



Consultation on ASX Corporate Governance Council's Fourth Edition of Corporate Governance Principles and Recommendations

Marque Lawyers
B Lab Australia and New Zealand

Submission on the ASX Corporate Governance Council's Fourth Edition of the Corporate Governance Principles and Recommendations

1. Terms of reference

In May 2017, the ASX Corporate Governance Council (**Council**) resolved to commence work on a fourth edition of the Corporate Governance Principles and Recommendations (**CGPR**) to address a number of issues, including:

- (a) social licence to operate;
- (b) corporate values and culture;
- (c) whistleblower policies;
- (d) anti-bribery and corruption policies;
- (e) an apparent slowing in the rate of progress in achieving gender diversity at board level;
- (f) a recommendation from the Senate Economics References Committee for increased guidance around carbon risk;
- (g) cyber-risks; and
- (h) other areas for improvement identified by KPMG in a review commissioned by the ASX Education and Research Program on the adoption of the recommendations in the third edition of the CGPR.

The Council's proposed changes anticipated and respond to some of the governance issues identified in recent enquiries, such as the ongoing Hayne Royal Commission. On 2 May 2018 the Council issued a consultation draft of a proposed fourth edition of the CGPR and called for submissions on the Council's proposed changes.

2. Who we are

2.1 Marque Lawyers

Marque Lawyers is a commercial law firm that aims to do law differently. Our purpose is to redefine the law firm as a collaboration of exceptional (and exceptionally happy) lawyers dedicated to using the power of the law for positive change – for ourselves, our clients and society. Our values at Marque govern how we operate, how we charge (by value not time) and how we conduct ourselves not only as lawyers but as people. In addition to our commitment to legal excellence, our values are:

- (a) being bold;
- (b) giving respect; and
- (c) having fun.

It is through these values that we write our submission. We recognise that our views and our overall position is not generally shared across the legal community. However, it is through a technical and nuanced reading of the law combined with and a broader understanding of culture and community that we find the courage to be bold in our submission.

We are also proud to be a certified B Corp, leading to us also including input from B Lab Australia and New Zealand Limited in this submission.

2.2 B Lab

B Lab was established in 2006 in the United States as a not for profit organisation whose mission is to build a global movement of people using business as a force for good. Business is a leading force in global markets and has the capacity to be a powerful tool, alongside government and the not for profit sector, in creating a shared and durable prosperity for all, particularly those least served by existing market structures.

Part of B Lab's work is focused on leading the discussion and advocating for systemic change to support the impact growth and longevity of for-purpose, for-profit businesses. B Lab does this through a number of tools, including:

- (a) an online impact assessment (The B Impact Assessment) where businesses can 'measure what matters';
- (b) a certification for businesses (known as the B Corp certification); and
- (c) advocating for the creation of an enabling policy and legal environment for for-purpose, for-profit companies and their investors; including the development of a new corporate form (the benefit company) that removes impediments to creating social benefit alongside shareholder value.

Over the last 12 years, B Lab has become a recognised global leader in the field of responsible business, driving companies towards higher standards of performance, accountability and transparency.

B Lab's Australian subsidiary, B Lab Australia and New Zealand Limited, was founded in 2013 and is part of a network of Global Partners that leverage B Lab's market infrastructure: impact standards, legal frameworks, trademarks, and a technology platform. In addition to Australia and New Zealand, Global Partners are currently active in the UK and parts of Europe, Latin America, Africa and Asia.

3. Focus and assumptions

3.1 Our focus

Our submission focuses on three main themes:

- (a) social licence to operate;
- (b) corporate values and culture; and

- (c) gender diversity.

