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6 May 2024

Ms Elizabeth Johnstone
Chair
ASX Corporate Governance Council

ASXCorporate.GovernanceCouncil@asx.com.au

Dear Ms Johnstone,

RE: ASX Corporate Governance Council Principles and Recommendations 5th Edition Consultation Draft (Consultation Draft)

Who we are

Governance Institute of Australia (Governance Institute) is a national membership association that advocates for a community of governance and risk management professionals, equipping over 8,000 members with the tools to drive better governance within their organisation.

Our members have primary responsibility within listed entities for developing governance policies, ensuring compliance with the Australian Securities Exchange (ASX) listing rules and supporting the board on all governance matters. Unlike many other Council members and other commentators, a number of which provide a single issue, single constituency perspective, our members work in listed and unlisted companies in all sectors across Australia. They are uniquely positioned to comment on the proposals outlined in the Consultation Draft. Our members' familiarity with the practical aspects of how to implement best practice governance frameworks and ensure sound reporting to shareholders and other stakeholders has informed the comments in this Submission.

Our members welcome the opportunity to comment on the proposed amendments to the Corporate Governance Principles and Recommendations (Principles and Recommendations). The Principles and Recommendations have played a vital role in improving corporate governance in Australian listed companies since the release of the first edition in 2003. The great strength of our members' review of the draft 5th edition is their ability to bring to light the practical and applied governance challenges that arise from changes to the framework.

This Submission is divided into general high-level comments, responses to the specific questions in the Consultation Paper (Attachment A) and other matters (Attachment B).

General comments

1. Continuing move away from a 'principles based approach' and prescriptive nature of Commentary

Notwithstanding the 'if not, why not' approach, the Principles and Recommendations are relied upon by members of the investment community as 'best practice' guidelines and are highly influential in

shaping their views and how they hold companies to account. Top 300 companies are reluctant not to follow any Recommendation due to the high potential that it will be detrimental to how they are perceived and assessed by members of the investment community. This extends to what might be characterised as 'suggestions' in the Commentary supporting the Recommendations. Particularly, for Top 300 companies the text of the Commentary becomes the expectation of some members of the investment community, rather than material designed to provide illustration or explanation. For example, the Commentary to Recommendation 6.2 refers to using technology to facilitate participation at Annual General Meetings which 'may include holding hybrid meetings'. In our members' experience these sorts of 'suggestions' in the Commentary become the expectation, particularly for Top 300 listed companies. Listed companies should have the flexibility to hold these meetings in a manner which not only meets the legal requirements but is best suited to their shareholder base.

Over time, the Principles and Recommendations and the Commentary have become increasingly prescriptive and less principles based. This can unintentionally encourage a 'compliance first'/'tick the box' mindset where the focus is on satisfying minimum requirements instead of encouraging boards to exercise their judgement to create genuine shared value for stakeholders.

The Principles and Recommendations are the leading Australian statement on good corporate governance practice and play a key role in influencing the governance practices of unlisted companies and other organisations. It is incumbent on the Council to be aware of this influence and ensure that the final document states genuine good governance practice as opposed to issues specific to particular single issue interest groups. Our members strongly encourage the Council to consider the purpose of the Commentary and review and reassess the level of prescription and detail.

2. Regulatory burden and associated opportunity cost

Our members are concerned with what they perceive as an increased regulatory burden. In some cases, there is a reaction to the governance 'hot topics' of the day. While it will not always be possible in a dynamic environment, the Principles and Recommendations should be sufficiently broad to withstand governance trends. At the same time that the Council is engaging on a review of the Principles and Recommendations there has been a recent acknowledgment, by way of a financial sector regulatory initiatives grid, that organisations in the financial services sector are facing significant and often uncoordinated regulatory change.[1] The grid is intended to 'enable entities to allocate their resources more efficiently when implementing regulation – reducing compliance burden and costs'. It is particularly directed at medium-sized and smaller companies. Our members consider this is a welcome development as the boards of Australian listed companies are being required to devote more and more of their time to meeting regulatory requirements and expectations, leaving less time to focus on value creation, performance and strategy. Unfortunately, the Council's activities are currently outside the scope of the grid initiative and our members encourage the Council to consider the scale of regulatory change currently facing listed companies in all sectors. The Principles and Recommendations are becoming an additional 'cost of compliance' for listed companies which risks deterring companies from listing and adds to the already significant costs of being a listed company in Australia.[2] At a time when there is a continuing global decrease in Initial Public Offerings it is important to ensure that Australian public capital markets offer an appropriate level of return for retail and institutional shareholders.[3]

[1] See Joint Media Release The Hon Jim Chalmers MP and The Hon Stephen Jones MP, Better coordinated financial service sector regulation, 11 March 2024.

