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## **ACSI submission to the consultation on the proposed third edition of the ASX Corporate Governance Principles and Recommendations**

The Australian Council of Superannuation Investors (ACSI) welcomes the opportunity to provide a submission on the proposed third edition of the ASX Corporate Governance Principles and Recommendations.

### **About ACSI**

The Australian Council of Superannuation Investors (ACSI) represents 34 profit-for-members superannuation funds who collectively manage over \$400 billion in investments on behalf of Australian superannuation fund members. Our membership also includes a number of major overseas pension funds with significant investments in the Australian listed equity market.

As long-term fiduciary investors, ACSI's members believe that good corporate governance is essential to sustainable long-term performance.

ACSI welcomes the proposed third edition of the Principles and Recommendations, which represent a notable improvement from the previous edition and reflect emerging perspectives in best practice corporate governance.

We believe that the changes proposed, in aggregate, have strengthened the Principles and Recommendations and successfully addressed a range of investor concerns from the previous edition. ACSI is highly supportive of all amendments to the Principles and Recommendations and believe that swift implementation of these amendments will result in improved investor decision-making and enhanced market integrity.

**In particular, ACSI notes the improvement to Principle 7.4 of the ASX Principles, which has been expanded to cover disclosures of environmental and social sustainability risks in addition to more traditional aspects of corporate risk management. ACSI considers that incorporation of this change is a significant step forward and a testament to the effectiveness of the ASX Corporate Governance Council consultation process to produce a very productive and progressive outcome in an increasingly critical area.**

The submission below provides ACSI's perspective on key sections of the revised Principles and Recommendations which we believe warrant special comments. ACSI has also referenced the latest edition of the ACSI Governance Guidelines where relevant<sup>1</sup>. ACSI's Governance Guidelines reflect the perspectives of our members with regards to the governance standards expected of the companies in which they invest. As such, we view alignment between the ASX Corporate Governance Principles and Recommendations and the ACSI Governance Guidelines as a positive development in the harmonisation of investor expectations and market practices.

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<sup>1</sup> ACSI's Governance Guidelines are available on our website at [www.acsi.org.au](http://www.acsi.org.au)

## Responses to New Principles and Recommendations

**Principle 1 - Lay solid foundations for management and oversight.** A listed entity should establish and disclose the respective roles and responsibilities of the board and management and how their performance is monitored and evaluated.

### Response

ACSI supports the extension of Principle 1 to include reference to the monitoring and evaluation of board and management's performance. Evaluation is an important aspect of governance oversight. Disclosures regarding the regular performance management of executives, and the board, have become commonplace in Australia's largest listed companies. The proposed amendments to Principle 1 capture this trend in a practical way.

Based on a growing body of research, as well as feedback from many of Australia's largest listed boards, ACSI believes that robust board evaluation processes assist boards to identify gaps in skills, experience and expertise to promote overall board effectiveness and company performance over the long-term.

**Recommendation 1.5:** A listed entity should:

- (a) have a diversity policy which includes requirements for the board:
  - 1. to set measurable objectives for achieving gender diversity; and
  - 2. to assess annually both the objectives and the entity's progress in achieving them;
- (b) disclose that policy or a summary of it; and
- (c) disclose as at the end of each reporting period:
  - 1. the measurable objectives for achieving gender diversity set by the board in accordance with the entity's diversity policy and its progress towards achieving them;
  - 2. either:
    - a) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined "senior executive" for this purpose); or
    - b) the entity's "Gender Equality Indicators", as defined in the Workplace Gender Equality Act 2012.

### Response

ACSI supports the changes made to Recommendation 1.5.

In particular, the diversity-related recommendations being placed under Principle 1, rather than their previous reference under Principle 3, are a notable improvement. This is due to ACSI's belief that improvements in diversity fall under a board's responsibility to ensure "solid foundations for management and oversight", with consideration to the impact of gender diversity on long-term performance. Several research reports shows that improvements in gender diversity result in enhanced corporate performance, and are therefore beneficial to the long-term stability and sustainability of companies.