3.2 Background and assumptions

- (a) A key area revamped in the 2014 third edition of the CGPR was the recommendation that a listed entity should establish a risk committee, either on a stand-alone basis or as part of the responsibility of the audit committee, or otherwise disclose its processes for overseeing risk. This change came about predominately as the result of the lessons learnt from the governance failings and shortcomings in risk behaviour exposed by the global financial crisis.
- (b) Despite an increased focus on risk management since the GFC, there have still been significant shortcomings in the attention and priority afforded to the governance and management of certain risks in various organisations. Following a series of corporate scandals, such as VW's manipulation of emissions data, massive corruption at Petrobras and closer to home, various incidents with the Australian banks, there has been erosion of trust in various institutions. It is claimed that the world is not in an economic crisis, but rather a crisis of trust.¹
- (c) Each of these scandals are, in isolation, concerning and each has been the subject of considerable public scrutiny. Each company has suffered considerable loss of capital, whether through the loss of value in their shares, or through fines and sanctions. The financial risks associated with these scandals are evident, however what is less visible or acknowledged is the loss to each of these entity's social capital or social licence.
- (d) An entity's social licence is inextricably linked to trust.² What is particularly interesting is that, evidence is now emerging, both at micro and macro levels, that a lack of trust jeopardises higher economic growth.³

4. Summary view

4.1 What we think generally

- (a) Given the potential impact of a loss of trust on the whole economy, we see the Council's proposed amendments to the CGPR as crucial best practice governance mechanisms to maximise trustworthiness in the corporate sector.
- (b) As we discuss below, there are a few areas where we think some of the proposed amendments could be adjusted. Taken as whole though, we mostly agree with the amendments proposed. We are supporters and we are keen to ensure that the voice of support is loud.
- (c) Survey after survey supports the fact that the majority of millennials make their purchasing and employment decisions based on a business's stance on social and

¹ Richard Edelman, 'A crisis of trust, A warning to both business and government', *The Economist – The World in 2018*, <<http://www.theworldin.com/article/10508/crisis-trust>>.

² Andrew G Haldane, 'The Great Divide' (Speech delivered at New City Agenda Annual dinner, 18 May 2016) <<https://www.bankofengland.co.uk/-/media/boe/files/speech/2016/the-great-divide.pdf?la=en&hash=D44B91D2A6F39A4333ED3B92CB6870DD45E40306>>.

³ Ibid.

political issues.⁴ Further, the Council's proposed amendments to the CGPR are not new, but rather follow the trend advocated by regulators across the globe.⁵

- (d) Companies are facing increasingly complex social and environmental challenges and continuing technological change. What the Council is proposing is not, 'psychobabble' (as Janet Albrechsten puts it⁶). Rather, this is risk management 101. It is about the boards of Australian listed entities recognising that social responsibility, reputation and trust are necessary ingredients for the long-term success of their entity. There are of course limits on the extent to which corporate governance can prescribe good behaviour, but corporate governance seeks to assist by the use of transparency and accountability on the practices of the corporations.
- (e) We question why the changes are considered controversial or 'knee jerk', when you have the likes of the chief economist of the Bank of England, Andy Haldane, in a speech given 2 years ago, talking about the huge losses caused by social capital losses and that trust is a vital ingredient for economic growth. Shockingly (well, to the dissenters, not us), Mr Haldane also spoke about the importance of purpose, culture and new corporate structures like the B-corporation.
- (f) The views of investors are also clearly changing. Consider the shift represented by Larry Fink, the CEO of BlackRock, including this statement in his 2018 letter to CEOs:

Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.

- (g) This shift in community expectations and recognition of what is key in driving long-term success do not require a change in (and is not inconsistent with) Australian corporations law⁷ for companies to be able to take maintaining their social licence to operate into account but can be incorporated into current best practice corporate governance.

4.2 Recommendations

- (a) We are supportive of the new references to social licence, purpose, values and culture generally throughout the CGPR (see sections 5.3 and 6.2).

⁴ See for example the Earned Brand Survey in Australia and Deloitte Millennial Survey 2018.

⁵ For example in the UK, the UK Financial Regulatory Council (FRC) has just released the *UK Corporate Governance Code 2018* which comes into effect on 1 January 2019. The new code, similar to the proposed amendments to the CGPR, include a stakeholder focus in response to the UK Government's request of the FRC to improve the UK's corporate governance framework in an effort to restore trust in business.

⁶ Janet Albrechsten, 'Why corporate Australia should resist the Left's social engineers', *The Australian*, 25 July 2018, <<https://www.theaustralian.com.au/opinion/why-corporate-australia-should-resist-the-lefts-social-engineers/news-story/9a00d18852d2dbfe524443dbaf6c8cd>>.

⁷ Though we would like to see a change in the law to permit a new opt in 'benefit company' form – see section 5.5 below.

