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Dear Mr Macdonald

**Consultation Paper:
Review of the NZX Corporate Governance Code**

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are unrivalled.

Our members have primary responsibility in listed companies to deal with the Australian Securities Exchange (ASX) and interpret and implement the listing rules. Our members hold primary responsibility within listed companies for developing governance policies and supporting the board on all governance matters.

Governance Institute is also a founding member of the ASX Corporate Governance Council and has participated in the development of each edition of the Council's *Corporate Governance Principles and Recommendations* (ASX Council's Principles and Recommendations). We did not provide comment on the NZX's discussion paper, but wish to provide comment on the proposed changes to the NZX Corporate Governance Code, given that the amendments have now taken form. Our members' familiarity with the Principles and Recommendations and the practical aspects of how to implement best practice governance frameworks and ensure sound reporting to shareholders have informed the comments in this submission.

Yours sincerely



Judith Fox
National Director, Policy & Advocacy

General comments

In a world where listed entities are seeking to attract global capital, we strongly support a new edition of the NZX Corporate Governance Code (the Code), and encourage NZX to align the Code as much as possible with the ASX Council's Principles and Recommendations, which are widely accepted and comparable with other governance codes in various jurisdictions. We are of the view that it is not to the benefit of NZ listed entities for their governance frameworks to differ greatly from those well established in other mature jurisdictions, such as Australia and the United Kingdom.

The ASX Council's 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. They have served Australia well in lifting and maintaining its standing as a country with a high-performing corporate governance environment. They have been updated on four occasions since 2003, whereas we note that this is the first update of the Code since 2003. The evolving nature of corporate governance necessitates a review of the ASX Council's Principles and also the NZX Code.

We therefore strongly recommend that NZX put in place a more regular process for reviewing and updating the Code, to ensure that the governance frameworks of NZ listed entities give confidence to investors globally, that NZ companies provide transparency and accountability concerning the stewardship of investor funds.

We note NZX has decided at this time to consider convening a panel of industry participants to consult with in respect of reviewing the operation of the commentary to the NZX Code following its implementation. One of the great strengths of the ASX Corporate Governance Council is that it is comprised of 21 stakeholder groups, representing all market participants. The Council is independent of ASX. While ASX provides the chair and secretariat support, it does not have a deciding vote or any more influence on the development of the Council's Principles and Recommendations than any other member of Council. The robust discussion at Council and working group meetings ensures that the views of all market participants are heard and that the final draft of a new edition of the Principles and Recommendations reflects a consensus view of sound practice. The draft is issued for public consultation, and amendments made to the final version for publication that takes into account feedback on the draft, as appropriate. As a result, all market participants champion the ASX Council's Principles and Recommendations. This has significant impact on their uptake and influence and their role as the primary source of corporate governance in Australia.

We strongly recommend that:

- NZX convene the panel of industry participants
- ensure that all market participants are involved on the panel, and
- formalise the panel with terms of reference, to clarify its role in reviewing and developing the Code on a regular basis to take account of developments in corporate governance.

We also support the 'comply or explain' approach taken in the Code. The last decade has shown that the approach taken by the ASX Corporate Governance Council in its Principles and Recommendations — 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, which is a flexibility tempered by the requirement to explain why' — is key to the success of the guidelines in being adopted by listed entities as the primary corporate governance document in Australia. The 'comply or explain' approach taken in the Code allows for listed entities at different stages of the life cycle of a company to put in place the governance framework most appropriate to their circumstances. It also works to ensure that the Code is the primary source of corporate governance guidelines for NZX Main Board issuers as well as other organisations such as private companies and not-for-profit organisations.

Finally, we also support the move away from the use of ‘best practice commentary’ to ‘commentary’. In the 2nd edition of the ASX Council’s Principles and Recommendations issued in 2007, the term ‘best practice’ was deleted, on the basis that the term ‘best practice’ creates a misunderstanding in the wider community that any other practice, no matter how sound, is implied to be second-class. The central concept of the Principles, the ‘if not, why not’ framework (similar to the ‘comply or explain’ approach), was therefore seen to be undermined by a false belief, given rise to by terminology, that practices that differed from those in the ASX Council’s Principles and Recommendations were by their very nature second-rate practices.

Detailed comments

Principle 1 – Ethical Standards

Recommendation 1.1

We support the recommendation that the board of an issuer should develop a code of ethics.

