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ASX Corporate Governance Council
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Consultation Submission to the proposed changes to the Principles & Recommendations in the 5th Edition to be issued in early 2025.

I make this submission on a personal basis and I am not representing my current or past employers being Institutional Shareholder Services, Deloitte, SSAMM Management Consulting, The Sydney University School of Law, and Kardos Scanlan. My personal submission is also not representing organisations that I am or have been affiliated with or worked with in other capacities, including fourteen current members of the ASX Corporate Governance Council, being the:

> Association of Superannuation Funds of Australia Limited, ASX Limited, Australasian Investor Relations Association, Australian Council of Superannuation Investors, Australian Institute of Company Directors, Australian Shareholders' Association, Chartered Accountants Australia and New Zealand, CPA Australia Ltd, Financial Services Council, Governance Institute of Australia, Institute of Internal Auditors, Australia Institute of Public Accountants, Law Council of Australia, and Stockbrokers and Investment Advisers Association.

The arc of evolutionary change to the corporate governance story is bookended by two Royal Commissions from HIH in 2003 to Hayne in 2019, both essentially assessing and evaluating corporate conduct by bad actors in play[1].

The focus of my submission will be on three areas of the eighteen questions posed in the 5th Edition Consultation draft of February 2024, namely:

1. Board Skills
2. Stakeholder Relationships
3. Management of Risk

Yours sincerely

Dr. Ulysses Chioatto

[1] HIH Insurance collapse; ASIC v Westpac [2022] FCA 2015 (7 related representatives' total penalties = Westpac penalties = $ 15.9m + $80m remediation costs.
ASIC v CBA (2018) 128 ACSR 289; FCA 941 at 125, breach s912A (1) 'relevant to assessment of penalty' i.e., polices re unconscionable conduct & supervision of staff'.

My Submission follows:

1. Potential changes to the 4th Edition Recommendations: from HIH to Hayne

Before I address the three areas of my focus to the proposed changes to the 4th Edition in the 5th Edition My view on the deletion, addition and new Recommendations is in the context of the two Royal Commissions noted above.

There is already significant regulation by Australian law (including duplication as identified by Hayne) The Hayne Royal Commission recommended an overhaul of the legislation. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, - aka: Banking Royal Commission or the Hayne Royal Commission from 14 December 2017 came about in part from media revelations of a culture of greed within Australian financial institutions (bonuses before customers), a lack of regulatory intervention, revelations of money laundering for drug syndicates, terrorism financing, and compounded by a lack of statutory reporting responsibilities, including and improper foreign exchange trading, all readily substantiated by the Commission' final report, on 1 February 2019, and a simple Google search.

The Final Hayne report included 76 recommendations. One of the 76 recommendations was to overhaul the Corporations Act 2001 (Cth), especially chapter 7 in relation to financial services law. This sentiment is echoed in this observation by Justice Rares in 2023.

> *"The Corporations Act is stupendously absurd. Instead of having a standard like the 10 Commandments – though shalt not steal – you've got 40 pages of how you might be able to steal."* [2]

The Corporations Act's scale and complexity of Corps Act is voluminous at 3,930 pages with 3,539 sections across 30 chapters, 242 parts, 382 divisions, 262 subdivisions, and 3 schedules.

Accompanied by Corporation's Regulations of 1,311 pages and 1,418 regulations across 25 chapters, 198 parts, 193 divisions, 74 subdivisions, and 29 schedules. These two pieces of legislation are in a complex and diverse legislative regime that includes:

- 270 legislative instruments (2,800 pages) issued by ASIC;
- 191 other legislative instruments (5,300 pages);
- 200 regulatory guides issued by ASIC (7,500 + pages);
- 20,000 ASIC instruments; and
- 677 ASIC reports (22,500 + pages)

In total that's 43,341 pages.

The Hayne recommendation has resulted in 3 Interim Reports from, 11 September 2020, by the Australian Law Reform Commission, with the final report being tabled in on 18th January 2024 and containing 58 Recommendations to change the Corporations Act 2001 (Cth).

It seems the potential changes to the 4th Edition Recommendations centre around corporate disclosures being outcomes-focused, intending to strengthen listed entities' governance, and increase transparency for investors especially in relation to corporate culture, accountability and integrity of reporting, this is essentially the theme that can be found in the final report of the Hayne Royal Commission, and harks back to the groundbreaking HIH Royal Commission of 2003 in establishing what many call modern corporate governance.

[2] Rares J farewell retirement ceremony Nov. 2023

In that context deleting the following Recommendations from the 4th Edition is appropriate.

Recommendations:

3.3 disclosure of whistleblower policy;
3.4 disclosure of anti-bribery and corruption policy;
4.2 CEO and CFO declaration for financial statements;
6.4 substantive security holder resolutions on a poll;
6.5 offering electronic communications to security holders;
8.2 separate disclosure of remuneration policies for non-executive directors, other directors, and senior executives); and
8.3 policy on hedging of equity-based remuneration.

However, moving Recommendation 1.5 (diversity) into Recommendations 2.3 (board diversity) and 3.4 (diversity and inclusion policy) may have the unintended consequence of a critical focal point in moving representation by women on bords from 30% to 50%, becoming lost.

Additional Recommendations for entities established outside Australia.

Given the deletion of Recommendations for significant regulation by Australian law it is appropriate to have these additional recommendations:

9.3 CEO and CFO declaration for financial statements;
9.4 substantive security holder resolutions on a poll;
9.5 offering electronic communications to security holders; and
9.7 policy on hedging of equity-based remuneration.