[2] 2023 AIRA survey shows: The median cost of being listed for ASX 50 listed entities is A$8.8 million. The median cost of being listed for listed entities in the ASX 51-100 is A$9.8 million. The median cost of being listed for listed entities in the ASX 101-200 is $A6.6 million. The median cost of being listed for ASX 200+ listed entities is A$4.4 million.

[3] See Press Release *WFE data shows a major reversal in global market capitalisation in 2023*, World Federation of Exchanges, 8 March 2023.

In the context of increased burden on listed companies a recent law firm article comments: 'Overall, we expect the proposed changes will require an increase in disclosure requirements for listed companies. The level of involvement is evident from the length of the document—the fifth edition, if published in this form, would run to over 60 pages (whereas the equivalent document in the United Kingdom is currently under 20 pages)'.[4] This is extremely concerning at a time when listed companies face significant regulatory change.

Our members consider the Principles and Recommendations need to strike an appropriate balance between the promotion of good corporate governance and enhancing confidence in capital markets, and the need to foster international competitiveness and economic growth. The investment community needs to have confidence that listed companies have appropriate governance structures in place. However, the Principles and Recommendations (and other regulation) are moving in a direction that prescribes a level of disclosure and red tape that is at times excessive for meeting the objective of ensuring listed companies have appropriate governance structures in place. In our members' experience this is already diverting significant resources and boards' and companies' attention away from creating shared value for stakeholders towards a 'tick-the-box' approach.

3. Creation of additional overlapping or modified quasi regulatory requirements

The Consultation Paper proposes deletion of six Recommendations because of regulatory overlap and invites comment on the possible deletion of Recommendation 3.3 (disclosure of whistleblower policies). Our members strongly support deletion of these Recommendations including the current Recommendation 3.3. These Recommendations all cover areas where there is existing law which has been the subject of consultation and inquiry. The 2019 amendments to the Corporations Act and the Tax Administration Act relating to whistleblower protection are due for review in 2024. The Council should not pre-judge the outcome of this review and Recommendation 3.3 in the 4th edition should be removed. The Principles and Recommendations should not duplicate or seek to modify regulation.

Our members consider it should not be the Council's role to second guess or attempt to replace the legislature by creating slightly different or overlapping requirements or introducing elements of what some commentators consider the law should say. This creates confusion for listed companies and other stakeholders. The proposed Recommendation 4.3 contains a new disclosure of the tenure of the auditor and when that was last comprehensively reviewed. This is currently a live debate – similar proposals in the UK are not currently proceeding and while there are some recommendations from the Australian Parliamentary Joint Committee review in 2020 there has been no government response. In addition, the Parliamentary Joint Committee on Corporations and Financial Services is currently engaged in an Inquiry into the consulting profession. The Council should not pre-empt the findings of this Inquiry. The situation is more nuanced and there are standards dealing with auditor independence. It is not the role of the Principles and Recommendations to drive this sort of change.

Similarly, Recommendation 7.2 proposes that boards review internal control frameworks 'at least annually'. While this is a current requirement for APRA-regulated listed companies under APRA *Prudential Standard CPS 220 Risk Management*, not all listed companies are APRA-regulated. Directors of non-APRA-regulated companies obtain comfort as to the effective operation of the control framework from second-line and third-line assurance and various other reports. An annual review of the internal control framework for non-APRA-regulated companies creates a significant additional obligation. There is no justification for extending the disclosure to non-APRA regulated companies in the Principles and Recommendations.

[4] See Insight Key steps to prepare for the fifth edition of the ASX Corporate Governance Principles and Recommendations, 12 April 2024.

The proposed Recommendation 8.2 conflicts with the Corporations Act which permits companies to seek shareholder approval to provide termination benefits to certain individuals including non-executive directors. This could lead to the perverse outcome of a listed company making an 'if not, why not' disclosure about a matter that is permitted by law.

While there is a public consultation process attached to the Principles and Recommendations, given they operate as quasi regulation they are not subject to the usual law-making processes, such as costing and regulatory impact assessments. Amendments need to be subject to thorough research and scrutiny with the appropriate expertise and experience, noting the wide-ranging impacts these changes have on listed companies. A number of the changes proposed appear to reflect the views of some quarters of the investment community but may not necessarily reflect a market consensus.

