Company Matters.

27 July 2018

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

Attention: Mavis Tan (mavis.tan@asx.com.au)

Dear Ms Tan

**Consultation Draft of the Fourth Edition of the ASX Corporate Governance Council's Principles and Recommendations**

Company Matters Pty Limited (**Company Matters**) welcomes the opportunity to provide feedback on the proposed 4th edition of the ASX Corporate Governance Council's (**Council**) Principles and Recommendations.

Company Matters is the consulting arm of ASX-listed Link Administration Holdings Limited (**Link Group**), and was established in 2006 as an incorporated legal practice, to bridge the gap between the public company secretarial service providers and M&A focused corporate law firms. Company Matters' specialised service offering is unique – focusing on prevailing governance and company secretarial matters within a boutique law firm structure.

Within its client base, and as at the date of this letter, a Company Matters practitioner is the:

- statutory appointed secretary and/or ASX Listing Rule 12.6 appointed representative for 34 ASX listed entities; and
- statutory appointed company secretary of a further 104 Australian incorporated, non-listed ASX entities, many of which are subsidiaries or joint ventures of large ASX listed entities.

In addition, Company Matters provides consultancy and 'white-label' company secretary services. In FY18, Company Matters provided these services to a further approximately 35 ASX listed entities, ranging from S&P/ASX 20 to small-caps, across a range of industries and sectors.

By way of example, in 2017 Company Matters practitioners:

- attended over 900 board meetings, predominantly for ASX listed entities;
- assisted over 300 clients, from S&P/ASX 20 entities to small-caps and not for profits, across a range of capacities from statutory company secretary, independent governance consultant, chief financial officer and director;
- attended over 60 security holder meetings, were involved with more than 10 secondary capital raisings and we prepared over 65 notices of meetings;
- released over 1,000 ASX announcements; and
- assisted six clients navigate their first year as listed entities.

As a result, Company Matters is uniquely placed to provide feedback on how the changes to the Principles and Recommendations will impact listed entities and, in particular, small-cap ASX-listed entities.

In forming a view on the Principles and Recommendations, we have also considered whether the additional recommendations or disclosures are really of benefit to an investor reading an entity's corporate governance statement.

We strongly support the Council's preservation of the 'if not, why not' framework, which is particularly important for small-cap ASX-listed entities. However, we are concerned that the proposed amendments:

- are overly prescriptive;
- have become too long; and
- contain elements of restatement of existing law or guidance, which is unnecessary.

We have provided examples of our concerns below, together with feedback on specific recommendations and/or commentary.

## The Principles and Recommendations are overly prescriptive

While it is important that there is clear guidance for entities to address the Principles and Recommendations, we are of the view that in some areas, the Principles and Recommendations have moved beyond guidance to prescription. In particular, we note the following examples:

- number of recommendations has increased by over 30% (by 9 to 38 recommendations);
- word 'ensure' appears 27 times (up from 15 in the previous edition);
- word 'should' appears in the document 260 times (up from 192 times in the 3rd edition);
- proposed commentary for Recommendation 2.2 (board skills matrix), indicates that there is no prescribed format for such a matrix, but then proceeds to set out, in some detail, the form a skills matrix 'usually' takes and what should be included;
- proposed commentary for Recommendation 2.3 (independence of directors), and the direction around where the board 'should rule the director ***not*** to be independent'[1];
- proposed commentary for Recommendation 2.6 (director induction and training), and the contents of training on legal duties/legislative framework/accounting matters, where the directive 'should' is used (where the first paragraph of the commentary uses the language 'this could include….', which would be a preferable approach); and
- proposed commentary for Recommendation 3.2 (code of conduct) proposes that the code of conduct should be reviewed at least once every three years. This is very prescriptive, and query why 'regularly' or 'periodically' would not have been as appropriate.

Similarly, we note that in a number of new recommendations, the combination of words 'should ensure' has emerged in the drafting, which once again gives an overly prescriptive tone to these recommendations and to the document more generally.