- (b) We would like to see the 30% gender target in Recommendation 1.5 extended to all listed company boards, and senior management as well (see section 7.3).
- (c) In respect of Principle 2, we are concerned that the addition of 'knowledge of the industry', if applicable to all board members, is inconsistent with the proposed changes to encourage diversity (see section 7.4).
- (d) Our suggested change to Principle 3 is to retain the focus on behaviour ('acting') instead of the proposed 'instilling culture' (see section 6.2).
- (e) We love Recommendation 3.1 (see section 6.2(c)).
- (f) We also consider the new Recommendation 7.4 to be sound.

We set out more detail below, broken into our three themes.

5. Social licence to operate

5.1 Corporate responsibility and shareholder primacy

- (a) 'Corporate responsibility' is typically defined as a corporation considering, managing and balancing the economic, social and environmental impacts of its activities. The imposition on corporations of some such responsibility has been a debated issue for quite some time. For an even longer period, much has been written by legal and management theorists around shareholder primacy and stakeholder theory and an array of views in between. The issue tends to boil down to the extent to which the directors of a corporation are required, or even permitted, to take into account the interests of other stakeholders (employees, the environment, the local community in which it operates), rather than simply seeking to maximise shareholder value and returns.
- (b) There is a distinction to be made between permitting corporations to consider other stakeholder interests in furthering the long-term value of the corporation, and mandating that the directors must take such interests into account, or as a further distinction, that directors can ever favour some of those other stakeholder interests over shareholder value. There is a general consensus in contemporary Australian corporate law (albeit some differences in the reasoning) that the current case law reflects the first of these.⁸
- (c) That said, in the current era, there is a growing sense that directors who do not take into account other stakeholder interests may well fall foul of their duties, by failing to predict what impact on the corporation's reputation, or social licence to operate, it may have if a decision is made purely based on generating or protecting shareholder wealth (see for example the literature around climate change risks becoming foreseeable and now forming part of ASIC risk disclosure policy).

⁸ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006) and CAMAC, *The Social Responsibility of Corporations* (2006).

5.2 Application to the CGPR

It is in this context that we strongly support the inclusion of reference to ‘the social licence to operate’ in Principles 3 and 7. We support the use of the term ‘social licence to operate’ in preference to ‘reputation’. While both arguably encapsulate trust, credibility and legitimacy; to our mind, the former appropriately considered those factors from the point of view of the impact on stakeholders, rather than the view of the corporation from the stakeholder position. Similarly, the previous reference to ‘acting responsibly’ in Principle 3 does not, in our view, import the same consideration of stakeholders as the social licence.

5.3 Principle 3

In the case of Principle 3, given the social licence to operate is not based in law but at most an ‘informal contract’, it is a matter of managing relationships and risk. Corporate governance policy is, in our view, therefore the right place for it. We say this mindful of the context of each review of Australian law on whether the law should change around the shareholder / stakeholder debate finding that it should not, given each review’s conclusion that the law is indeed sufficiently broad to permit consideration of the other stakeholders in the quest for long term value.⁹ The proposed Principle 3 reference to the social licence is therefore consistent with law and conducive to good decision-making.

5.4 Recommendation 7.4

Recommendation 7.4 suggests that listed entities should consider and disclose any material exposure to environmental or social risks. ‘Material exposure’ is defined as ‘a real possibility that the risk in question could materially impact the listed entity’s ability to create or preserve value for security holders over the short, medium or longer term’. We think that this longer term view is appropriate, given risks to a corporation’s social licence to operate (incorporating the two definitions of environmental risk and social risk) are generally likely to be considered a ‘non financial risk’ in the short term (as compared to risks required to be set out in the operating and financial report under s299A of the Corporations Act, being matters that may have an adverse impact on the achievement of the financial performance or outcomes disclosed in the report).