However, we do not agree that a more detailed recommendation about ethics is useful, that is, we do not agree that the recommendation should prescribe the contents of that code, as currently proposed in clauses (a) to (g).

We recommend that Recommendation 1.1 should conclude at the words ‘...describe the issuer’s expectations about behaviour’ and that the content in clauses (a) to (g) should be included in the commentary as general explanation and guidance.

We note that Recommendation 3.1 in ‘Principle 3: Act ethically and responsibly’ in the ASX Council’s Principles and Recommendations states that a listed entity should have a code of conduct for its directors, senior executives and employees and disclose that code or a summary of it, but that the suggested contents of such a code are suggestions only, set out in Box 3.1 (page 20), which forms part of the commentary. This provides flexibility to issuers to develop a code of conduct best suited to their circumstances, which will vary over time and/or across industries.

We are concerned that disclosures against proposed Recommendation 1.1 in the NZX Code will be ‘boilerplate’ should clauses (a) to (g) be included, with the potential for each listed entity’s code of conduct to be identical, as the current prescriptive approach drives a compliance culture, rather than a culture of ethics. The purpose of a principles-based approach to a governance code is to trigger board discussion of governance issues. A better outcome will be achieved if the board of each listed entity discusses how it wishes to articulate and document its code of ethics, rather than issuing one that repeats the words in the recommendation as they are prescribed.

Recommendation 1.2

We support the recommendation that an issuer should have a staff share dealing policy which extends to directors.

However, we do not support disclosure of all policies in full as a general principle, as this needs to be assessed on a case-by-case basis.

We recommend that this be revised to state: ‘This policy or a summary of the policy should be disclosed’.

Many governance policies can run up to 50 pages in length. A large amount of information contained within these policies would not be of use to investors as it is directed towards management and other employees to assist them in complying with the policy. This information is different from the explanation of the processes that are in place to manage the legal and reputational risks associated with staff share dealing, which should be disclosed (as currently set out in the consultation paper). The more detailed information can include the details of which

person within the entity individuals should contact in relation to this matter, and procedures for seeking approval and a range of other operational details, none of which are relevant to investors.

In order to assist communication with investors and other stakeholders, it can be more user-friendly to post a summary of any such lengthy policies to a website. This was recognised in the 2nd edition of the ASX Council's Principles and Recommendations, and in both that edition and the 3rd edition the recommendation attached to any governance policy is that a listed entity should 'disclose that policy or a summary of it'.

This does not detract from the fact that a share trading policy may be disclosed in full and companies should be encouraged to do so.

Principle 2 – Board composition and performance

Board composition

It is good governance for a board to have a majority of independent, non-executive board members, who do not maintain another role within the organisation, and do not have a material business relationship with the organisation. This ensures that directors bring independence of judgment to their decision-making and that board appointments do not introduce either real or perceived conflicts of interest which could cause stakeholders to doubt the independence of board decision-making.

We recognise that the pool of directors in New Zealand is small, and thus including a recommendation of this nature in the Code is difficult. We also note that this issue will be addressed in future amendments to the Listing Rules, which will include revisiting the independence definition. We would encourage all listed entities to aspire to independent boards.

We have no further recommendations to make in relation to board composition.

Recommendation 2.6: Director training

We note that the capacity to fulfil the role of director and meet the duties inherent in the role is a personal responsibility that cannot be delegated to the listed entity.

While we recognise that the proposed Code seeks to make directors responsible for their ongoing professional development in Recommendation 2.6, the commentary speaks only of the responsibility of the issuer to provide resources to help develop and maintain directors' skills and knowledge. However, we note that it is legal duty of directors rather than the listed entity to ensure they have the skills necessary to fulfil the role.

Directors have the obligation to undertake continuing education on legal and accounting matters, as offered by a number of bodies such as professional associations and law firms. This can be met by availing themselves of opportunities. The entity itself is not best placed to provide such education. The entity could provide advice on where directors could seek such education, but the onus should be on the director to avail themselves of those educational opportunities. The entity will ensure that the directors receive briefings and updates on entity-specific or industry-specific matters, and may also provide briefings on governance matters and some legal issues.

We recommend that the Code expand the commentary attached to this recommendation. The 3rd edition of the ASX Council's Principles and Recommendations makes it clear in the commentary to its Recommendation 2.6 (page 18) that the board or nomination committee is responsible to

regularly review whether the directors as a group have the skills, knowledge and familiarity with the entity and its operating environment required to fulfil their role on the board and on board committees effectively and, where any gaps are identified, consider what training or development could be undertaken to fill those gaps.