While this combination of words appeared in existing commentary for recommendation 1.2, and in the text of recommendations 2.1(b) and 4.3, we now find 'should ensure' (or a combination of these words) in proposed recommendations 2.7 (and its commentary), 3.2(b) (and its commentary), 3.3(b),

[1] In 2015, changes were made to Australian taxation laws that apply to employee equity plans. As a result of these changes and the generally accepted view that directors should have some 'skin in the game', we have seen a re-emergence of non-executive director equity plans. These plans are designed to allow non-executive directors to sacrifice fees in return for equity in the entity (often using a 'share right' to facilitate the award). These plans generally do not involve any sort of performance hurdle or link to the performance of the entity. We recommend that it is made clear that employee incentive schemes (e.g involving a sacrifice of fees where there is no performance hurdle or other link the entity's performance) be carved out from Box 2.3.

3.4(b), 5.2 (and its commentary) and 6.4. By way of example, recommendation 6.4 could equally be restated as *'A listed entity should decide all resolutions at a meeting of security holders by a poll rather than a show of hands'*.

The increased level of prescription is not consistent with the intent of the Principles and Recommendations as a flexible disclosure based approach to corporate governance reporting.

There is also concern that the word 'ensure' places a higher level of responsibility/obligation on directors and blurs the roles of directors and management. In addition, we have concerns about the potential limitations on what the board is actually able to 'ensure' and the potential legal risks if Courts/other regulators interpret the term 'ensure' inconsistently. Similar concerns were raised to the Australian Prudential Regulation Authority (**APRA**) in 2013/2014 about the ambiguity of the use of the word 'ensure' in prudential standards and the concern that it creates an unrealistic burden on non-executive directors. APRA reconsidered its use of the word 'ensure' and clarified its meaning.

We are also concerned about the additional burden that will be placed on ASX listed entities, especially for small-caps where resources are limited and already stretched. We question whether the proposed amendments will result in improved corporate governance practices and benefit investors (and potential investors) or whether the amendments will add further pressure on ASX listed entities, many of which are struggling to comply with the already complex Australian regulatory environment.

We suggest that the language and tone of the entire document be reviewed to address the overly prescriptive tone which has emerged in the Principles and Recommendations.

## The Principles and Recommendations have become too long

The Principles and Recommendations have increased in length to 55 pages, up 38% from 40 pages for the 3rd edition. While this has undoubtedly been the result of the addition of 9 new recommendations and related commentary, we query whether:

- all the new recommendations are sufficiently important examples of good governance practice to warrant a separate recommendation, or are some of these recommendations superfluous or could have otherwise been incorporated into existing recommendations (refer to our submission below); and
- the commentary provided for these new recommendations is sufficiently succinct. By way of example, the commentary around a number of the Principle 3 recommendations is quite long.

We are mindful of ASIC Regulatory Guide 228 (Prospectuses: Effective disclosure for retail investors) in relation to the presentation of certain documents in a 'clear, concise and effective manner.'

Although that document is primarily aimed at the prospectus disclosures for retail investors, it does contemplate that the guidance on 'clear, concise and effective' disclosure is relevant to a broad range of corporate communications.[2] In this regard, we ask the Council to be mindful of this guidance and give consideration to the length and prescriptiveness of the Principles and Recommendations and the consequential reporting obligations on entities.

[2] ASIC Regulatory Guide 228 (RG 228) applies more broadly than just in relation to prospectuses. ASIC notes in RG 228.15 that 'our guidance on 'clear, concise and effective' disclosure is relevant to a broad range of corporate communications…some of these documents are not subject to a statutory requirement to be 'clear, concise and effective' but we consider similar duties arise under the general law (e.g. directors' duty to inform members and prohibitions on misleading or deceptive conduct).'

**The Principles and Recommendations contain elements of restatement of existing law or guidance**

We suggest that there are aspects of the Principles and Recommendations which contain elements of restatement of existing law or guidance. Specifically we note:

- Recommendation 2.7 is covered by Section 180 of the Corporations Act 2001 (Cth) (**Corporations Act**). Directors have a duty of care and diligence, and this duty would include the ability to sufficiently understand the business being discussed at a meeting. This would be the expectation of security holders. If a director is not able to sufficiently understand the dialogue and discussions at a meeting, or as presented in the papers, we would suggest that they would be in breach of their duty and the Corporations Act (see below for our recommendation regarding foreign incorporated entities – we suggest that the Council move this recommendation to an annexure that covers foreign incorporated entities only, given this overlaps with the Australian legal requirements);
- Recommendation 3.3 overlaps with the proposed new provisions of the Corporations Act as set out in the Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 (**Whistleblower Bill**); which we understand is likely to be passed in the near future. Assuming the Whistleblower Bill is passed, we question whether Recommendation 3.3 is necessary for Australian incorporated entities;
- Recommendation 5.3 is a situation that is currently covered by ASX Listing Rule 3.1 and the ASX Listing Rules Guidance Note 8 (**GN8**) on continuous disclosure. In particular, GN8, at paragraph 7.7, is sufficiently specific, in our view, on the disclosure required in the circumstances alluded to in this recommendation; and
- Recommendation 8.4 – see our separate comments below.

