

27 July 2018

ASX Corporate Governance Council  
C/o ASX Limited  
PO Box H224  
Australia Square, NSW 1215

Attention: Ms Mavis Tan

*via email: mavis.tan@asx.com.au*

Dear Ms Tan,

### **Review of the ASX Corporate Governance Principles & Recommendations**

Thank you for the opportunity to provide a submission in response to the consultation draft of the proposed fourth edition of the ASX Corporate Governance Council (**Council**) Corporate Governance Principles and Recommendations (**Principles**).

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 43,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD has supported the Principles since their inception. We consider that the current and previous editions of the Principles and the “if not, why not” reporting model have served the business and investor communities well. As a committed member of the Council, we agree that now is an opportune time to review the Principles and consider whether they remain fit-for-purpose in the context of emerging domestic and global issues in corporate governance.

The consultation draft prepared by the ASX Secretariat reflects careful consideration of these issues and we appreciate the detailed work involved in its release.

The AICD strongly recommends that the fourth edition retain a principles-based approach, rather than becoming too granular or prescriptive. We encourage review of the consultation draft against this objective.

As acknowledged in the Principles, “which governance practices a listed entity chooses to adopt is fundamentally a matter for its board of directors”. A more prescriptive approach carries with it the risk that listed entities may view adherence to the Principles as a compliance matter rather than as a starting-point for a consideration of their own corporate governance needs, bearing in mind their unique circumstances (including strategic and operational imperatives), investors, and other stakeholders. Further, the more detailed the guidance, the more difficult it will be for smaller, resource-constrained organisations (which comprise the majority of ASX listed entities) to embrace and support the Principles.

While many of the individual issues canvassed in the consultation paper are topical and important, we recommend a focus on the most material issues in this revision, limiting commentary that overlaps existing regulation. This approach would help maintain the broad

support of listed entities, their boards and stakeholders for the Principles and their continued acceptance as a useful, well accepted resource for good governance.

Our comments seek to support this balance recognising that the Principles should not endeavour to address all of the various challenges facing the business sector.

It is imperative that the Principles retain widespread support given they represent a self-regulatory standard (via the operation of ASX Listing Rule 4.10.3) by which listed entities are judged by investors and other stakeholders – a testament to their value to the market and broad acceptance. While, importantly, reporting is on an “if not, why not” basis, there are strong incentives for entities to comply with the Principles. Accordingly, it is important that the Principles remain tightly drafted, and their remit appropriately targeted to core governance issues.

The following submission has been prepared with these overarching comments in mind.

## **1. Executive summary**

- In our view, the current third edition of the Principles have worked well because a) they operate within the legal framework for companies and directors’ duties and give practical governance guidance on how to work within it; and b) they are a principles-based approach which recognises that governance frameworks must respond to a company’s context and strategic and operational imperatives. Any revised edition must adopt the same approach.
- The AICD acknowledges that the proposed amendments cover many topical and important issues. However, we are concerned that the consultation draft has moved too far towards prescription, adding nine new recommendations and significantly expanding commentary, including moving from explanatory guidance to additional action or disclosure by listed entities in certain instances. We are concerned that this may encourage a shift to a “checkbox” compliance approach, compared to the benefits of a principles-based model.
- We support many of the proposed changes relating to the board’s role, composition and operation within the Principles, but there is a need to ensure that some of the language in the commentary does not lead to unintended consequences (for example, by implying a particular board composition or proposing arbitrary timeframes for certain actions).
- The AICD supports the Principles promoting a focus on long-term value creation and recognising the importance of active consideration and engagement by listed entities with stakeholders and community expectations. We are concerned, however, that concepts proposed to be introduced such as “social licence to operate” and acting in a “socially responsible manner” (see Principle 3) are subjective and will add unnecessary complexity and uncertainty. With this in mind, we recommend that the document be reviewed to ensure that it appropriately reflects the legal and fiduciary obligations of directors.

Our comments are outlined in further detail below with some general observations followed by more specific feedback on particular sections of the document. Attached to this submission is an **Appendix** which provides further comments on proposed changes.

## **2. General observations**

It is important to acknowledge from the outset that Australia’s corporate governance model is robust, well respected globally, and has withstood the test of time. The World Economic Forum 2017-18 Global Competitiveness report ranks Australia as 8th out of 137 nations for “efficacy of corporate boards”, while we come in at 11th place for the “ethical behaviour of firms”. The Asian Corporate Governance Association has also ranked Australia first in corporate governance

practices compared to 11 other jurisdictions in Asia, including Singapore, Hong Kong, Japan and South Korea, in a 2017 study.

While this does not mean that improvements cannot or should not be made, it is important that any revision to the Principles builds on the strong corporate governance framework - underpinned by the general law and statute – that already exists. The role of the Principles is important in this framework, offering a flexible, industry-led model of good corporate governance practice. Its purpose should not be to pre-empt the legislature, nor ongoing inquiries, such as the Hayne Royal Commission, which is playing a vital role in bringing to light poor practices in Australia's financial services sector.

While the AICD notes the critical role played by the Principles in setting a benchmark for corporate governance, we also acknowledge that they cannot be a panacea for the challenges facing corporations, including the trust deficit with the community. Instead this trust must be rebuilt from the ground up, with each organisation, led by its board and senior management, carefully considering what is necessary in their unique circumstances.

### *2.1 Moving from principles to prescription*

The AICD is concerned that the proposed expansion of the Recommendations (from 29 to 38), with expanded commentary, adds unnecessary prescription and detail to the revised edition.