4. Board skills matrices

Proposed Recommendation 2.2(b) recommends disclosure by a listed company 'of its process for how it assesses that the relevant skills and experience are held by its directors'. This too raises a number of concerns:

- While the Commentary notes 'commercially sensitive information of the skills of individual directors' can be excluded, for some stakeholders as noted above the Principles and Recommendations and the Commentary operate as a statement of what companies **must** do. Our members consider this Recommendation is more likely to result in boilerplate disclosures than a broader range of skills on boards.
- The Commentary also refers to it being 'better practice' to include information on the skills of individual directors – our members report that this practice is not in fact widespread and where individual directors are identified as having particular skills they are not identified by name.
- Boards are a collective, and board skills and experience should be viewed collectively for the board as a whole. Identifying the skills of individual directors runs counter to this basic governance principle of how boards operate. In addition, as different companies have different skills matrices, definitions and assessment criteria, there is a risk individual directors are assessed at a different level across different companies, which will create confusion.
- A focus on individual directors' skills also potentially detracts from boards being collectively responsible.
- In an increasingly litigious environment, the disclosure also potentially exposes directors to liability.

5. Codes of conduct

Proposed Recommendation 3.2 (c) recommends disclosure on a de-identified basis of the outcomes during the last reporting period of actions taken by the company in response to material breaches of the code of conduct. Our members have significant concerns about this proposal. They include:

- Material breaches of a code of conduct frequently result in legal proceedings and/or regulatory intervention. These matters can take time to be resolved and disclosure even on a de-identified basis could potentially lead to the inadvertent disclosure of individuals' identities. This could apply to both the alleged wrongdoer and to any victims of wrongdoing and could also interfere with any legal proceedings or regulatory action on foot. The risk for re-identification of individuals is even greater for smaller listed companies.
- The focus should be the board, or a committee, being informed of material breaches and, if such material breaches have occurred, the board, or a committee, should oversee that appropriate actions have been taken in accordance with the company's accountability framework, so that there are proportionate disciplinary outcomes and remedies. It is also unclear what is intended by 'material' in this context which is a potential source of confusion for companies and their investors

given that existing concepts of materiality are unlikely to be of assistance. While APRA regulated entities provide information to APRA this is not necessarily public. Our members are concerned that this disclosure could inadvertently identify vulnerable staff members, particularly in the context of whistleblower disclosures, thereby breaching legal obligations.

- From the perspective of the continuous disclosure obligations, it is unclear that a reasonable person would expect such disclosures to be made or that such disclosures would influence a reasonable person in their decision whether to buy or sell shares in a particular entity.
- Companies want to encourage speak up cultures – but requiring disclosure means companies are unlikely to want to disclose large numbers of breaches – presumably what the Council intends is that boards receive information about systemic issues? Our members are also concerned that employees and others may also be reluctant to raise issues if they know they will be publicly reported, albeit on a de-identified basis.

6. Claw back disclosure

Our members do not support the proposed Recommendation 8.3(b) in relation to disclosure on a de-identified basis of the use of claw back or other limitation of remuneration outcomes. There is a substantial and existing body of regulation, including the Accounting Standards, relating to remuneration disclosure. By adopting the term 'senior executive' in Recommendation 8.3(a) rather than the term used in the legislation and the Accounting Standard 'Key Management Personnel' the Council is creating an additional reporting obligation which is at odds with existing requirements. While APRA regulated entities provide information to APRA this is not necessarily public. Our members are concerned that the disclosure in Recommendation 8.3(b) could inadvertently identify vulnerable staff members, particularly in the context of whistleblower disclosures, thereby breaching legal obligations. The suggested disclosures in the Commentary in the draft Recommendation make it even more likely that identification of vulnerable staff members may occur.

7. Impact on smaller listed companies

Our members from smaller listed companies have provided feedback that many of the proposals in the Consultation Draft do not consider the considerable impact of the proposals on this cohort. While public attention and commentary focuses on governance practices in Top 300 listed companies the Principles and Recommendations apply to all listed companies. This puts them in the invidious position of knowing they are not able to adopt the various Recommendations and reporting on an 'if not, why not' basis with the potential negative consequences noted above or producing formulaic, unhelpful disclosures. Many of these companies adopt alternative practices because of their board size, the scale of their business or lack of resources. They should not be penalised for doing so. Adopting alternative practices also potentially puts them at a disadvantage when raising capital.

Our members from smaller listed companies also report that the proposed changes in the 5th edition will place more of a burden on smaller entities and are likely to be considered just another piece of 'red tape'. For smaller listed companies, the proposed changes are unlikely to receive much attention, simply because they lack the resources and even where some Recommendations are adopted, they are unlikely to be adopted in full.

Smaller listed companies welcome the increase of the security holder reference to 10 per cent. Firstly, because it aligns with other jurisdictions and secondly, because initial or early investors in these types of companies are more likely to hold higher percentages of shares.