Recommendation 1.5 also serves to harmonise the ASX Principles and Recommendations with recent changes in legislation as introduced by the Workplace Gender Equality Act 2012 which requires employers to publicly disclose performance against gender equality indicators to the *Workplace Gender Equality Agency (WGEA)*. WGEA has been established with the express intent of promoting and improving gender equality in the workplace<sup>2</sup>. Where an employer fails to comply with the Act, the Agency may name the employer to the Minister, creating a reputational risk for companies who do not comply with the Act.

Under these circumstances, Recommendation 1.5 provides companies with guidance that is consistent with, but does not duplicate the Act and therefore assists in mitigating potential reputational risks on this issue.

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<sup>2</sup> <http://www.comlaw.gov.au/Details/C2012C00899>

**Principle 2 - Structure the board to add value.** A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.

## Response

The changes made to Principle 2 with reference to the inclusion of skills matrix consistent with ACSI's Governance Guidelines and aligns with our expectations in this area. These changes improve transparency in a listed entity and result in enhanced accountability to shareholders. Specifically, ACSI's Governance Guidelines state that:

"Companies must ensure that the following factors are considered in director appointment, succession and nomination processes:

- a) Any gaps in the board skills-sets and experience of current directors relevant to the company and its strategy. Disclosure of a skills matrix of the full board is an effective means to demonstrate how the skills across the boardroom link to the oversight of company operations and strategy."<sup>3</sup>

ACSI also notes that the non-prescriptive nature of Principle 2 allows companies to adopt this reporting practice without having to disclose commercially sensitive information.

### **Box 2.1 – the defining characteristics of an independent director**

*A director of a listed entity should be characterised and described as an independent director only if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, his or her 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.*

*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 related 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, shareholder, director or senior employee of a professional adviser or consultant to the entity or any of its related entities;*
- *is, or has within the last three years been, a material supplier or customer of the entity or any of its related entities, or an officer of, or otherwise associated directly or indirectly with, such a supplier or customer;*
- *is a substantial shareholder of the entity or an officer of, or otherwise associated directly or indirectly with, a substantial shareholder of the entity;*
- *has a material contractual relationship with the entity or its related 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 more than 9 years.*

*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.*

## Response

The changes made to Box 2.1 are aligned with ACSI's views in this area.

Broadly, ACSI believes that this more extensive set of guidance on the issue of director independence is beneficial to companies and is also consistent with ACSI's Governance Guidelines.

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<sup>3</sup> ACSI Governance Guidelines, Australian Council of Superannuation Investors, 2013

ACSI agrees with the framing of this guidance as factors which ‘might cause doubts’ regarding the independence of directors as opposed to a more prescriptive requirement. This allows for assessment on a case-by-case basis, and aligns with the approach taken by ACSI which avoids a ‘tick the box mentality.’ Considering the context of each board is important, for instance - the last point in Box 2.1, that the independence of directors of more than 9 years may cause doubt raises the important issue of board renewal rather than a proscription that directors must leave after 10 years on a board.

The point regarding “close family ties” is also a welcome addition, and echoes good governance recommendations from other sources, such as those regarding closely related parties as defined in the Corporations Act.

**Recommendation 2.4:** *The board of a listed entity should:*

(a) *have a nomination committee which:*

1. *has at least three members, a majority of whom are independent directors; and*
2. *is chaired by an independent director,*

*and disclose:*

3. *the charter of the committee;*
4. *the members of the committee; and*
5. *as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or*

(b) *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, experience, independence and knowledge of the entity to enable it to discharge its duties and responsibilities effectively.*

## Response

In ACSI’s view changes to Recommendation 2.4 represent an effective consolidation. Overall the recommendation is consistent with the standards used by listed companies that we review as well as ACSI Governance Guidelines regarding nomination committees.

**Principle 4 - Safeguard integrity in financial reporting:** A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its financial reporting.

**Response:** ACSI approves of the inclusion of the terms “formal and rigorous” with regard to the processes for verification and the protection of integrity with regard to financial reporting in Principle 4. This wording is consistent with ACSI’s view that companies must provide an accurate and true representation of their financial management, performance and reporting in line with relevant legal and accounting standards.