We feel that these areas represent opportunities to refine the focus of the Principles and Recommendations to those areas that are not codified elsewhere, while also addressing the length of the document.

***Suggested approach for foreign incorporated entities***

We suggest that an annexure (similar to the annexure for externally managed listed entities in the 3rd edition of the Principles and Recommendations) could be included (in lieu of the additional recommendations that overlap with Australian law) for the relatively low number (approximately 10%) of ASX listed entities that are incorporated in jurisdictions outside Australia.

The annexure could contain the proposed recommendations that are already covered by Australian law or other applicable regulation, for example Recommendation 3.3, Recommendation 4.4, Recommendation 5.2, Recommendation 5.3 and Recommendation 8.4 (see below). This would be helpful in reducing the administrative and reporting burden applicable to Australian entities.

We also have specific feedback on the following Principles and Recommendations:

**Principle 3 – instil the desired culture – should be amended**

While an entity's 'social licence to operate' is a topical issue in corporate Australia, we feel that care needs to be taken so that the final form of Principle 3 is not read in conflict with the existing duties of directors under section 181 of the Corporations Act.

We are pleased to see that the stronger wording that 'a listed entity must have regard to the views and interests of a broader range of stakeholders than just its security holders' (as mentioned on page 6 of the Council's Consultation Paper) was not replicated in the text of the draft Principles and Recommendations.

However, there remains a concern that the reach of the proposed Principle is inconsistent with the statutory and general law duties of directors – specifically, that section 181 of the Corporations Act requires directors and other officers to act in good faith in the best interests of the corporation and for a proper purpose – section 181 of the Corporations Act does not require mandatory consideration of other stakeholders.

We are also concerned that the phrase 'social licence to operate' and the accompanying commentary could be subject to a broad range of interpretations, given the subjectivity of the statement. The concept 'social licence to operate' goes far beyond the expectation of 'good corporate citizen' and the two should not be used interchangeably.

These aspects of the proposed revisions require careful consideration by the Council, given the potential uncertainty it could create for directors and management.

**Recommendation 1.5 – diversity – should be amended**

We strongly support the need for, and importance of, diversity at board and senior management level and throughout an entity's workforce more generally. However, diversity should not be achieved at the expense of board performance and having the right skills on the board.

While we broadly support this recommendation, we raise the following issues for consideration:

- the commentary for this recommendation proposes that an entity's diversity policy expresses its 'commitment to embrace diversity at all levels and in all facets; including gender, marital or family status, sexual orientation, gender identity, age, physical abilities, ethnicity, religious beliefs, cultural background, socio-economic background, perspective and experience'. While this is an important and valuable commitment, it should be acknowledged that quantitative reporting on elements of diversity beyond gender and age are likely to be problematic, as the only information that most Australian entities keep in relation to the attributes of their directors, executive and the general workforce relate to age or gender – all other attributes would unlikely be recorded in an entity's records. We also note that collection of some of this data is illegal under certain countries' privacy laws (for example, sexual orientation);
- the guidance regarding board composition and avoiding 'groupthink' by appointing directors of different ages, ethnicities, culture or socio-economic background should be reconsidered – the composition of a board must fundamentally be determined by reference to the strategy and business needs of the entity, not a philosophical aspiration and broad-brush approach to diversity. We question whether this would result in better governance for most entities; and
- the commentary on diversity policies and practices needs to include a cross reference to the commentary on the board skills matrix – diversity and skills should be considered together.

**Recommendation 3.4 – anti-bribery and corruption policy – should be amended**

While we strongly support that entities have appropriate policies and messaging to employees, contractors and other stakeholders around zero tolerances for bribery, corruption and related actions and behaviours, we suggest that entities be given the option of either incorporating their policies around anti-bribery and corruption into other existing documents or a stand-alone anti-bribery and corruption policy.