Specifically, the increased level of commentary and prescription (from a 38 page third edition to a proposed 55 page fourth edition) risks detracting focus from the most material issues, while in some instances deviating from established legal frameworks. In our view, the greater the degree of detail and prescription, the greater the risk that the Principles will be seen as a “checkbox” compliance exercise. This would obviously deviate from the core objective of the document which is to provide principles-based, rather than prescriptive, guidance to companies. It is not intended to deliver a “one-stop shop” for good corporate governance.

This approach also appears to contrast with other jurisdictions, such as the UK, in recently refreshing, and significantly condensing, similar corporate governance codes.<sup>1</sup> Singapore's draft revised Code of Corporate Governance – currently being publicly consulted on - has also been made more succinct and streamlined, in order to “encourage companies to move away from a compliance mindset and adopt thoughtful corporate governance practices that will best support their long-term business objectives”.

Some examples of areas where we believe there is an opportunity to review commentary and reduce prescription in the consultation draft include:

- Commentary to proposed Recommendation 1.5 – while the AICD supports the recommendation, the commentary is overly granular. Over two pages of commentary is provided on this topic, significantly more than on other, also important, recommendations;
- Proposed Recommendation 2.7 – we consider this unnecessary given the existing law is clear on directors' duties – if there is a concern with market practice this should be addressed by the relevant regulatory authorities;
- Proposed Recommendation 3.3 – while we support the presence and disclosure of a whistleblowing policy, we note that there is currently law reform proposed by the Commonwealth government that will soon impose different obligations upon companies. Our view is that proposed Recommendation 3.3 and associated commentary should

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<sup>1</sup> See UK Corporate Governance Code 2018, <https://www.frc.org.uk/news/july-2018/a-uk-corporate-governance-code-that-is-fit-for-the>

remain high-level and avoid duplicating the law. In particular, references to the policy covering “socially responsible” behaviour may create ambiguity given that term lacks clear definition (see further below);

- Proposed Recommendation 3.4 – while having an anti-bribery and corruption policy is important for companies, it unclear why this has been highlighted specifically. There is a risk that by focusing on anti-bribery and corruption policies, other equally important issues could be seen as requiring less focus;
- Proposed Recommendation 8.4 – in our view, related party disclosure and the existing legal framework adequately address relevant concerns. The proposed recommendation would be restrictive, and costly, for smaller listed entities.

## *2.2 The role of commentary to the Principles*

The consultation draft includes significantly expanded commentary which at times sets a higher bar for action by entities, rather than explanatory guidance on how an entity might seek to comply with a recommendation, or additional detail on the rationale for the recommendation.

For example, the commentary to:

- Recommendation 1.5 (diversity) suggests that entities should consider disclosing any insights from the annual review conducted and any changes the entity has made to its gender diversity objectives as a result, as well as any outcomes taken in response to pay equity audits and benchmarking exercises;
- Recommendation 3.2 (code of conduct) states that the Council would encourage a listed entity to disclose the actions it has taken to enforce its code of conduct and review the code at least once every three years, which appears to be an arbitrary timeframe;
- Recommendation 7.2 (risk review) encourages entities to disclose any insights it has gained from a risk review and any changes that it has made, removing the important qualification of ‘where appropriate’ in the current edition.

We note that a comparison of the third edition of the Principles with the proposed fourth edition reveals that the latter contains a material increase in such expectations/suggested practices (see for example, commentary to Recommendations 1.5, 3.2, 6.2, 7.4 and Principle 8).

We would welcome a focused review of areas where the document would benefit from a less detailed and prescriptive approach. The AICD’s view is that such language should be appropriately circumscribed and remain explicitly “*explanatory* commentary” (as articulated in the current and proposed edition of the Principles), for the reasons discussed above.

We recommend that the preface more explicitly emphasise the explanatory nature of commentary.

## **3. Board role, composition and operation**

There are number of proposed changes that relate to the board’s role, composition and operation. Our comments in relation to the most material proposed changes are as follows.

### *3.1 Amendment to Recommendation 1.1: role of board and management*

We support requiring a listed entity to have and disclose a board charter, given the importance of this document to the sound governance of any organisation. We also believe there is value in an entity defining its purpose as this can help assist with decision-making, including navigating potentially competing interests.

We are generally supportive of the explanatory commentary to the recommendation but suggest that the use of the word ‘usually’ be revisited, given the proposed new inclusions.

### 3.2 *Amendment to Principle 2: structure the board to be effective and add value*

It is proposed to amend the wording of this Principle to incorporate reference to the board having “knowledge of the entity and the industry in which it operates”. While it is of course important that the board, as a whole, has the ability to draw on this knowledge, there is a risk that the language will be interpreted as restricting the pool of suitable director candidates (i.e. implying the need for more executive directors as well as *only* individuals with specific sectoral experience). We acknowledge that such an outcome could be an unintended consequence of the current draft and encourage review so that the focus is on the appropriate balance of skills and experience across the board as a whole, as well as diversity of thought and perspective.

It is important to acknowledge that there is a great deal of value that board members who come from outside an industry, can bring to the board table. For example, in other director roles, they may have already faced challenges that have not yet emerged in a specific industry, so can bring significant insight. Similarly, a board with a predominance of sectoral experience could encourage “group think” and a failure to sufficiently challenge management on business practices and behaviours.

### 3.3 *Amendment to Recommendation 2.2*

The proposed new commentary to Recommendation 2.2 states that “boards are increasingly being called upon to address new or emerging issues including around culture, conduct risk, digital disruption, cyber security, sustainability and climate change. The board should regularly review its skills matrix to make sure it covers the skills needed to address existing and emerging business and governance issues”.

