be formed to review significant related party transactions.

We note that this is often the remit of the audit committee. In Australia, the audit committee must be comprised of independent directors.

We recommend that the wording be amended to state that 'A committee of independent directors should review significant related party transactions to determine whether they are in the best interests of the company and if so to determine what terms are fair. This need not be a separate committee but could be an existing committee comprised of independent directors, for example, the audit committee'.

5 Risk oversight

We recommend that additional wording be included, to the effect that a board may choose its own means of best satisfying its management of risk. We refer to the 3rd edition of the ASX

Corporate Governance Council's *Corporate Governance Principles and Recommendations* which states in Principle 7 that:

> While ultimate responsibility for a listed entity's risk management framework rests with the full board, having a risk committee (be it a stand-alone risk committee, a combined audit and risk committee or a combination of board committees addressing different elements of risk) can be an efficient and effective mechanism to bring the transparency, focus and independent judgement needed to oversee the entity's risk management framework.

6 Remuneration

6.5

We note that the United Kingdom is the only jurisdiction in which shareholders vote on the remuneration policy. Again, this requirement lends a distinctly UK-centric focus to the Draft Principles.

We also note that the European Commission has adopted a package of corporate governance reforms, one of which is to require companies to put their remuneration policy to a binding shareholder vote every three years. However, the directives need to go before the European Parliament and do not have regulatory force.

There is no legislative obligation in Australia on companies to put the remuneration policy to a shareholder vote.

6.8

We refer to our earlier comments that not all listed entities will be able to form separate board committees and recommend that the wording be amended in similar fashion as proposed in 3.4.

7 Reporting and audit

7.3

We note that listed entities are required to report against the accounting standards operable in their jurisdiction, and that these differ around the world.

On this basis, we recommend that 7.6 should replace 7.3, which seeks to paraphrase various accounting standards, and 7.3 should be deleted.

However, if 7.3 is maintained, we have the following comments on aspects of 7.3.

7.3(a) Governance Institute understands why 7.3(a) has been included, and why investors seek reporting that is relevant to investment decisions.

However, there are aspects of the annual report in Australia that are not relevant to investment decisions but that are required for legal and regulatory reasons. Listed entities will be subject to varying statutory obligations in relation to annual reporting and on this basis will not be able to satisfy 7.3(a).

7.3(a) therefore should be deleted but an additional sentence could be included in the commentary to 7.3, prior to the bullet point list, as follows:

> As appropriate, taking into account statutory and regulatory obligations in each jurisdiction, the annual report should seek to be relevant to investment decisions, enabling investors to evaluate risks, past and present performance, and to draw inferences regarding future performance.

7.3(d) We note that listed entities are required to report against the accounting standards operable in their jurisdiction, and that these differ around the world. Rather than seek to paraphrase accounting standards, Governance Institute recommends that the wording of 7.3(d) be amended to state:

> report yearly results in line with accounting standards applicable in the relevant jurisdiction, for example, IFRS and GAAP.

Again, we note that 7.6 should be moved up to replace 7.3.

7.3(f) There are different accounting standards applicable in different jurisdictions, and so no listed entity can present financial reports in a way that enables comparisons against other entities in other jurisdictions. Given that the ICGN Principles are intended to apply globally, this is a requirement that cannot be met. We recommend that this be deleted or amended.

7.5
Notwithstanding the requirement that the directors, by way of the annual report (through the annual financial statements) confirm the solvency of the enterprise at the time the report is approved, the directors are required to monitor and be mindful of solvency at all times.

7.7
Governance Institute notes that 7.7(a) and 7.7(d) again blur the division of responsibilities between boards and shareholder, by providing for investors to extend the scope of the audit and be involved in the audit tender process.

To have investors involved in either process sees them stepping into a management role and begs the question of why boards exist, if shareholders are to start assuming board responsibilities. If shareholders start assuming board and management responsibilities, it undermines the foundation of corporations legislation, in Australia and other common law countries, which consistently confirms that the business of a company is to be managed by or under the direction of a board of directors appointed by and accountable to the shareholders, and the directors exercise all powers of a company except those that are required to be exercised in a general meeting.

We recommend that 7.7(a) and 7.7(d) be modified to ensure that they do not call for shareholders to assume board responsibilities.

We also note that in 7.7(a) the assumption that there is a ‘right’ to agree the scope of an audit that can be extended to shareholders is misleading. It is a responsibility of the audit committee but it is not a right (which would be enshrined in law).

7.7(i) Governance Institute strongly recommends that this be the first bullet point in 7.7, as this is the fundamental responsibility of the audit committee.

8 Facilitating general meetings

8.6(b)
Governance Institute understands the principle being enunciated that existing shareholders should be offered new shares prior to their being offered elsewhere, but we note that this is not always in the best interests of the company. Directors have a fiduciary duty to act in the best interests of the company, and there are times when institutional placements may be more appropriate to the needs of the company than a pro-rata offer.

For example, during the onset of the global financial crisis, if Australian companies had not raised funds as quickly as they did through institutional placements, many of them would not have survived and shareholders' investments would have been lost completely. Any board faced with the certainty of institutional placements at a time when capital needed to be raised very quickly versus the uncertainty of whether sufficient interest would be generated from equity holders when the market was plummeting had to act in the best interests of the company. Retail shareholders were leaving the market in significant numbers, which added to the uncertainty as to whether sufficient interest would be generated from equity holders in a capital raising.

Another example is that mid to small caps have limited access to venture capital and debt funding, particularly at early stages in their life cycle. They need to raise funds in a cost-effective manner while balancing shareholder rights. The Australian Securities Exchange recognises this, and the listing rules provide for companies outside the S&P/ASX 300 with a market capitalisation of $300 million or less to raise an additional ten per cent of capital, subject to shareholder approval by special resolution and disclosure obligations being met.

Indeed, we note that in the United Kingdom a taskforce was formed to explore different means of raising capital, as the emphasis on rights issues was causing difficulties in capital raising. The UK taskforce looked to the Australian regulatory model as an example of a jurisdiction which operated effectively.

The Draft Principles do not accommodate a range of reasons why a rights issue may not be appropriate. A rights issue is an expensive means of raising capital, yet it comes with no guarantee that demand from existing shareholders will meet the capital needs of the entity. Moreover, in small to medium-size companies, the size of the shareholder base may not make a rights issue a viable means of raising capital. Boards should retain the flexibility to raise capital in the manner that is most appropriate to the circumstances of the company and in the best interests of the company as a whole in the long-term.

Governance Institute strongly recommends that recognition be given in the ICGN Principles to the right of board discretion in this matter, on condition that such placements are subject to limits in any one year.

8.7
Governance Institute recommends that the wording be amended as follows:

> It is appropriate to allow proposals to be put forward (whether vexatious or not), but any threshold should be high enough to ensure that the debate and discussion is of importance to all shareholders and not only to a small minority of shareholders.

Section B: Investors

We note that without reference to definitions we are unable to provide feedback on this section.