Other aspects of the proposed 5th edition will be particularly difficult for this cohort:

- **Diversity –** as a general rule, smaller listed companies with boards of three directors currently find it difficult to achieve gender diversity 'targets'. In addition, because many of these companies have

small numbers of employees, some would not meet the WGEA reporting threshold of 100 employees and disclosure of matters like the effectiveness of their diversity and inclusion practice is likely to be significantly skewed by small movements in employees.

- **Code of Conduct -** The reporting of material breaches of the code of conduct on a de-identified basis also creates the risk for these companies of re-identification of the relevant individual. In addition, there is also the potential risk of under-reporting as a common outcome of any mediated Fair Work action is resignation of the employee and confidentiality associated with the mediated outcome.
- **Performance Based Remuneration - Non-Executive Directors -** It would be helpful to clarify what is considered performance-based remuneration. For example, are options with an exercise price materially above the current share price considered performance based? An element of performance-based remuneration for non-executive directors may be warranted for smaller entities where directors are more closely involved with the company and its success is more dependent on their involvement. In addition, remuneration may not be able to be paid in cash given that it can be a scarce resource for smaller listed entities. These companies may not have sufficient funds on an ongoing basis to attract and retain appropriately qualified directors and simple service rights may lead to significant dilution over the longer term.

8. Adoption date

Australian companies, particularly listed companies and APRA regulated entities are facing significant regulatory change, including for many larger companies, mandatory climate-related financial disclosure coming into effect. [5] The final version of the 5th edition will not be available until late in 2024 and the adoption date is currently proposed as the first full financial year commencing on or after 1 July 2025. This adoption date would not allow sufficient time for listed companies to prepare for the introduction of the 5th edition and mandatory climate-related financial disclosure, particularly as some boards may only meet three times during that period. Our members consider the adoption date should be deferred and there should be a full year between release and the commencement of the first reporting period. As with previous editions, the Council can encourage early adoption by those companies in a position to do so. Deferral of the adoption date would also allow time for finalisation of the mandatory climate-related financial disclosure legislation.

If you have any questions in connection with this Submission, please contact me or Catherine Maxwell General Manager, Policy and Advocacy.

Yours sincerely,

Megan Motto

CEO

[5] See Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 [Provisions].

Attachment A - Responses on specific questions

1. **Do you support deletion of the following 4th Edition Recommendations, on the basis that there is significant regulation under Australian law?**
   a. Recommendation 3.4 (disclosure of anti-bribery and corruption policy)?
   b. Recommendation 4.2 (CEO and CFO declaration for financial statements)?
   c. Recommendation 6.4 (substantive security holder resolutions on a poll)?
   d. Recommendation 6.5 (offering electronic communications to security holders)?
   e. Recommendation 8.2 (separate disclosure of remuneration policies for non-executive directors, other directors and senior executives)?
   f. Recommendation 8.3 (policy on hedging of equity-based remuneration)?

As noted above our members strongly support deletion of these Recommendations on the basis that there is significant existing regulation under Australian law. The Principles and Recommendations should not duplicate or seek to modify regulation. These Recommendations all cover areas where there is existing law which has been the subject of consultation and inquiry. The Council's role is not to second guess the legislature by creating slightly different or overlapping requirements or what some commentators consider the law should say. This creates confusion for listed companies and other stakeholders.

Governance Institute supports deletion of these Recommendations.

2. **In particular, the Council encourages feedback on the proposed deletion of Recommendation 3.3 (disclosure of whistleblower policy). Would you prefer to retain this Recommendation?**

Our members support deletion of Recommendation 3.3. The 2019 amendments to the Corporations Act and the Taxation Administration Act relating to whistleblower protection are due for review in 2024. The Council should not pre-judge the outcome of this review and Recommendation 3.3 in the 4th edition should be removed.

Governance Institute recommends deletion of Recommendation 4.3.

3. **Recommendation 2.2: The Council already recommends disclosure of a board skills matrix or skills a board is looking for. Do you support disclosure of the following information about board skills? a. Recommendation 2.2(a): current board skills and skills that the board is looking for? b. Recommendation 2.2(b): the entity's process for assessing that the relevant skills and experience are held by its directors?**

Proposed Recommendation 2.2(b) recommends disclosure by a listed company 'of its process for how it assesses that the relevant skills and experience are held by its directors'. As noted above this proposal raises a number of concerns:

- While the Commentary notes 'commercially sensitive information of the skills of individual directors' can be excluded, for some stakeholders as noted above the Principles and Recommendations and the Commentary operate as a statement of what companies **must** do. Our members consider this Recommendation is more likely to result in boilerplate disclosures rather than a broader range of skills on boards.
- The Commentary also refers to it being 'better practice' to include information on the skills of individual directors – our members report that this practice is not in fact widespread and where individual directors are identified as having particular skills they are not identified by name.
- Boards are a collective, and board skills and experience should be viewed collectively for the board as a whole. Identifying the skills of individual directors runs counter to this basic governance principle of how boards operate. In addition, as different companies have different skills matrices,

definitions and assessment criteria, there is a risk individual directors are assessed at a different level across different companies, which will create confusion.