In our view, this passage could be interpreted as suggesting that directors should have specific subject matter expertise, say on cyber security, rather than the ability, judgment and experience to consider existing and emerging business and governance issues (including recognising where there may be a need to source appropriate independent or management advice). Indeed, it may not be appropriate for the entity to appoint a director who is a subject matter expert in one area, given that the board will be expected to deal with complex issues that will change in priority from time to time. This does not diminish the importance of regular skills matrix assessment and review, nor the need for board members to educate themselves on new or emerging issues.

### 3.4 *Other board-focused changes*

Further comments are outlined in the **Appendix** to this submission.

## **4. “Social licence to operate” and acting in a “socially responsible manner”**

The AICD acknowledges a worrying lack of trust in institutions in Australia, including our corporations, as revealed in the periodic Global Edelman Trust Barometer results. In response to this and broader stakeholder feedback, over a number of years, the AICD has highlighted to our members, including through our education programs, the importance of consciously developing a healthy and sustainable organisational culture.<sup>2</sup> The Hayne Royal Commission

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<sup>2</sup> For example, the AICD’s Company Directors Course addresses culture and ethics in course materials and case studies, including in modules on duties and responsibilities, decision-making, risk and strategy. Other AICD programs also focus on the board’s role in culture, including courses on cyber-risk management, innovation, governing vulnerable people and our annual Essential Director Update briefings. AICD publications also explore these issues, available at [www.aicd.com.au](http://www.aicd.com.au).

and APRA prudential inquiry report into the Commonwealth Bank of Australia have further highlighted the importance of this issue and the need for boards to proactively and systematically manage non-financial risks.

The AICD has also emphasised the importance of directors understanding and engaging with the range of stakeholders that have an interest in their company – including employees, customers, suppliers, regulators and the broader community – as an essential part of preserving, and indeed building, long term shareholder value.

#### *4.1 Social licence to operate – what does it mean and to whom?*

This notwithstanding, we have significant concerns with the proposed revisions to Principle 3, including the introduction of the fluid concepts of a “social licence to operate” and acting in a “socially responsible manner”. Specifically, the draft proposes to change Principle 3 from (currently) “[a] listed entity should act ethically and responsibly” to “[a] listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner”.

The consultation draft notes the importance of an entity’s social licence to operate and the need to act to preserve it, stating that to maintain that licence, an entity *must* have regard to the views and interests of a broader range of stakeholders than just its security holders, including “employees, customers, suppliers, creditors, regulators, consumers, taxpayers and local communities”.

The concept of “social licence” is highly subjective and will be interpreted differently by different stakeholders, as will the criteria listed in the Principles commentary as examples of being a good corporate citizen (e.g. paying a “living wage” or not engaging in “aggressive tax minimisation strategies”).

These proposed changes have caused significant concern amongst the director community. Specifically, directors have expressed the view that the new wording introduces concepts with broad, perhaps changing, interpretations, without referencing the legal and fiduciary framework of director duties – including to act in the best interests of the company (see further below).

Companies are of course already subject to a range of targeted laws dealing with their impact on specific sets of stakeholders, for example in the areas of workplace health and safety (WHS), consumer protection and the environment, amongst others.

#### *4.2 Consistency with fiduciary and statutory duties of directors*

The AICD is also concerned that the proposed commentary on Principle 3 risks creating confusion about the general law and statutory duties of directors under the *Corporations Act 2001*.

It is well-settled that the overriding test as to what constitutes “acting in the interests of the company” as a whole is the well-being of the company and therefore the shareholders generally. The High Court stated in *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 that “it may be readily accepted that directors and other officers of a company must act in the best interests of the company as a whole and that this will usually require those persons to have close regard to how their actions will affect shareholders.”

According to *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th edition, 2018 (**Ford**), directors must consider the interests of existing members because they are proprietors of the company who have risked their capital in the hope of gain. Ford states that “although it is sometimes said that directors should be obliged to consider interests of employees, customers, contractors and the community when making decisions for the company, there is no case law or corporations legislation in Australia that imposes that obligation”.<sup>3</sup>

Of course, this is not to say that directors are prevented from considering the interests of other stakeholders in their deliberations. Far from it – boards of listed entities will carefully consider a range of (often complex and competing) stakeholder interests in acting in the best interests of the company. This does not subordinate shareholders’ interests to those of other groups but accepts that stakeholder considerations are part of a strategy to promote company sustainability and maximise value over the longer term.

Professor Bob Baxt AO in his 2016 text on directors’ duties articulated a similar view, noting that a fundamental principle of Australian company law is that directors owe their duty to the company and not to any other persons. Professor Baxt also emphasised that it would be “foolish” for directors, especially of publicly listed companies, to ignore stakeholder interests, which play a significant part in how companies must behave in order to prosper.<sup>4</sup>

The issue of the extent to which directors may take into account the interests of stakeholders was considered in detail by the Corporations and Markets Advisory Committee (**CAMAC**) in its 2006 report *The Social Responsibility of Corporations*. CAMAC accepted that under common law and the relevant statutory provisions, directors, in acting in good faith, in the best interests of the company and for a proper purpose, may take into account a range of factors external to the shareholders if this benefits the shareholders as a whole.

Endorsing the “business approach” to stakeholders, CAMAC concluded that while directors are able to have regard to other interests under the current legal framework, they should remain accountable to shareholders and “any extension of accountability to other stakeholders would undermine effective corporate governance”.