Looking at this from the perspective of smaller listed entities, the recommendation in its current form (ie to have a separate policy) represents a potential additional administrative burden for these entities who, notwithstanding their listed status, often operate with very small 'head office' teams.

In these circumstances, we suggest that an amendment to the recommendation be made to permit for the anti-bribery and corruption matters to be included either in an existing policy or code (such as the code of conduct) or (as provided in the current drafting) as a separate, standalone policy.

**Recommendation 4.4 – validation process for corporate reports released to the market – should be deleted**

We support the need for accurate reporting to the market. However, approaching this recommendation from the perspective of smaller listed entities, specifically the requirement to disclose the process to validate the annual directors' report (and other corporate reports), we would query the level of due diligence and work that would be required to satisfy the required disclosure and the benefits this would provide to investors (and potential investors).

In particular, we suggest that this recommendation would impose an unnecessary and unreasonable burden and cost on smaller listed entities.

Furthermore, it is our view that:

- it is already the duty of a director to gain appropriate comfort around proper process in place when it comes to corporate reporting for market release;
- any 'forward looking statements' contained in an entity's report are already subject to Australian law and the board must have a reasonable basis in fact or else they will be deemed misleading;
- there is no reason to differentiate reports which have been audited by the entity's external auditor – the board should not be relying on the external auditor's to provide absolute validation and comfort as to the accuracy of reports. Each director should apply an enquiring mind to the consideration of the reports, not blindly rely on the assurance of the external auditor. The entity should have appropriate processes in place to validate reports, irrespective of whether the report has been subject to an external audit; and
- detailing an entity's verification and validation processes publicly offers very little benefit to investors (and potential investors).

From a practical perspective, the validation and verification process will also vary between reports and sections of reports and reporting on this process will be complicated and add an unnecessary level of complexity to an entity's reporting process.

For these reasons, we suggest that this new recommendation should be deleted.

**Recommendation 5.2 – board to receive copies of all Listing Rule 3.1 announcements promptly after they have been made – should be deleted or should be included as part of another recommendation**

We agree that directors should be aware of the material disclosures that are being made by the entity to the ASX (and on the face of it, if an entity is making an announcement in accordance with Listing Rule 3.1, it would be material in nature). We also agree that it is good practice for directors to be informed of such disclosures promptly after they have been made.

However, it is our view that most entities would already have a mechanism in place by which directors are promptly made aware of material disclosures and if not, we question whether a director is properly fulfilling their duties as a director under the Corporations Act if material announcements are being released and the director is not aware of the announcement either ahead of release or promptly after release.[3]

[3] For example, in circumstances where an announcement must be released immediately and time does not permit approval by the full Board (in which case senior management or the Disclosure Committee would rely on delegations in place to allow an entity to respond to the need to make immediate disclosures).

In such circumstances, we believe it is the responsibility of the board (and each individual director) to put appropriate systems in place to confirm that each director is receiving all information (which would include material ASX announcements) that the director requires to satisfy their duties as a director.

From a practical perspective and based on our work with a large number of boards, including in circumstances where entities have been required to immediately make an unplanned announcement in circumstances where confidentiality has been lost or there is market speculation, we consider it would be a highly unusual situation for directors not to be informed of all announcements made under Listing Rule 3.1 either ahead of release (even if time did not permit formal approval from the full board to be obtained) or promptly after release.

There may be many good practices relating to the communication by a listed entity with its directors on various matters of utility or importance, but we would query whether these practices would be of sufficient concern to security holders, potential investors or analysts reading the entity's corporate governance statement to warrant inclusion in the Principles and Recommendations.

For these reasons, as well as taking the overall length of the document into account, we suggest that this new recommendation should be deleted or, in the alternative, that it be incorporated into an existing recommendation (or commentary).

**Recommendation 6.3 – hybrid meetings – we are supportive of the use of hybrid meetings (if appropriate for the entity having regard to its member base)**

We support the use of technology to provide options to both issuers and security holders in relation to the holding of security holder meetings. Link Group has developed and offers clients the use of Link Group's fully integrated platform to facilitate hybrid member meetings (by enabling members to vote and ask questions either in person or online).