- A focus on individual director's skills also potentially detracts from boards being collectively responsible. In an increasingly litigious environment, it also potentially exposes directors to liability.

Governance Institute recommends deletion of proposed Recommendation 2.2(b) and adjustment of the Commentary as noted above.

4. **Recommendation 2.3: Women hold approximately 35% of all S&P/ASX300 directorships. This exceeds the existing measurable objective of at least 30% of each gender for those boards. Do you support raising the S&P/ASX300 measurable objective to a gender balanced board?**

Governance Institute is a long-standing supporter of improving gender and other diversity on listed company boards and supported the inclusion of the measurable objective in the 4th edition. Many of our members also report that their organisations have voluntarily adopted a gender balanced board. However, given the concerns noted above about the increasingly prescriptive nature of the Principles and Recommendations and the Commentary, they question whether the document is the most appropriate vehicle by which to pursue this objective and are also mindful of the need for a principles-based approach.

While the Recommendation is limited to the Top 300 listed companies, as noted earlier, the Principles and Recommendations apply to all listed companies and smaller listed companies are in a position where they are unable to follow what is considered 'best practice' for larger companies or report on 'if not, why not' basis with the potential negative consequences noted above or producing formulaic, unhelpful disclosures. These sorts of 'targets' are also challenging for smaller listed company boards which are more common in smaller listed companies which are then under pressure to increase the size of their boards.

Governance Institute strongly supports improving gender and other diversity on listed company boards, but questions whether the Principles and Recommendations is the most appropriate vehicle to drive this change and notes the impact of the proposal on smaller listed companies and listed companies with smaller boards.

5. **Recommendation 2.3(c): The Council already recommends disclosure of a board's approach and progress on gender diversity. Do you support the proposed disclosure of any other relevant diversity characteristics (in addition to gender) which are being considered for the board's membership?**

Our members continue to have concerns about the inclusion of proposed Recommendation 2.3(c). Much of the discussion on these issues is coming from other jurisdictions with different contexts. The topic of ethnic diversity on boards has been problematic during the most recent AGM season where some foreign investors have taken strong positions and voted against directors due to a lack of ethnic diversity without being able to articulate what 'ethnic diversity' or a 'minority' means in an Australian context. This is more relevant in the US or UK context. The proposed Recommendation is likely to put pressure on boards to tick diversity boxes. The situation is very different in relation to gender diversity where the rationale in an Australian context is much more apparent. Our members consider the proposed Recommendation is unlikely to lead to meaningful disclosure and question whether the Principles and Recommendations is the most appropriate vehicle to drive this change.

Governance Institute does not support the proposed disclosure of any other relevant diversity characteristics as it is unlikely to lead to meaningful disclosure and questions whether the Principles and Recommendations is the most appropriate vehicle to drive this change.

6. **Recommendation 3.4(c): The Council already recommends disclosure of an entity's diversity and inclusion policy and disclosure of certain gender metrics. Do you support the proposal to also recommend disclosure of the effectiveness of an entity's diversity and inclusion practices?**

The Consultation Draft proposes that listed entities, in each reporting period, include disclosure about the effectiveness of their diversity and inclusion practices. As noted above, our members are concerned about the subjective nature of disclosure about the 'effectiveness' of entities' diversity and inclusion practices. They question whether the Council has considered how companies would practically make disclosure against this proposal. They also consider It is very challenging both mathematically and practically to identify the impacts of diversity because they cannot necessarily be statistically isolated. Diversity characteristics, other than age and gender and in some cases ethnicity, are generally the subject of voluntary disclosure so may not necessarily represent a true picture. As noted above this type disclosure of matters like the effectiveness of their diversity and inclusion practice is likely to be significantly skewed by small movements in employees in smaller listed companies.

While it is appropriate to prepare aggregated statistics across sectors at state and national levels our members consider it is overreach for the Principles and Recommendations to require this kind of disclosure.

Governance Institute does not support the proposed disclosure of the 'effectiveness' of an entity's diversity and inclusion practices.

7. **Recommendation 2.4: Do you support increasing the security holding reference included in Box 2.4 (factors relevant to assessing the independence of a director) from a substantial holder (5% or more) to a 10% holder (10% or more)?**

Our members support increasing the security holding reference to a 10 per cent holder on the basis that it is appropriate to have a consistent definition with the Listing Rules. The change is also welcomed by smaller listed companies. Firstly, because it aligns with other jurisdictions and secondly, because initial or early investors in these types of companies are more likely to hold higher percentages of shares.