To avoid creating unnecessary uncertainty in expectations or understanding of accountabilities, the legal position should be reflected accurately in the Principles (see section 4.4 below).

#### 4.3 *Social responsibility example*

In our view, the inherent ambiguity of the concepts of “social licence” and “social responsibility” would create a difficult environment for listed entities to report against in corporate governance statements. The following hypothetical, though entirely plausible, example illustrates how it will not always be clear what is meant by a company acting in a “socially responsible manner”:

- Hypothetical facts: Company X is seeking to engage in natural gas exploration and extraction adjacent to a rural community and has obtained the necessary licensing and regulatory approvals from the relevant authorities;
- First set of stakeholders: sections of the local community welcome the new employment opportunities offered by the project;

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<sup>3</sup> The position changes where a company is insolvent or approaching insolvency, whereby the interests of creditors will need to be considered: see for example, *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1.

<sup>4</sup> See B Baxt AO, *Duties and Responsibilities of Directors and Officers*, 21st Edition, 2016.

- Second set of stakeholders: different sections of the local community oppose the project as they believe it will detract from a recent boom in local tourism;
- Third set of stakeholders: environmental groups may oppose the project given concerns regarding the potential impact on the local aquifer and carbon emissions;
- Fourth set of stakeholders: Company X employees welcome the project as it improves their job security;
- Fifth set of stakeholders: the majority of shareholders are pleased to see the project proceed as it is expected to deliver long term value for the company;
- Sixth set of stakeholders: a minority of shareholders are opposed to the project as they share the concerns of environmental groups; and
- Seventh set of stakeholders: some consumers and members of the public want the project to proceed as they believe it will contribute to lower energy prices.

In such a scenario, it is clear there will be conflicting views on whether the investment would constitute socially responsible behaviour.

#### *4.4 An alternative approach*

As an alternative to the proposed new wording in Principle 3 we recommend that it be drafted as “acting lawfully and ethically” (i.e. remove reference to acting socially responsibly). This would send the clear message to companies that compliance with the law is essential but will not always be enough, and that they should apply an ethical overlay to their decision-making and business practices. In our view, such terminology benefits from clarity and broad director support without introducing ambiguous, subjective terminology into a core corporate governance document. There are also established frameworks to grapple with ethical issues, offering company’s practical tools to navigate challenging scenarios.

As an alternative to language around social licence, it may be preferable for the commentary to highlight the importance of entities taking active steps to preserve and build their “brand and reputation”, including by appropriately managing non-financial risks. Such a formulation would be consistently understood by listed entities, their boards and stakeholders, and avoid unhelpful debate around loosely worded terminology. It would also be consistent with directors’ duties.

The AICD recommends that the explanatory commentary refer to the current legal framework of directors’ duties in order to avoid any confusion or potentially contradictory views as to whom obligations are owed. We note that the recently released UK Corporate Governance Code contains express wording to clarify that nothing in it overrides or is intended as an interpretation of the statutory statement of directors’ duties in the relevant legislation. A similar statement would assist in the Australian context.

For completeness, we note that the term “social licence to operate” is also referenced in Recommendation 7.4 (sustainability disclosures), and the commentary to Principle 8 (remunerate fairly and responsibly). The former reference is particularly problematic as entities will be required to disclose whether and/or how they manage “social risks”, including those risks that can lead to the loss of an entity’s social licence to operate (see further below). Consequently, for the reasons outlined above, we would suggest the terms be removed from the Principles.



## **5 Diversity policies**

The AICD supports the proposed changes to Recommendation 1.5, including the new 30% measurable gender objective for the ASX 300, noting that, as at 31 May 2018, women accounted for 27.7% of ASX 200 directorships (30% of ASX 100 directorships). If introduced, the recommendation would support the momentum towards more gender-balanced boards. It is important to recall that in 2009, only 8.3% of ASX 200 board roles were filled by women. We note that the timeframes and strategies to achieve the measurable objective would remain at the discretion of individual companies. The AICD encourages consideration of extending the 30% minimum measurable objective to all listed entities.

### *5.1 The business case for diversity*

The AICD supports the draft highlighting that there is a strong business case for diversity. For example, in 2007, a McKinsey study “Women Matter” showed greater diversity in leadership correlated with better economic performance. The study found that these results were further improved where at least 30% of women were in leadership roles – below this level, no improvement was observed.

These findings were affirmed in the 2018 McKinsey study, “Delivering through Diversity”, which found a positive correlation between gender diversity on executive teams and measures of financial performance: top-quartile companies on executive-level gender diversity worldwide had a 21 percent likelihood of outperforming their fourth-quartile industry peers on EBIT margin, and they also had a 27 percent likelihood of outperforming fourth-quartile peers on longer-term value creation (measured using an economic-profit margin). The data set was extensive, covering over 1000 companies across 12 countries.

Significantly, the same McKinsey research also found that for ethnic and cultural diversity, there was a 33 percent likelihood of outperformance on EBIT margin, demonstrating the importance of taking a multi-faceted approach to diversity. Companies in the fourth quartile on both gender and ethnic diversity were also more likely (29%) to underperform their industry peers.

Where an organisation consistently produces a homogenous team (whether at executive, board or broader workforce level) companies should ask themselves why this is occurring, including considering measures to address any unconscious (or conscious) bias that may be at play. For example, “blind” reviewing of job applications (removing personal names and other information that may reveal a candidate’s gender, cultural or other background) may assist this process.