In 2016 and 2017, Link Group held its annual general meeting using its technology to enable members to participate in the AGM, either in person or online.

The statistics evidencing the general decline in security holder participation at AGMs have been extensively reported.[4] Critics of the AGM argue that it is an archaic process that does not reflect advances in technology and the realities of operating in a world of continuous disclosure.[5] While this may be true to an extent, the 2017 AGM season demonstrated that not all security holders see the process as routine and made themselves heard, certainly in relation to remuneration matters, director elections and environmental, social and governance issues.

So if the AGM is not dead, why not embrace technology and take a new approach to engaging with security holders and increase accessibility and transparency? While a hybrid AGM might be a daunting concept for some boards and every meeting should adopt a fit-for-purpose approach, there are some entities which are welcoming the opportunity to engage with security holders in a myriad of ways and hear the thoughts and views of the entity's owners — both positive and negative.

Hybrid meetings will not suit all entities, but the technology is now available and some entities have already used it to improve member engagement and create options for how their members elect to participate in meetings.

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4 Link Group data indicates a low percentage of security holders attending AGMs for Australian entities — according to Link Group data, in 2017, only 0.18% of security holders attended AGMs.

5 ASX Listing Rule 3.1 requires ASX listed entities to immediately disclose market sensitive information. In addition, ASX Listing Rule 3.13.3 requires ASX listed entities to give ASX the contents of any prepared announcement that will be delivered at a meeting of security holders no later than the start of the meeting.

**Recommendation 6.4 – polls for all resolutions at security holder meetings – should be amended and/or qualified**

We support the notion, from the perspective of good governance, that the ideal position would be for all resolutions put to meetings of security holders to be decided by a poll. However, there are a number of factors to take into account from the perspective of small-cap ASX-listed entities which make it more difficult to mandate this proposition. We would seek that there be some flexibility in the application of this recommendation.

We note that it is common practice for share registries to impose a charge to an entity for the work associated with each poll they undertake at a meeting. Cost concerns aside, it is our strong view for any entity, regardless of size, which has a contentious agenda item or pre-meeting proxy numbers indicating a strong 'no' vote on any item of business on the agenda, to arrange for such items to be determined by a poll.

However, in the case of small-cap ASX-listed entities, where the proxies indicate a strong 'yes' vote (say greater than 95%) for any item, we would seek flexibility to be able to determine such items on a show of hands.

At the same time, in the event that there was any 'mandating' of resolutions being determined by poll, we would suggest that clarification would need to be given so that such a stance only applied to resolutions included in the notice of meeting, and not resolutions made from the floor during the course of the meeting (which should be determined by a show of hands).

**Recommendation 8.4 – independent advice ahead of entering into agreement for consultancy services by a director or senior executive – should be deleted**

We acknowledge the importance of obtaining the appropriate approvals and disclosing transactions with related parties. However, we would contend, particularly for small-cap ASX-listed entities, that the proposed need to seek independent advice when entering into a consultancy service agreement with a director or senior executive imposes a further financial and compliance burden on these entities (in an environment where there is already a legislative and regulatory framework around related party agreements and related disclosures).

In particular, we note the requirements of:

- section 208 of the Corporations Act, where member approval is required for any related party benefit (which is not on arm's length terms or does not fall within another exception to the requirement for member approval);
- ASX Listing Rule 3.16.4, where immediate notification is to be made to the ASX of the material terms of any employment, service or consultancy agreement a listed entity (or child entity) enters into with its chief executive officer (or equivalent), any of its directors or any other person or entity who is a related party of the chief executive officer or any of its directors; and
- the Australian Accounting Standards, where there is a requirement for disclosure in the annual financial statements of any related party agreements, that such agreements are on arm's length terms (or otherwise) and the amounts paid under any such agreements.

Given the above, we are of the view that the proposed recommendation, for the main part, duplicates legislative and regulatory safeguards and measures that are already in place around the entering into agreements with related parties. For this reason, we suggest that this recommendation should be deleted.

In relation to foreign incorporated entities, as noted above, it would be more appropriate to include an annexure (similar to the annexure for externally managed listed entities in the 3rd edition) to cover off the Australian laws that do not apply to foreign entities.

Please do not hesitate to contact us if you wish to discuss any of these matters in more detail.

Yours sincerely

**Melissa Jones**
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**Company Matters**