Governance Institute supports the proposed amendment.

8. **Recommendation 3.2(c): The Council already recommends that a listed entity should have a code of conduct and report material breaches of that code to its board or a board committee. Do you support the proposed disclosure (on a de-identified basis) of the outcomes of actions taken by the entity in response to material breaches of its code?**

Proposed Recommendation 3.2 (c) recommends disclosure on a de-identified basis of the outcomes during the last reporting period of actions taken by the company in response to material breaches of the code of conduct. As noted above, our members have significant concerns about this proposal. They include:

- Material breaches of a code of conduct frequently result in legal proceedings and/or regulatory intervention. These matters can take time to be resolved and disclosure even on a de-identified basis could potentially lead to the inadvertent disclosure of individuals' identities. This could apply to both the alleged wrongdoer and to any victims of wrongdoing and could also interfere with any legal proceedings or regulatory action on foot. The risk for re-identification of individuals is even greater for smaller listed companies.
- The focus should be the board, or a committee, being informed of material breaches and, if such material breaches have occurred, the board, or a committee, should oversee that appropriate actions have been taken in accordance with the company's accountability framework, so that there

are proportionate disciplinary outcomes and remedies. It is also unclear what is intended by 'material' in this context which is a potential source of confusion for companies and their investors given that existing concepts of 'materiality' are unlikely to be of assistance.

- While APRA regulated entities provide information to APRA this is not necessarily public. Our members are concerned that this disclosure could inadvertently identify vulnerable staff members, particularly in the context of whistleblower disclosures, thereby breaching legal obligations.
- From the perspective of the continuous disclosure obligations, it is unclear that a reasonable person would expect such disclosures to be made or that such disclosures would influence a reasonable person in their decision whether to buy or sell shares in a particular entity.
- Companies want to encourage speak up cultures – but requiring disclosure means companies are unlikely to want to disclose large numbers of breaches – presumably what the Council intends is that boards receive information about systemic issues? Our members are also concerned that employees and others may also be reluctant to raise issues if they know they will be publicly reported, albeit on a de-identified basis.

Governance Institute recommends deletion of the proposed Recommendation.

9. Principle 3: Do you support the proposed amendments to Principle 3 (acting lawfully, ethically and responsibly), to include references to an entity's stakeholders?

Our members support the proposed amendment to Principle 3 but have concerns about some of the Commentary sitting under Recommendation 3.3 – see the response to Question 10 below.

Governance Institute supports the proposed amendments to Principle 3 but has concerns with the accompany Commentary – see 10 below.

10. Recommendation 3.3: Does this new Recommendation appropriately balance the interests of security holders, other key stakeholders, and the listed entity? "A listed entity should have regard to the interests of the entity's key stakeholders, including having processes for the entity to engage with them and to report material issues to the board."

While our members support the drafting of Recommendation 3.3, they continue to have concerns with some of the Commentary sitting under this Recommendation:

- They question why the examples of organisations which represent the interests of stakeholders is limited to 'unions, environmental or consumer groups'. There are a number of other types of organisation which represent stakeholders, for example, patient advocacy groups or tenant representatives. They recommend this sentence of the commentary is redrafted to read 'Stakeholders may also include organisations which represent the interests of stakeholders.'
- It would be helpful to have further clarity on what companies are expected to do here and how this should be demonstrated. As much as possible, entities should be able to rely on their existing engagement processes to evidence following this Recommendation, rather than creating yet further bureaucracy and process.
- Our members also consider that the Commentary blurs the distinction between board and management. The Australian Institute of Company Directors guidance on elevating stakeholder voices to the board is quite clear about the roles of board and management and acknowledges that much of the work in this area is carried out by management with the board responsible for oversight.[6] Our members consider this is the preferable approach.
- Paragraph 6 notes one of the board's activities as 'overseeing due diligence on the entity's stakeholder relationships'. Again, this blurs the distinction between the role of board and

[6] See Elevating stakeholder voices to the board: A guide to effective governance, Australian Institute of Company Directors, April 2021 at page 8.

management. We recommend this is redrafted as 'requiring information about the impact of the entity's stakeholder relationships, including human rights impacts'. Further, the reference in this part of the commentary to the board 'overseeing due diligence on the entity's stakeholder relationships' is problematic and our members question what is intended in this context.

- The Commentary refers to escalation of issues to the board where the reporting is to a board committee. Our members question the value of a board committee if all issues must be escalated to the board. It should be a matter for each company's committee charters and the delegations given to those committees from the board, either through the charters or separately. We recommend the final paragraph be redrafted to read 'There should be procedures to ensure that important information and trends are communicated to the board.'