### *5.2 Proposed commentary and need to highlight skill and experience requirement*

As articulated in section 2.2 above, we are concerned that proposed Recommendation 1.5 contains extensive commentary. We recommend that the draft be reviewed with the objective of shortening commentary, so as to provide non-prescriptive guidance to entities on how they can comply, rather than detailing further actions that listed entities could take. As examples, the AICD suggests removing commentary encouraging listed entities to link remuneration to KPIs on gender participation and to consider disclosing insights from annual reviews and changes the entity has made as a result of these. Instead, commentary could point to useful external references for the reader.

Of course, while all organisations should seek to achieve a diverse workforce and leadership team, this is not to say that listed entities should appoint any executive or director who is unqualified. The starting premise must always be to appoint individuals with the requisite skills and experience necessary to fulfil the duties of the role, regardless of their gender or other personal background. This should be reflected in the commentary to Recommendation 1.5.

## **6 Corporate reporting**

The AICD is concerned by the proposal under Recommendation 4.4 for entities to have and disclose the process to “validate” their annual directors’ report and any “other corporate report it releases”. The commentary goes on to state that where such a report is not subject to assurance by the entity’s external auditor, “the entity should have an appropriate process in place to validate that the report is accurate, balanced, and understandable and provides the market with appropriate information to make informed investment decisions”.

We have received feedback from members that the term “validate” may suggest a requirement to prove each statement made in all corporate reports. There would be a significant compliance burden imposed if entities were required to undertake the level of validation/verification that entities undertake for a prospectus.

We understand this is not the intent of the recommendation and suggest that this be made clear in the explanatory commentary.

Alternative options would be to move the disclosure requirement to the commentary and introduce a threshold to encourage entities to disclose, in summary form, the reasonable steps they have taken to establish the accuracy of information in corporate reports in respect of *material* particulars.

We also recommend that consideration be given to:

- providing a definition of the term “corporate reports” so that the intended coverage of the Recommendation is clear – for example it is unclear whether it would encompass documents such as earnings releases, investor presentations, or modern slavery statements; and
- removing the reference to reports being “understandable” given the complexity inherent in certain reports and the subjectivity of the term. We have received feedback that it may be difficult for an entity to report against this requirement and that to do so meaningfully may require investigation (e.g. market surveys) or conflict with reporting obligations (e.g. where legislative or other regulatory frameworks codify the form of reporting).

## **7 Environmental and social risks**

The draft proposes to amend Recommendation 7.4 to refer to “environmental and social risks” rather than (currently) “economic, environmental and social sustainability risks”. Social risks are defined as “the negative consequences to a listed entity arising from its impact or perceived impact on social groups (including employees, customers, suppliers and local communities) or from being seen to operate outside accepted community standards. It includes risks that can “lead to the loss of an entity’s “social licence to operate” mentioned in the commentary to principle 3 above”.

### *7.1 Social risks and the social licence to operate*

Directors have expressed concerns around these proposed changes, especially the incorporation of the term “social risks” and “social licence to operate” into the recommendation (see discussion at section 4 above). Instead, we suggest that the current wording of the Principles (third edition) be retained, given it has market acceptance and is well-understood.

## 7.2 *Climate change disclosure*

The AICD supports the proposed updated commentary in relation to climate change related risk, including the suggestion that entities that believe they do not have any material exposure to climate change risk should carefully consider the basis for that belief and undertake peer benchmarking.

We note that investors are increasingly seeking greater disclosure on such issues, and that over the last twelve months, key regulators, including ASIC and APRA, have highlighted the importance of companies taking a proactive approach to climate change risk management.

We also support the Council encouraging “listed entities with material exposure to climate change risk to consider implementing the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD)”. Provided this remains framed as encouragement to consider, it is an appropriate balance noting that market practice is clearly evolving. Indeed, ACSI’s 2018 Corporate Sustainability Report found that 95 ASX 200 companies (48%) have disclosed a climate-related policy statement, 112 companies reported their greenhouse gas (GHG) emissions, 42 companies had GHG emission reduction targets, and 22 companies reported against the TCFD framework or have committed to do so.

It is appropriate that the commentary is limited to encouraging consideration of the TCFD framework given that the TCFD recommendations are complex, and will require significant work by entities in order to produce reports that are accurate and would be of high value to end users, including investors. This is particularly the case for scenario-based modelling.

## **8 Next steps**

We trust our comments will be of assistance when formulating the proposed fourth edition of the ASX Principles. It is imperative that the final draft is appropriately targeted to core governance issues and does not waver from its core purpose of providing flexible, principles-based guidance to listed entities. We look forward to working closely with other Council members and stakeholders towards that end.

If you would like to discuss any aspect of this submission further, please do not hesitate to contact Christian Gergis, Head of Policy, on (02) 8248 8431 or at [cgergis@aicd.com.au](mailto:cgergis@aicd.com.au).

Yours sincerely,



**LOUISE PETSCHLER**  
General Manager, Advocacy

APPENDIX – AICD COMMENTS ON THE DRAFT *ASX PRINCIPLES* – 27 JULY 2018

- This table should be read in conjunction with the substantive comments outlined in the AICD’s submission dated 27 July 2018.
- As a general statement, the AICD encourages review of all proposed commentary to reduce detail and prescription.

