Guerdon Associates
Executive Pay & Board Governance

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Ms Mavis Tan
ASX Corporate Governance Council
c/o ASX Limited
PO Box H224
AUSTRALIA SQUARE NSW 1215

By email: mavis.tan@asx.com.au

Submission on the fourth edition of the ASX Corporate Governance Principles and Recommendations

Guerdon Associates appreciates the opportunity to provide its submission on the fourth edition of the ASX Corporate Governance Principles and Recommendations.

This submission provides background on the nature of our firm, an overview of the suggested principles and nature of changes, followed by specific suggestions to principles and recommendations where appropriate.

Specific suggestions are ***italicised and bold*** for emphasis and ease of reference.

About Guerdon Associates

Guerdon Associates is an independent[1] executive remuneration and board governance consulting firm. Our clients include a significant proportion of companies in the ASX 300, and private and pre-IPO companies. Offices are located in Melbourne and Sydney, with affiliate offices in London, Paris, Zurich, New York, Los Angeles and Beijing. The firm has worked with a significant proportion of Australia's listed company boards, and is well known in the corporate governance community.

The firm's submissions were among the most cited in the Productivity Commission's review of executive remuneration and, over the years, it has contributed to Treasury, ASIC and Australian Taxation Office consultations on numerous regulatory and legislative changes, as well as engaging with APRA on remuneration matters.

Overview

In the proposed fourth edition, the ASX Corporate Governance Principles and Recommendations will increase from 29 to 38 recommendations, and the number of pages increases from 40 to 55. This increase contrasts with the recently released update to the UK Financial Reporting Council's revised Code, which is significantly shorter and sharper than the prior Code (13 pages versus 30), although the UK's structure (i.e.

[1] Independence is defined as a specialist provider of consulting services to boards to minimise the potential for conflicts of interest that may arise from being a broad-based supplier of multiple services to both management and boards.

'Principles' supported by 'Provisions') and 'comply or explain' approach have been retained and are broadly similar to the ASX Governance Council Principles.

It appears that this increase involves significantly more prescription, such that the Principles and Recommendations are moving away from their original purpose of guiding principles to a prescriptive set of rules.

This may not necessarily improve corporate governance in Australian boardrooms, as its length and prescription may foster a 'tick-the-box' approach. A reversion to a higher level principles based approach may instead foster less box-ticking on governance matters and more critical thinking on how the company can best meet the higher principles.

It would be preferable to determine a concise set of higher level principles that guide rather than prescribe behaviours and outcomes.

Overarching Principles

Principle 3

The original version of Principle 3 *"Act ethically and responsibly: A listed entity should act ethically and responsibly"* permits boards to focus on observable outcomes consistent with better risk management than the proposed version, that charges boards to instil a *culture* of acting lawfully, ethically and in a socially responsible manner.

The proposed wording obfuscates the clear requirement for *acting* ethically and responsibly. *Acting* is observable, measurable and verifiable. Efficacy of a board to *act* can be reliably compared across companies. It is not clear or apparent how a board can "instil the desired culture"? It is not easily observable, measurable and verifiable in ways that can be agreed and compared across companies.

While the current Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry can determine whether companies have acted lawfully, ethically and in a socially responsible manner, it would be difficult for the Commission to decide whether the boards of those companies had instilled a particular culture. It is doubtful that a regulator could also prove that boards have failed to instil an appropriate culture, given that a standard definition of company culture has not yet been developed or accepted.

In contrast, acts, and acting, can be readily and reliably observed.

It is recommended that the current drafting be retained.

Principle 8

The addition of "over the short, medium and longer term" is unnecessary and prescriptive. It implies that remuneration should be structured in a particular way. This would be inappropriate for some companies in some situations.

Investors have different time horizons and objectives. Value creation for a company will depend on the board's strategy, the company's industry, its positioning in capital markets, its stage of development, its financial health at a particular point in time, and many other factors.

The current reference to short, medium and long term risks codifies the way in which remuneration should be structured, rather than allowing the board to determine the structure that is fit for the company's purposes at a point in time.

It is recommended that "over the short, medium and longer term" not be included.

Individual Recommendations

Recommendation 1.5

The proposed change to this recommendation states that S&P/ASX 300 companies should have at least 30% of each gender on the board.

The wording of this recommendation is ambiguous and problematic. While the Australian Government currently only includes three genders in its classification (male, female and unspecified/indeterminate/intersex), there are many more genders currently recognised by other bodies that could be included in a classification system in the future. Gender definition is currently very fluid and subject to change. What will not change is that there will be male and female genders.

If the number of genders increases to 4 or more, it is impossible for Australian companies to have 30% from each gender on the board. More specific wording (30% male and 30% female) is appropriate.

Change wording in the recommendation to "have not less than 30% male and 30% female directors".

Recommendation 3.2 b)

It is preferable to specify that the board acts on material breaches of the code of conduct in addition to being informed of such breaches.

Alter recommendation from "is informed of" to "is informed of and acts on".

Recommendation 3.3 b)

The drafting might specify that the board should act on material concerns rather than purely being informed of them.

Alter recommendation from "is informed of" to "is informed of and acts on".

Recommendation 3.4 b)

The drafting might specify that the board should act on material breaches of that policy rather than purely be informed of them.

Alter recommendation from "is informed of" to "is informed of and acts on".

Recommendation 4.4

This recommendation appears redundant. It is a requirement of the listing rules and the Corporations Act 2001 that the entity and its directors do not issue false and misleading statements.

If the objective is for more companies to follow frameworks such as the Integrated Reporting Standards that will provide investors with information on the non-financial factors important for making investment decisions, it would be best to explicitly state this.

Omit this recommendation.

Recommendation 5.2

This recommendation is redundant. If the board consists of directors with the requisite skill and experience as required by Principle 2, they will understand their obligations and be conscientious about ensuring they read all ASX announcements in a prompt manner.

Omit this recommendation.

Recommendation 5.3

This recommendation would appear to be redundant, as there are already rules that govern the disclosure of this information. The disclosure of information a reasonable person would consider to have a material effect on the price or value of shares is covered in the ASX Listing Rules Chapter 3. Further guidance specifically on analyst and investor briefings is provided in ASX Listing Rules Guidance Note 8 and ASIC Regulatory Guide 62.

Omit this recommendation.

Recommendation 8.4

This recommendation will be a boon for consultants, since it directly specifies directors seek independent advice that consultancy services provided by directors or executives are at arm's length, reasonable and outside the scope of the director/executive's duties.

We believe the board should have sufficient skill and expertise as well as knowledge of the organisation and the relevant consulting services to judge this for itself. There might be a reference in the commentary to the board's ability to call upon the judgement of an independent consultant, but doing so should not be prescribed.

Guerdon Associates recommends that the wording of "has independent advice" is replaced by "has determined". Any mention of engaging independent advice should be made in the commentary.

Concluding remarks

The foregoing comments and suggestions are provided with a view to ensure the final Principles and Recommendations are both workable and achieve their intended effect.

We would be pleased to respond to any queries you may have in relation to this submission.

Michael Robinson
Director

Martin Morrow
Principal