5.5 The proposed introduction of legislation to introduce a ‘benefit company’

- (a) We think it is worth mentioning at this juncture that we support amending Australian corporations law to introduce an ‘opt in’ category of a benefit company. The purpose of this proposal is to permit companies to put social benefit at the centre of their business and as part of their contract with their shareholders (which of course they already can do, but in a way that clarifies the consequences). Further information about the proposed benefit company governance structure is available [here](#).
- (b) The three key characteristics of the benefit company are:
 - (i) a binding corporate purpose in the company’s constitution requiring the company to create ‘a material positive impact on society and the environment, taken as a

⁹ Ibid.

whole, from the business and operations of the company' (known as 'general public benefit');

- (ii) expanded directors' duties to require directors to consider the interests of non financial stakeholders in addition to the financial interests of shareholders; and
 - (iii) reporting publicly at regular intervals on overall social and environmental performance.¹⁰
- (c) There are already 5 ASX-listed companies that are certified B Corps¹¹ and it is likely there will be more in the future. If the opt in benefit company regime is introduced, these certified B Corps will likely become benefit companies. For these companies, the requirements of Principle 3 and Recommendation 7.4 will be part of their obligations as a benefit company.

6. Corporate purpose, values and culture

6.1 Addressing the loss of trust

- (a) The Council has proposed three main ways to tackle the loss of trust in business, ie by restoring a listed entity's social licence to operate by:
 - (i) re-examining the short-term, shareholder-centric model of public companies (see Principle 3) – this has already been addressed in our submission under section 5 above;
 - (ii) reinforce and broaden the 'purpose' of companies, to better reflect their broader societal role – their role in serving stakeholders (employees, customers, clients) as well as shareholders (see Recommendation 1.1 and Recommendation 3.1); and
 - (iii) setting the tone from the top, to address the issues of corporate value and culture (see Principle 3).

6.2 Principle 3

- (a) On the whole, we strongly support the various proposed changes to the CGPR that are aimed at arresting the loss of trust in business.
- (b) Our one suggestion in respect of Principle 3 from this purpose, values and culture angle is around the language used to describe Principle 3. While we agree with the attached commentary (including its references to culture), we are of the view that, rather than requiring the entity to 'instil the desired culture', the Principle would be better left as 'act lawfully, ethically and socially responsibly'. Culture is the consequence of behaviours; it is a result, not a cause. Behaviour is driven by values, not culture, and therefore we would suggest that what a listed entity is charged with is not reinforcing a culture, but rather

¹⁰ William H. Clark, Jr., Drinker Biddle & Reath LLP; Larry Vranka, Canonchet Group LLC, 'White Paper: The need and rationale for the benefit corporation: why it is the legal form that best addresses the needs of social entrepreneurs, investors and ultimately the public', January 18, 2013, http://benefitcorp.net/sites/default/files/Benefit_Corporation_White_Paper.pdf.

¹¹ Australian Ethical Investments Limited (ASX: AEF), Silver Chef Limited (ASX: SIV), Murray River Organics Group Limited (ASX: MRG), Arowana International Limited (ASX: AWN) and Vivid Technology Limited (ASX: VIV).

defining the entity's purpose (as suggested in Recommendation 3.1) and then setting a strategy to deliver it. Where a board is not satisfied that policy, practices or behaviour throughout the business are aligned with the entity's purpose, values and strategy, the board should seek assurance that management has taken corrective action.

- (c) We consider Recommendation 3.1 to be the critical addition, which we whole-heartedly support. A governing purpose or objective, being a statement of what the entity is fundamentally trying to achieve, is essential for good corporate governance. If the only goal is to maximise shareholder wealth, there is no guidance on how to assess the entity's decision making in balancing its allocation of resources and consideration of stakeholder interests (which, as explained in section 5.1 above, is part of maximising shareholder wealth).

7. Gender diversity

7.1 Gender diversity generally

- (a) Gender diversity generally refers to the equitable or fair representation between genders. A lack of gender diversity reinforces gender segregation and gender division which in turn fosters a binary culture that leads to undervaluing and overvaluing one gender from the other. While we understand and recognise that gender diversity is not necessarily limited to the male / female binary, for the purposes of this submission, we have focused only on the lack of *female* representation on boards and in senior management.
- (b) Of course, gender diversity is not a listed company issue but rather a broader societal issue. It raises questions of pay inequality, targets, quotas, merit, flexibility etc and in Australia the lack of female representation and inclusion has resulted in a 17% pay gap.¹²
- (c) As is often quoted, until recently, the ASX 200 had more CEOs named Peter than female CEOs all together. While there is some movement towards diversity education, policy and practice, the actual number of women on boards and in executive positions remains less than impressive. In the last couple of months, there has been a drop in female appointments to below 50% for the first time since January 2018. We also note that there are 5 companies in the ASX 200,¹³ and 31 in the ASX 300, that still do not have any women appointed to the board at all.