Consultation Draft Reference	AICD comments and suggestions
<b>Preface</b>	
More detailed guidance in the preface to the recommendations on what should be disclosed by entities that follow the Council’s recommendations including a new section dealing with proposed recommendations not likely to be relevant to the majority of listed entities.	<ul style="list-style-type: none"> <li>• We suggest that, given the increase in detail and prescription proposed in commentary, the note at the end of ‘<i>The linkage with ASX Listing Rules</i>’ section, that states that the principles and commentary do not trigger any specific disclosure obligations, be supported by a further statement. This should explicitly clarify that the commentary is intended to be <b>explanatory</b> only, to avoid any risk of the expanded commentary being interpreted as establishing new requirements or expanding reporting expectations.</li> </ul>
<b>Principle 1: Lay solid foundations for management and oversight.</b> A listed entity should <del>establish and disclose</del> <u>clearly delineate</u> the respective roles and responsibilities of its board and management and <u>disclose</u> how their performance is monitored and evaluated.	
<p><b>Recommendation 1.1:</b> Have and disclose a board charter setting out roles and responsibilities.</p> <p><b>Commentary 1.1:</b> Adding to the list of ‘usual responsibilities of the board’ (purpose, code of conduct, remuneration alignment, and others)</p>	<ul style="list-style-type: none"> <li>• The AICD <b>supports</b> the amendment to require listed entities to have a board charter</li> <li>• The AICD <b>supports</b> explanatory commentary outlining suggested inclusions for consideration.</li> <li>• We <b>query</b> use of ‘usually’, given the additions proposed on new issues such as core values and code of conduct, and suggest this be re-framed. We note that not all listed entities require all senior executive appointments to be approved by the board and suggest this be separated from the re-stating of the legal requirement for the company secretary to be appointed by the board. We note inconsistency in use of ‘core values’ and ‘values’ and suggest this be resolved.</li> </ul>
<p><b>Recommendation 1.2:</b> Add ‘senior executive’.</p> <p><b>Commentary 1.2:</b> New wording on disclosure of the outcomes of checks, and addition of ‘reasons why’ to board statement on director candidates.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>supports</b> the amendment to Recommendation 1.2.</li> <li>• The AICD <b>suggests</b> that the new wording on disclosure of the outcomes of checks be removed, or at a minimum, re-framed, to avoid privacy and reputation issues. Encouraging statements of the reasons why candidates are recommended is sufficient.</li> </ul>
<p><b>Recommendation 1.3:</b> No change.</p> <p><b>Commentary 1.3:</b> Appointment letters should require director to notify or seek approval before accepting any new role.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>suggests</b> that the proposed wording clarify that approval be sought from the chair as the representative of the entity.</li> </ul>

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## APPENDIX – AICD COMMENTS ON THE DRAFT ASX PRINCIPLES – 27 JULY 2018

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Consultation Draft Reference	AICD comments and suggestions
Letters of appointment should be with individuals, not entities, with footnote.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed amendments to explanatory commentary that letters of appointment should be with individuals and the associated footnote.</li> </ul>
<p><b>Recommendation 1.5:</b> Significant change as outlined in the consultation paper.</p> <p><b>Commentary 1.5:</b> Significant change as outlined in the consultation paper.</p>	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> listed entities in the ASX 300 having a minimum measurable objective of gender diversity of 30%, noting that timeframes and strategies to achieve this goal would be at the discretion of the entity. The AICD <b>suggests</b> that consideration be given to applying this to all listed entities.</li> <li>The AICD <b>supports</b> including senior executive roles and the workforce generally.</li> <li>The AICD <b>recommends</b> that explanatory commentary include a statement clarifying that the skills and expertise of individual directors, and the board collectively, are the context for the commentary.</li> <li>The AICD <b>queries</b> whether the level of detail and prescription proposed for the explanatory commentary is required, including, for example, commentary on KPIs. Footnotes or reference to external groups with expertise in these matters is preferable to including this text in the Principles.</li> <li>The AICD <b>does not support</b> commentary encouraging listed entities to disclose insights gained from the annual review and changes made to its objectives and programs.</li> </ul>
<p><b>Recommendation 1.6:</b> New requirement for annual reviews of board, committees and directors.</p> <p><b>Commentary 1.6:</b> Addition of currency of director's knowledge and impact of other commitments.</p>	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> requiring listed entities to have and disclose a process for evaluating the performance of governance bodies. The AICD <b>does not support</b> mandating that evaluations be conducted on an annual basis for the board, all committees and individual directors. In our view, this is too prescriptive, particularly for smaller cap entities. Periodic evaluations as determined by the board would be preferable.</li> <li>The AICD <b>does not support</b> commentary encouraging boards to disclose insights gained from the evaluation as a matter of course.</li> </ul>
<p><b>Recommendation 1.7:</b> New requirement that senior executive reviews be conducted annually.</p>	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed revision, which we note is market practice and expectation.</li> </ul>
<p><b>Principle 2. Structure the board to be effective and add value:</b> A listed entity should have a board of an appropriate size, composition, skills and commitment and knowledge of the entity and the industry in which it operates, to enable it to discharge its duties effectively and to add value.</p>	
<p><b>Recommendation 2.2:</b> No change</p>	

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## APPENDIX – AICD COMMENTS ON THE DRAFT ASX PRINCIPLES – 27 JULY 2018