New Recommendations

The following focus on updated disclosure expectations compared to the 4th Edition, these are appropriate and include:

2.2 board skills held and sought, and the process for assessing skills and experience;
2.3(c) disclosure of relevant board diversity characteristics being considered;
3.2(c) de-identified disclosure of outcomes from code of conduct breaches;
3.3 interests of key stakeholders;
3.4 diversity and inclusion effectiveness;
4.2 verification processes for periodic corporate reports;
4.3 disclosure of auditor tenure and review;
7.4 disclosure of material risks;
8.2 non-executive director remuneration); and
8.3 provisions for clawback of performance-based remuneration and de-identified disclosure of their use.

2. Confusing Outputs and Outcomes in good corporate governance

As noted above these changes to the 4th Edition in the 5th Edition are intended to strengthen listed entities' governance, and increase transparency for investors, especially changes in relation to corporate culture, accountability and integrity of reporting. Having analysed the reporting of hundreds if not thousands of ASX listed entities in the past twenty years, it seems that many confuse outputs for outcomes. Corporate reporting, in adopting the ASX Principles and Recommendations, is an output, not an outcome, an outcome of reporting could be more knowledgeable, skilled and ethical directors and officers of listed entities engaging with their stakeholders in delivering on their investment narrative. Reporting integrity should lead to outcomes not ever more sophisticated 'boilerplate' outputs, year on year.

I make the following observations on the following three of eighteen Recommendation changes:

2.4: board skills held and sought, and the process for assessing skills and experience.
3.3: interests of key stakeholders
7.4: disclosure of material risks.

3. Board Skill: Recommendation 2.2

Recommendation 2.2 does not align with Principle 2. The principle speaks of directors "discharging their duties[3] and effectively and add value". Add value goes to the Board and its directors' involvement in strategy formulation for their company, directing that process with the executive team and providing oversight and accountability in the executive delivering on the corporate strategy.

A skills matrix must be mapped out against the entity's current corporate strategy in order to, as stated in the Commentary "identify gaps". If it's a growth strategy, marketing skills may be more relevant than legal skills. Changes to the board should then align to strategy not a pre-determined "shopping list" of the usual suspects, legal, accounting, governance but more specifically to the strategy of the company.

My paper published by the Governance Institute of Australia in their *Governance Directions* [4]which is the official journal of Governance Institute of Australia, provides a fulsome discussion of the thesis outlined above. The paper highlights recent research on the state of board evaluations based on corporate disclosures across ASX 300 companies, to read more go to:

http://www.governanceinstitute.com.au/

For further information contact publishing@governanceinstitute.com.au. or ring (02) 9223 5744 or 1800 251 849 and ask to speak to the Publishing Manager.

4. Stakeholder Relationships: Recommendation 3.3

Corporate stakeholder relations are fraught with the vexed question of the company identifying their stakeholders, and that stakeholder engagement is a journey not a destination. The two-operative phrase in the proposed changes "have regard" and engage with them" are not well supported with the ensuing commentary. In the second paragraph of the commentary a list of possible stakeholders is provided but it masks the reality that within each of those potential stakeholders there are a plethora of views and opinions.

Take "local community" or "host communities" since when do you achieve consensus in that catch all phrase: local community, there are always opposing community leaders and groups? First Nations peoples are noted but as with any group of people they also hold many diverse views.

[3] presumably section 180 to 185 of the Corporations Act and the relevant case law that has illuminated those duties.

[4] **Chioatto**, U. (2015). A **studied approach** to **board assessments and skills matrices**. Governance Directions, 67(7), 415.

There must be some commentary or at least acknowledgement that a company should establish a process to communicate how it identifies its stakeholders and why it considers them stakeholders[5] before reporting material issues, this would provide a framework on what those issues may be for that company and its stakeholders.[6]

5. Management of Risk: Recommendation 7.4

Precise articulation of a "risk" to a company is critically important for a Board, its management, in fact the whole enterprise, undertaking the risk management process[7]. As with a board's skills matrix the proposed changes do not align, in this case with the risk management process undertaken by companies based on the international standard.

Disclosing "material risks" begs the question of, material to what? The answer is to the company's strategy. An example is CBA's assessment of climate change impact on it home loan portfolio. Valuation of that strategic portfolio to the bank would be undermined, literally, as climate change may dry out the soil and foundations of many houses reducing their value in relation to their mortgages[8].

The commentary must clearly articulate what is defined as a 'material risk". The risk examples in the second last paragraph of the commentary are not risk but headings to what may be a risk. The second sentence in relation to digital disruption comes close to being a better example of a material risk.

Mention of the company's operating financial review, forward looking statements and "information that is likely to unreasonably prejudice the entity" have been obstacles to reporting integrity which essentially undermined this proposed change in the 5th Edition.

A detailed discussion of these challenges of a meaningful operating financial review and disclosing material risk is set out in my article published by the Australian Institute of Company directors, see:

https://www.aicd.com.au/organisational-culture/business-ethics/issues/lenfant-terrible.html

The article is based on an extensive review of many listed entities of their material risk disclosure, while in my role as Head of Australia for Institutional Shareholder Services.

[5] Post, J.E., Preston, L.E. and Sauter-Sachs, S., 2002. Redefining the corporation: Stakeholder management and organizational wealth. Stanford University Press.

[6] Pedrini, M. and Ferri, L.M., 2019. Stakeholder management: a systematic literature review. Corporate Governance: The International Journal of Business in Society, 19(1), pp.44-59.

[7] ISO 31000:2018, Risk management – Guidelines, provides principles, a framework and a process for managing risk.

[8] SMH 'Billions in CBA mortgages exposed to extreme weather risks, climate analysis finds' 22/8/2022 Simon Fox Koob