7.2 Application to CGPR

It for this reason that we welcome and endorse the Council's amendments to Principles 1, 2, 3 and 8 in relation to diversity. As the Council points out in its commentary – greater diversity on boards delivers better financial outcomes and a higher return to shareholders. It is also true that gender diversity coupled with an inclusive culture facilitates higher quality decision making, greater innovation and fresh strategic thinking.¹⁴

¹² Workplace Gender Equality Agency, *Gender Equity Insights 2017 Inside Australia's Gender Pay Gap* (2017) <https://www.wgea.gov.au/sites/default/files/BCEC_WGEA_Gender_Pay_Equity_Insights_2016_Report.pdf>.

¹³ ARB Corporation Limited (ASX:ARB), Tassal Group Limited (ASX:TGR), Ardent Leisure Group (ASX: AAD), TPG Telecom Limited (ASX: TPM), Ausdrill Limited (ASX: ASL).

¹⁴ Deloitte Access Economics, *Research Report Toward Gender Parity: Women On Boards Initiative Department of Communities, Child Safety and Disability Services, Office for Women* (October 2016)

7.3 Thirty percent target

- (a) Recommendation 1.5 suggests that listed entities should have a diversity policy, which includes set measurable objectives for achieving gender diversity. The proposed updates seek to expand these objects not only at a board level but also at a senior executive level and across the workforce generally.
- (b) The recommendation further includes a 30% target for those companies listed in the S&P / ASX 300. While we agree it is a step in the right direction, we suggest that the recommended should apply to:
 - (i) all ASX listed companies; and
 - (ii) senior management as well board composition.
- (c) According to the Australian Institute of Company Directors:
 - (i) of the top 200 listed entities, women comprise of 28%;
 - (ii) of the top 300 listed entities, women comprise of 25%; and
 - (iii) of the all ordinaries, women comprise of 21%,

of board representation.¹⁵ This means that generally, the larger the entity the more likely it is to appoint women to its board. Given the top performing companies have access to additional resources, better implementation strategies, well written policies and generally carry a higher level of public scrutiny – reaching the 30% target is likely and, for the most part, already satisfied. It is however the smaller listed entities that require further guidance and direction if they are to make any progress. It is for this reason that we suggest the measurable target extend to all listed entities in order to push for any major change.

7.4 Industry knowledge

- (a) We further submit that the additional language relating to a director's knowledge of the entity's industry, included in Principle 2, should be removed.
- (b) In particular, Principle 2 requires that a listed entity have a board of an appropriate size, composition, skills, commitment and *knowledge of the entity and industry in which it operates* to enable it to discharge its duties effectively, and to add value.
- (c) We suggest that the inclusion of industry knowledge as a pre-requisite for board appointments is inconsistent with the diversity imperative provided in Principle 1. Diversity at a board level seeks to break down any group-think and provide fresh, innovative approaches to otherwise traditional board practices.

<<https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-toward-gender-parity-women-on-boards-initiative-041016.pdf>>.

¹⁵ Australian Institute of Company Directors, *Board Diversity Statistics* (07 March 2018) <<http://aicd.companydirectors.com.au/advocacy/board-diversity/statistics>>.

- (d) The effects of including industry knowledge in relation to board appointments is that it will create further hurdles and boundaries for women on boards in male dominant industries where women have not traditionally held roles.
- (e) We therefore suggest that the requirement should either be removed entirely or made broader and should recommend directors to skill up in an industry rather than exclude them entirely based on current knowledge of that industry.

8. Final thoughts

Given the shift in community expectations and a loss of trust in the economy generally, we suggest that the changes are appropriate and required to reflect the current state of affairs.

It is our submission that the Council's recognition of this shift and how it affects long-term success is not inconsistent with Australian corporations law but rather provides the necessary guidance required to reflect best practice corporate governance in today's corporate landscape.

While we have suggested some minor tweaks to the recommendations, we welcome the Council's changes to the CGPR and hope that our submission provides assistance.