Governance Institute recommends amendment to the Commentary to Recommendation 3.3.

11. Recommendation 4.2: Do you support the proposed disclosure of processes for verification of all periodic corporate reports (including the extent to which a report has been the subject of assurance by an external assurance practitioner)?

Our members support the proposed Recommendation 4.2 but caution that the draft standard for assurance of climate-related financial disclosures is currently undergoing public consultation and is likely to be finalised by the end of 2024.[7] Where matters are covered by the accounting and sustainability standards they should not be included in the Principles and Recommendations and the Council should not pre-empt the Auditing and Assurance Standards Board consultation.

Governance Institute supports the proposed disclosure of processes for verification of periodic corporate reports but notes that consultation is under way on the assurance of climate-related financial reporting and **recommends** the Council not pre-empt the Auditing and Assurance Board consultation.

12. Recommendation 4.3: Do you support the proposed disclosure of an entity's auditor tenure, when the engagement was last comprehensively reviewed and the outcomes from that review?

As noted above, the proposed Recommendation 4.3 contains a new disclosure of the tenure of the auditor and when that was last comprehensively reviewed. This is currently a live debate – similar proposals in the UK are not currently proceeding and while there are some recommendations from the Parliamentary Joint Committee review in 2020 there has been no government response. In addition, the Australian Parliamentary Joint Committee on Corporations and Financial Services is currently engaged in an Inquiry into the consulting profession. The Council should not pre-empt the findings of this Inquiry. The situation is more nuanced and there are standards dealing with auditor independence. It is not the role of the Principles and Recommendations to drive this sort of change.

Governance Institute does not support the proposed disclosure.

13. Recommendation 7.4: The Council is seeking to enhance the quality of existing reporting of material risks to an entity's business model and strategy, such as in the operating and financial review in its directors' report. Do you support the proposal that the entity identify and disclose its material risks, rather than identifying specific risks for all entities to disclose against?

Our members support the revision to Recommendation 7.4 however, once again caution the Council against including in the Commentary matters which are or are likely to be the subject of legislation in the short term. Attempting to create slightly different or overlapping requirements or introducing what

[7] See Assurance over climate and other sustainability information, Auditing and Assurance Standards Board.

some commentators consider the law should say, is not the Council's role. As noted above Top 300 companies are reluctant not to follow any Recommendation due to the high potential that it will be detrimental to how they are perceived and assessed by members of the investment community. This includes 'suggestions' in the Commentary supporting the Recommendations. It also creates confusion for listed companies.

Given that the legislation introducing mandatory climate-related financial disclosure is likely to be finalised during 2024 our members recommend the Council review the Commentary to Recommendation 7.4 to ensure there is no overlap or duplication with legislative requirements. The Council should not go beyond what is required by law and should not be influenced by stakeholders who may be unhappy with the final form of this legislation, to create additional or different obligations for listed companies.

Governance Institute recommends review of the Commentary to Recommendation 7.4 in light of the introduction of the mandatory climate-related financial disclosure legislation.

14. **Recommendation 8.2: This proposed Recommendation reflects and simplifies existing commentary in the 4th Edition. Do you support this proposed Recommendation that non-executive directors not receive performance-based remuneration or retirement benefits?**

Our members have two concerns about the proposed Recommendation 8.2. Firstly, it conflicts with the Corporations Act which permits a company to seek shareholder approval to provide termination benefits to certain individuals including non-executive directors. This goes to the point that the Recommendations should not duplicate or modify regulation or legislation. Secondly, the Commentary provides that 'Where remuneration or retirement benefits are not in accordance with this Recommendation, the entity should consider obtaining security holder approval' which could lead to a perverse 'if not, why not' disclosure where the company follows the Corporations Act requirements and obtains shareholder approval which would seem unnecessary where a company is acting in accordance with the law. A preferable option is to amend the Recommendation 8.2 to read 'A listed entity should not give performance-based remuneration to non-executive directors' and remove the reference to 'retirement benefits' or include a caveat at the beginning of the Recommendation 'Subject to shareholder approval, …'.

Our members also consider it would be helpful to provide a sentence of guidance about what is or is not a retirement benefit. For example, presumably a farewell gift to a long-serving director should not be considered a retirement benefit. As noted above it would also be helpful to clarify what is considered performance-based remuneration. For example, are options with an exercise price materially above the current share price considered performance based? An element of performance-based remuneration for non-executive directors may be warranted for smaller entities where directors are more closely involved with the company and its success is more dependent on their involvement. In addition, remuneration may not be able to be paid in cash given that it can be a scarce resource for smaller listed entities. These companies may not have sufficient funds on an ongoing basis to attract and retain appropriately qualified directors and simple service rights may lead to significant dilution over the longer term.