While the commentary continues to note that ‘Where necessary, the entity should provide resources to help develop and maintain its directors’ skills and knowledge’, the first paragraph maintains the necessary link to the personal obligations of directors to be capable of fulfilling the role. This should be clarified in the NZX Code as well.

Recommendation 2.7: Board evaluation

We strongly support the recommendation that the board should establish a formal procedure to regularly assess director, board and committee performance.

Board evaluations have been recommended in governance codes in other mature jurisdictions for many years. It is good governance for the board of directors to regularly assess the composition and effectiveness of the board as a whole, as well as any upcoming need for new directors, which will include a review of the required mix of skills, experience and other attributes of directors. Periodic board evaluation is an ideal time to assess the board’s composition, and develop a board skills matrix.

Board evaluation can provide a board with meaningful information as the basis for improvement, and will assist in optimising board performance and effectiveness. A formal periodic evaluation not only involves examining past and current performance, but has a strategic focus in looking forward at how the board can add further value to the performance of the organisation. Board renewal is critical to performance. This is also an opportunity for directors to indicate areas for the individual and collective development of skills and knowledge.

Principle 3: Board committees

Recommendation 3.2:

Governance Institute has concerns with the recommendation that directors who are not members of the audit committee should only attend audit committee meetings at the invitation of the audit committee.

We note that it is common practice for directors to be able to attend any and all committee meetings in Australia, including those of which they are not a member. While the board may use committees to manage workload, the duties and liabilities of directors are personal. A director should not be excluded or constrained from any aspect of board decision-making and should be free to attend any committee meeting.

From a practical perspective, having directors present at all committee meetings can facilitate the efficient running of the meeting of the board as the directors have sat in on the committee meetings and reports of their proceedings can be tabled rather than debated at length.

We recommend that, whether this is retained as a recommendation or moved to commentary, ‘directors’ should be deleted from this recommendation and it should only apply to employees.

We agree that relevant employees should be invited to attend audit committee meetings, but note that the CEO and CFO will always be invited to attend audit committee meetings. Directors may hold ‘in camera’ sessions without the CEO and CFO being present, but any invitation to the CEO and CFO would be a standing invitation.

Principle 4 – Reporting and Disclosure

Recommendation 4.2

The current wording of this recommendation is somewhat vague in its use of the term ‘other key governance documents’.

We recommend that Recommendation 4.2 be revised to state: ‘An issuer should make its code of ethics, board committee charters and the policies or summary of the policies recommended in the Code available to interested investors and stakeholders in a clearly accessible corporate governance section of the website’.

Recommendation 4.3

We support the recommendation that an issuer should provide both financial and non-financial disclosure, and should indicate how non-financial targets are measured. We support the proposal to address ESG reporting within commentary.

However, we do not support the prescriptive approach taken in the consultation paper that issuers must report against the Global Reporting Initiative (GRI) guidelines. The GRI guidelines are utilised by many large, listed entities, but they have been found to be onerous for smaller listed entities. While GRI states that the guidelines are applicable to entities of all sizes, this has not been the experience of smaller entities.

Moreover, other reporting frameworks exist, such as Integrated Reporting (<IR>). Many investors support <IR> and are keen to see entities report against the framework. Many investors have a preference for <IR> over GRI, as they are of the view that it presents a more holistic picture of all of the non-financial risks that an entity may need to manage, with more focus on materiality than GRI.

We also strongly oppose listed entities being compelled to report against ESG reporting guidance specifically developed by NZX or any other exchange. Given the existence of other models for reporting, such as GRI and <IR>, introducing yet another model will make it extremely difficult for investors to find the comparability they are seeking. NZX should not seek to introduce bespoke guidance on ESG that will limit NZ issuers wishing to 'tell their story' to providers of capital globally.

The need for flexibility that respondents to the discussion paper emphasised is missing in the commentary at present.

We strongly recommend that the Code provide for flexibility in the commentary rather than prescribing that issuers must report against either the GRI or guidance specifically developed by NZX. The commentary should not prescribe reporting against one model or another but seek to have issuers report on how non-financial targets are measured.

Principle 5 – Remuneration

We support the proposals set out in the consultation paper.

We also agree that it is appropriate to require heightened disclosure in respect of CEO remuneration as proposed, noting that disclosures of commercially-sensitive information may need to be curtailed to some degree.