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Consultation Draft Reference	AICD comments and suggestions
<b>Commentary 2.2:</b> Significant new commentary, including emerging risk areas and detail on format.	<ul style="list-style-type: none"> <li>The AICD <b>suggests</b> that the Council revisit proposed wording, per section 3.3 of our submission.</li> </ul>
<b>Recommendation 2.3:</b> ‘Association’ replaced with ‘affiliation’. <b>Commentary 2.3:</b> Significant additions including more prescriptive framing of expectations of directors in determining independence based on Box 2.3 factors.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed revision, subject to clarification that no scope change is intended.</li> <li>The AICD <b>suggests</b> that the new explanatory commentary proposed ahead of Box 2.3 be revisited, to reduce the level of prescription and be expressed more clearly as <i>explanatory</i> guidance.</li> <li>The AICD <b>supports</b> the revisions proposed to Box 2.3.</li> </ul>
<b>Recommendation 2.4:</b> No change <b>Commentary 2.4:</b> New wording encouraging listed entities that do not follow the recommendation to have at least more than one independent director.	<ul style="list-style-type: none"> <li>The AICD <b>recommends</b> that this wording be removed from the explanatory commentary, so that the focus remains on the recommendation that a majority of the board be independent, with listed entities reporting on an ‘if not, why not’ basis. If the ASX or regulators wish to impose minimum representation levels, we suggest these should be covered in the Listing Rules (or legislation). We are concerned that the wording may lead some entities to form the view that two independent directors is sufficient.</li> </ul>
<b>Recommendation 2.6:</b> Add periodic review of need for professional development of directors. <b>Commentary 2.6:</b> More prescriptive commentary.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed recommendation.</li> </ul>
<b>Recommendation 2.7:</b> New recommendation that a listed entity with a director who is not fluent in the language in which meetings are held or key documents written should disclose the processes it has in place to ensure the director understands and can contribute to discussions at those meetings.	<ul style="list-style-type: none"> <li>The AICD <b>does not support</b> the addition of this new recommendation. In our view, this re-states directors’ duties, supported by recent case law and compliance action. It will not be relevant to the majority of listed entities and seeks to address a concern that is more appropriately targeted through compliance activities by relevant regulators.</li> </ul>
<b>Principle 3. <del>Act ethically and responsibly. Instil the desired culture.</del> A listed entity should act ethically and responsibly. A listed entity should instil and continuously reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner.</b>	
New commentary proposed referencing social licence to operate, acting in a socially	<ul style="list-style-type: none"> <li>The AICD has significant concerns about the change to Principle 3 and proposed commentary. As outlined in section 4 of our submission, the AICD <b>does not support</b> the proposed change.</li> </ul>

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## APPENDIX – AICD COMMENTS ON THE DRAFT ASX PRINCIPLES – 27 JULY 2018

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Consultation Draft Reference	AICD comments and suggestions
responsible manner and providing more details on 'good corporate citizen' conduct.	<ul style="list-style-type: none"> <li>In particular, the proposed changes to Principle 3 introduce ambiguous concepts such as acting in a "socially responsible manner" and a "social licence to operate" which are highly subjective and will vary over time. The AICD <b>suggests</b> that the Principle refer simply to "acting lawfully and ethically".</li> <li>There is no reference in the commentary to existing statutory and general law duties to act in the best interests of the company, which may confuse some directors and purport to place stakeholders on the same footing as shareholders. The AICD <b>recommends</b> this be clarified.</li> <li>New examples of good corporate citizenship proposed in the commentary are highly subjective, e.g.: "aggressive tax minimisation" and "paying a living wage", and should be removed.</li> </ul>
<p><b>Recommendation 3.1:</b> New requirement to articulate and disclose core values.</p> <p><b>Commentary 3.1:</b> New commentary describing considerations in articulating core values.</p>	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed recommendation.</li> <li>The AICD <b>recommends</b> that the explanatory commentary be redrafted to focus on a brief description of core values, removing some of the detail and direction in the current wording.</li> </ul>
<p><b>Recommendation 3.2:</b> New requirements to ensure the board is informed of material breaches of the code of conduct</p> <p><b>Commentary 3.2:</b> New detail including requiring three year reviews of codes of conduct.</p>	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed recommendation, however we <b>do not support</b> the commentary introducing an expectation that entities disclose actions they have taken to enforce their code of conduct. Entities are already subject to continuous disclosure obligations. Disclosure of code of conduct enforcement is likely to lead to undue focus on immaterial matters, and could encourage entities to ignore breaches for fear of then needing to disclose them. The commentary and Box 3.2 should also remove reference to "socially responsible" per the comments in section 4 of our submission.</li> <li>The AICD <b>does not support</b> the inclusion of a three-year review timeframe for review of codes of conduct. We suggest replacing this with 'periodic' to allow entities to determine the appropriate timeframe.</li> </ul>
<p><b>Recommendation 3.3:</b> Whistleblowing policy</p> <p><b>Recommendation 3.4:</b> Anti-bribery and corruption</p>	<ul style="list-style-type: none"> <li>The AICD has <b>concerns</b> with this recommendation, per section 2.1 of our submission. While we support strong policies in these areas, we query highlighting these areas over other, also important, policy areas. We also note that law reform is underway in relation to both substantive areas.</li> </ul>
<p><b>Principle 4: <del>Safeguard integrity in corporate reporting</del>. Produce corporate reports of high quality and integrity.</b> Commentary that a listed entity should provide corporate reports of <u>high quality and integrity</u> that give the reader a <u>reasonable understanding of the entity's business model, strategy, risks and opportunities, remuneration policies and practices and governance framework, as well as its financial performance.</u></p>	