ACSI notes that boards play a critical role is safeguarding the integrity of financial reports, as Justice Middleton held in the *Centro Case*:

*All directors must carefully read and understand financial statements before they form the opinions which are to be expressed in the declaration required... Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company’s financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director.<sup>4</sup>*

ACSI is pleased to note that Principle 4 also seeks to emphasise this issue and is supportive of ongoing diligence in this area.

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<sup>4</sup> ASIC v Healey & Ors [2011] FCA 717.

**Recommendation 4.2:** *The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity.*

### Response

ACSI agrees that Recommendation 4.2 enhances the accountability of the CEO and CFO regarding financial records. In doing so, Recommendation 4.2 is consistent with moves towards enhanced safeguards for financial reporting and ACSI is supportive of the change.

**Principle 6 - Respect the rights of security holders:** A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.

### Response

ACSI is in agreement with the changes to Principle 6 regarding the terms "by providing them with the appropriate information and facilities to allow them to exercise those rights effectively". Transparency allows shareholders to make effective decisions. Without such information, market efficiency is impaired. The addition of these terms emphasises the importance of transparency, and communicating timely and accurate market disclosure specifically to investors.

**Recommendation 6.1:** *A listed entity should provide information about itself and its governance to investors via its website.*

### Response

ACSI supports the changes in Recommendation 6.1 regarding the enhanced utilisation of a listed entity's website to communicate information regarding governance and other matters, particularly where this results in decreased complexity and length of annual reports.

**Recommendation 6.3:** *A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.*

### Response

ACSI is supportive of Recommendation 6.3.

As noted in our submission to Corporations and Markets Advisory Committee consultation regarding the AGM and shareholder engagement, "ACSI strongly supports constructive engagement between company boards and their investors, and encourages any efforts to promote and improve these interactions. However, we do not believe that formal legislative or quasi-legislative measures are required to clarify the role of the board (or of individual directors) in engaging with shareholders."

ACSI is confident that the ASX Corporate Governance Principles and Recommendations are the appropriate place to provide guidance to companies on these matters and that Recommendation 6.3 adequately captures the investor perspective.

**Recommendation 7.4:** *A listed entity should disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks.*

## Response

The changes made in Recommendation 7.4 represent a very significant step forward by the Council. ACSI firmly believes that the changes to Recommendation 7.4 are necessary for sound long-term investment decision-making. Companies must publicly disclose their economic, environmental and social sustainability risks so that investors are able to appropriately value the impact of these risks on performance. Ultimately, these impacts effect investment decisions. Without this information, these long-term decisions are hindered.

The inclusion of “economic, environmental and social sustainability risks” in the list of risks that companies need to have regard to also ensures that guidance for Australian listed entities will reflect contemporary international standards on corporate disclosure.

For example:

- In July 2010 the UK Government reinstated the directors’ annual reporting requirements to ensure that directors’ social and environmental duties are covered in reporting through accountability and transparency.
- In South Africa, the introduction of the Code of Corporate Practices and Conduct, more commonly referred to as the King Code, introduced mandatory integrated reporting for all corporate entities in South Africa, alongside a suite of other ‘comply or explain’ corporate governance measures. The Code is premised on the belief that governance, strategy and sustainability are inseparable.
- France introduced the New Economic Regulations (‘NRE’) Law in 2001 which mandated the disclosure of specific social, territorial and environmental indicators and items on an annual basis.
- In 2008, Denmark also introduced similar disclosure requirements through an amendment to its Financial Statements Act (Accounting for CSR in large businesses)<sup>5</sup>.
- In the European Union, the Accounts Modernisation Directive amendment under Article 46 now requests disclosure of environmental and employee data, where appropriate for the overall review of operations

Recommendation 7.4 is also consistent with the ASIC guide on the Operating and Financial Review (OFR). This guide now states that an OFR “should include a discussion of environmental and other sustainability risks where those risks could affect the entity’s achievement of its *financial* performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy.”<sup>6</sup>

Similarly, Recommendation 7.4 goes some way towards fulfilling the requirements of the emerging Sustainable Stock Exchanges initiative, which aims to encourage global stock exchanges to include requirements for sustainability disclosure in their listing requirements. Coordinated by the Principles for Responsible Investment, ACSI supports the Sustainable Stock Exchanges initiative and encourages moves by the ASX to require listed entities to provide sustainability disclosure on an “if not, why not” basis, such as in Recommendation 7.4.