We note that remuneration reporting is an evolving area. Despite the multiple, detailed statutory obligations that have been introduced in Australia in relation to the remuneration report, many listed entities are nonetheless seeking to reduce the length of their reports and 'tell their story' in a manner that provides investors with confidence that the board has structured a remuneration framework appropriate to the circumstances of the company. Simplicity aligned with accountability and transparency is the key.

Principle 6: Risk management

While we note that the commentary states that: 'The key risks will vary between issuers depending on their size and the nature of their businesses but these may include health and safety, other ESG factors (see also recommendation 4.3) and cyber security', we do not think that it is helpful to specify risks of health and safety, ESG factors and cyber risk.

We note that specific risks can shift and change as circumstances evolve. For example, cyber risk is topical, but as entities become better placed to be confident about their mitigating systems for dealing with this risk, it may become less of a key risk. Health and safety risks are also 'top of mind' at present for NZ listed entities, due to the amendments to the legislation, but as issuers become more familiar with the new legislative requirements and satisfied that their

risk management frameworks are sound, it will not be considered one of the key risks for all entities, although it will remain a key risk for some issuers.

We recommend that the commentary not specify any risks, even as examples, as they will indeed vary from issuer to issuer. The inclusion of specific risks in the commentary may produce the unintended consequence of issuers reporting on these risks, even if they are not material to the company. More importantly, they may lull directors into thinking that they have considered the key risks to the company, when in fact these may not be the material risks for that entity. The aim of the recommendation and commentary should be to trigger discussion by the board of the material risks facing the entity, so that the board can satisfy itself that management has implemented a risk management framework that is sound.

If it is desired that some guidance on risks be provided in the commentary, we suggest that they be categories of risk, for example, environmental, social, economic, operational etc.

Internal audit

The board needs to satisfy itself that the risk management framework established by management is operating effectively and as intended. It tests the effectiveness from time to time through assurance providers such as internal and external audit.

An internal audit function brings a systematic, disciplined approach to evaluating and continually improving the effectiveness of the organisation's risk management and internal control processes. The head of that function should have a direct reporting line to the board or to the board audit committee (and risk committee or committees if separate) to ensure there is independence of assurance.

Smaller organisations may not have an internal audit function, but should be able to demonstrate the processes in place for evaluating and continually improving the effectiveness of their risk management and internal control processes.

We recommend that a new recommendation be adopted on internal audit.

Many listed entities in Australia are too small to maintain an in-house resource, and so there was concern that if a recommendation was introduced requiring disclosure of whether an internal audit function existed, the majority of disclosures would state that such a function did not exist.

The 3rd edition of the ASX Council's Principles and Recommendations resolved this dilemma by introducing new Recommendation 7.3 (page 30) stating that:

A listed entity should disclose:

- (a) if it has an internal audit function, how the function is structured and what role it performs, or
- (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.

A similar approach adopted in the NZX Code would ensure that directors turned their collective minds to testing the effectiveness of their risk management framework, regardless of the size of the entity.

Principle 7: Auditors

We support the proposal that NZX adopt an additional recommendation that the external auditor should attend the annual meeting to answer questions from shareholders in relation to the audit.

Principle 8 – Shareholder Rights and Relations

We do not have any concerns about principle 8 and 9 being merged into a single recommendation regarding shareholder interests.

Recommendation 8.2

We note that the current recommendation that an issuer should allow investors the ability to easily communicate with the issuer, including providing the option to receive communications from the issuer electronically, only contemplates one-way communication. Investor relations is mentioned only briefly in the commentary, with the emphasis on technology rather than two-way communication.

We recommend that the commentary could be expanded to facilitate shareholder engagement by focusing more attention on the value of an investor relations program, and the benefits attached to providing for investors to express their views to the entity on matters of interest or concern to them. That is, the commentary could focus more on engagement and less on process.

Transition and implementation arrangements

Under the current transition proposals, issuers would need to commence reporting under the new regime for periods ending 30 June 2017 and onwards.

The practical effect of this timeframe is that issuers will be reporting that they do not meet any of the new recommendations, even if they are in the process of implementing them. While the 'comply or explain' model provides for explanations of why governance frameworks differ from those recommended, the disclosures will be of little value to investors in this case, as it will appear as if NZ issuers are not seeking to implement the recommended governance practices, even if they are.

We recommend that reporting commence as of end June 2018, as this provides a full year for issuers to implement any changes to their governance processes and practices, if they wish to do so. Early adopters can disclose against the new recommendations in 2017.