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Consultation Draft Reference	AICD comments and suggestions
<b>Recommendation 4.4:</b> Have and disclose processes to validate corporate reporting.	<ul style="list-style-type: none"> <li>The AICD <b>suggests</b> redrafting of this new recommendation and commentary, per section 6 of our submission, including clarifying that prospectus-level verification is not expected of listed entities.</li> </ul>
<b>Principle 5: Make timely and balanced disclosure.</b> New commentary clarifies that this means timely and balanced disclosure of information that a reasonable person would expect to have a material effect on the price or value of its securities.	
<b>Recommendation 5.1</b> Now requiring listed entities to disclose continuous disclosure policies in full.	<ul style="list-style-type: none"> <li>The AICD <b>does not support</b> the proposed recommendation. Full disclosure of the policy is not necessarily more useful to investors than a summary. Given the volume of material disclosed to the market, it should remain at the company's discretion whether or not to disclose in full or summary.</li> </ul>
<b>Recommendation 5.2:</b> New recommendation that listed entity boards receive all Listing Rule 3.1 announcements promptly as they are made.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> this recommendation but suggests that the drafting of commentary be revisited to ensure that listed entities have full flexibility in the manner in which copies are made available.</li> </ul>
<b>Recommendation 5.3:</b> New requirement that investor briefings be released ahead of time.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed recommendation.</li> </ul>
<b>Principle 6: Respect the rights of security holders.</b> A listed entity should <del>respect the rights of</del> provide its security holders by providing them with appropriate information and facilities to allow them to exercise <del>these</del> their rights as owners effectively.	
<b>Recommendation 6.1:</b> No change <b>Commentary 6.1:</b> Addition of links to other corporate reports and core values on website.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed commentary.</li> </ul>
<b>Recommendation 6.2:</b> Minor change <b>Commentary 6.2:</b> Adds reference to proxy advisers and retail investors.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed additions to commentary, in particular recognition of retail investors.</li> </ul>
<b>Recommendation 6.3:</b> Change from disclosing policies and processes to disclosing how the entity facilitates and encourages participation at security holder meetings. <b>Commentary 6.3:</b> Encouragement to choose reasonably accessible meeting venues and consider use of technology.	<ul style="list-style-type: none"> <li>The AICD <b>supports</b> the proposed recommendation.</li> <li>The AICD <b>supports</b> the intent of the commentary and suggests it be clearly expressed as encouragement and guidance (for example, replace 'should' with encouragement to consider).</li> </ul>



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Consultation Draft Reference	AICD comments and suggestions
<p><b>Recommendation 6.4:</b> New Recommendation that all meetings be decided by poll.</p> <p><b>Commentary 6.4:</b> States that certainty on will of meeting can only be determined by poll.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>supports</b> the proposed recommendation. We recommend that consideration be given to drafting the recommendation so that it applies to contested, material resolutions.</li> <li>• The AICD <b>suggests</b> that the explanatory commentary clarify expectations for procedural resolutions and remove the statement that certainty is only delivered by poll.</li> </ul>
<p><b>Principle 7: Recognise and manage risk.</b> New commentary added: <u><i>A sound risk management framework...should address financial and non-financial risk, as well as risks with a short, medium or long-term horizon.</i></u></p>	
<p><b>Recommendation 7.1:</b> No change</p> <p><b>Commentary 7.1:</b> New detail on risk committee.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>queries</b> whether the degree of detail proposed to be included is necessary or helpful.</li> </ul>
<p><b>Recommendation 7.2:</b> Inclusion of risk appetite statement reference.</p> <p><b>Commentary 7.2:</b> New wording on risk appetite statements and disclosure of risk review outcomes.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>suggests</b> that the commentary be amended to reinstate the qualification of 'where appropriate' in relation to disclosure of the outcomes of risk reviews.</li> </ul>
<p><b>Recommendation 7.3:</b> No change</p> <p><b>Commentary 7.3:</b> Encouragement to establish internal audit function, plus new footnote.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>supports</b> the proposed commentary, and suggests that it be made explicit in commentary that an internal audit function can be out-sourced (a common market practice).</li> </ul>
<p><b>Recommendation 7.4:</b> Change to environmental and social risks (rather than economic, environmental and social sustainability risks).</p> <p><b>Commentary 7.4:</b> Social risks and climate change</p>	<ul style="list-style-type: none"> <li>• The AICD <b>does not support</b> the drafting of the recommendation, in particular reference and commentary on social risks, per section 7 of our submission.</li> <li>• The AICD generally <b>supports</b> the climate change references proposed in commentary, with the suggestion that the commentary be clearly expressed as explanatory guidance.</li> </ul>
<p><b>Principle 8: Remunerate fairly and responsibly.</b> Commentary changed to add '<u><i>over the short, medium and longer-term</i></u>' to value creation, note the risk of rewarding conduct contrary to values or risk appetite, and the implications for social licence if entities are perceived to be remunerating 'excessively'.</p>	
<p>New commentary with reference to social licence to operate risk from excessive remuneration.</p>	<ul style="list-style-type: none"> <li>• The AICD <b>does not support</b> including social licence for reasons discussed in section 4 of our submission. We suggest inclusion of 'competitive' as a further consideration in the explanatory commentary.</li> </ul>

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Consultation Draft Reference	AICD comments and suggestions
<b>Recommendation 8.4:</b> New proposal to require that entities should only enter into agreements for consultancy services with directors/officers if they have independent advice on several matters.	<ul style="list-style-type: none"><li data-bbox="831 379 2085 469">• The AICD <b>does not support</b> the proposed recommendation. We consider related party disclosure and compliance with the law adequately addresses this concern and consider the new requirement unduly prescriptive were it to apply in all instances (particularly for smaller cap entities).</li></ul>

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