ACSI believes that all companies are exposed to economic, environmental and social sustainability risks. As outlined in the ESG (Environmental, Social and Governance) Reporting Guidelines produced by ACSI and the Financial Services Council in 2011, companies have a range of ESG risks that investors require information about to make informed investment decisions.

With regard to Integrated Reporting, ACSI notes that the Council “considers that it would be premature to expect listed entities in Australia to adopt integrated reporting until the international framework for such reporting is much better developed than it currently is”. ACSI agrees that the Integrated Reporting framework requires further development before broad level adoption is possible. However, ACSI notes that in December 2013 the first edition of the Integrated Reporting framework will be completed and several companies have indicated willingness to report in accordance with the framework.

As such, ACSI suggests that the Council considers including under Principle 7, a reference to Integrated Reporting as an emerging form of reporting that companies are encouraged to pursue in order to summarise and consolidate annual disclosures.

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<sup>5</sup> <http://www.csrgov.dk/sw51190.asp>

<sup>6</sup> Regulatory Guide 247 ‘Effective disclosure in an operating and financial review’, Australian Securities and Investments Commission, March 2013, p. 19

**Principle 8 - Remunerate fairly and responsibly:** A listed entity should endeavour to pay remuneration that is sufficient to attract, retain and motivate high quality directors and senior executives and that is aligned to the creation of value for security holders.

**Recommendation 8.1:** The board of a listed entity should:

(a) have a remuneration committee which:

1. has at least three members, a majority of whom are independent directors; and
2. is chaired by an independent director,

and disclose:

3. the charter of the committee;
4. the members of the committee; and
5. as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or

(b) if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for directors and senior executives and ensuring that such remuneration is appropriate and not excessive.

## Response

The inclusion of 8.1 (b) under Recommendation 8.1 to accommodate smaller listed entities with fewer board members is supported by ACSI.

**Recommendation 8.3:** A listed entity should:

(a) have a “clawback” policy which sets out the circumstances in which the entity may claw back performance-based remuneration from its senior executives;

(b) disclose that policy or a summary of it; and

(c) disclose as at the end of each reporting period:

1. whether any performance-based remuneration has been clawed back in accordance with the policy during the reporting period; and
2. where performance-based remuneration should have been clawed back in accordance with the policy during the reporting period but was not, the reasons for this.

## Response

ACSI supports “clawback” policies and supports the introduction of Recommendation 8.3.

As noted in our 2011 submission on ‘the Clawback of Executive Remuneration where Financial Statements are Materially Misstated’, ACSI endorses the principle that all boards retain discretion to claw back all variable pay in the event of poor performance or excessive risk-taking.

ACSI supports the proposed Recommendation 8.3 as it allows boards to consider whether claw back mechanisms are appropriate, and how they will be applied. In practice, clawback arrangements have already been introduced by a large number of major companies over the past four years led by a number of major listed financial institutions.

Recommendation 8.3 consolidates this approach and requires a company, and its board, to consider how they should apply practical clawback mechanisms on behalf of their shareholders. ACSI supports this approach over past proposals to have clawback policy invoked only in situations of material financial misstatement. In practice, there have been a wide range of circumstances related to risk and company performance which have seen boards apply discretionary clawback arrangements.

## Conclusion

Overall ACSI is satisfied that the proposed third edition of the ASX Corporate Governance Principles and Recommendations have appropriately captured the standard of governance expected of listed entities by investors. The changes that have been made reflect thorough assessment and discussion by the ASX Corporate Governance Council members and the results appropriately balance good corporate governance standards and the nature of Australian listed entities and their regulatory environment.

ACSI commends the ASX on a successful revision of the Principles and Recommendations and looks forward to its on-going participation in the ASX Corporate Governance Council.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ann Byrne', written in a cursive style.

Ann Byrne  
Chief Executive Officer