Governance Institute recommends the deletion of 'retirement benefits' from the proposed Recommendation or the inclusion of a caveat 'subject to shareholder approval' and provision of guidance about what is meant by 'retirement benefit' and performance-based remuneration.

15. **Recommendation 8.3: Do you support the following proposed clawback Recommendations?**
    a. Recommendation 8.3(a): remuneration structures which can clawback or otherwise limit remuneration outcomes for senior executive performance-based remuneration?

Our members do not support the proposed Recommendation 8.3(b) in relation to disclosure on a de-identified basis of the use of claw back or other limitation of remuneration outcomes. There is a substantial and existing body of regulation, including the Accounting Standards, relating to remuneration disclosure. By adopting the term 'senior executive' in Recommendation 8.3(a) rather than the term used in the legislation and the Accounting Standard 'Key Management Personnel' the Council is creating an additional reporting obligation which is at odds with existing requirements. While APRA regulated entities provide information to APRA this is not necessarily public. Our members are concerned that the disclosure in Recommendation 8.3(b) could inadvertently identify vulnerable staff members, particularly in the context of whistleblower disclosures, thereby breaching legal obligations. The suggested disclosures in the Commentary in the draft Recommendation make it even more likely that identification of vulnerable staff members may occur.

Governance Institute recommends amendment of the term 'senior executives' to 'Key Management Personnel' and **does not support** the proposed Recommendation 8.3(b).

16. **Do you support the inclusion of the following new Recommendations for entities established outside Australia, on the basis that these Recommendations generally reflect expectations under Australian law?**
    a. **Recommendation 9.3 (CEO and CFO declaration for financial statements)?**
    b. **Recommendation 9.4 (substantive security holder resolutions on a poll)?**
    c. **Recommendation 9.5 (offering electronic communications to security holders)?**
    d. **Recommendation 9.7 (policy on hedging of equity-based remuneration)?**

Governance Institute supports the inclusion of new Recommendations for entities established outside Australia.

17. **Should any new or amended Recommendations in the Consultation Draft apply differently to externally managed entities, compared to the manner proposed in *The application of the Recommendations to externally managed listed entities*?**

Our members do not consider there should be a different application of any new or amended Recommendations to externally managed listed companies.

Governance Institute does not support differential application of the proposals to externally managed entities.

18. **Do you support an effective date for the Fifth Edition of the first reporting period commencing on or after 1 July 2025?**

As noted above Australian companies, particularly listed companies and APRA regulated entities are facing significant regulatory change, including for many larger companies, mandatory climate-related financial disclosure reporting.[8] The final version of the 5th edition will not be available until late in 2024 and the adoption date is currently proposed as the first full financial year commencing on or after 1 July 2025. This adoption date would not allow sufficient time for listed companies to prepare for the introduction of the 5th edition and mandatory climate-related financial disclosure, particularly as some boards may only meet three times during that period. Our members consider the adoption date should be deferred and there should be a full year between release and the commencement of the first reporting period. As with previous editions, the Council can encourage early adoption by those companies in a position to do so. Deferral of the adoption date would also allow time for finalisation of the mandatory climate-related financial disclosure legislation.

[8] See Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 [Provisions].

Governance Institute recommends the effective date for the Fifth Edition should commence on the first full financial year commencing on or after 31 December 2025.

19. Do you wish to provide any other comments on the content of the Consultation Draft, including any other changes you would propose?

See **Attachment B**.

Attachment B

19. Do you wish to provide any other comments on the content of the Consultation Draft, including any other changes you would propose?

- **'If not, why not' approach**

Adopted from the UK Corporate Governance Code, the 'if not, why not' approach is intended to give listed companies, particularly smaller listed companies, the flexibility to adapt their governance practices on the proviso they explain why an alternative governance approach is appropriate for their circumstances.

Our members consider that the Council should provide more explanation in the introductory sections about the 'if not, why not' model. This is important given the expansion of many areas of the commentary. It is also especially important for smaller listed entities to be able to point to this in the document itself where they may not have the resources to adopt many of the suggested practices in the 5th edition so refer to the fact that they adopt an alternative practice that meets the spirit of the relevant Principle.

Explanation of the model is important, given the preponderance of other governance guidelines issued by multiple parties, including intermediaries acting collectively on behalf of asset owners as well as individual asset owners, fund managers, proxy advisers and shareholder groups. While there can be commonality in some areas between these multiple guidelines, they can also conflict. The approach in some of these other guidelines can also be unduly prescriptive. Our members note the most recent edition of the UK Corporate Governance Code includes the following:

> *The Code's success relies on companies, investors and a wide range of stakeholders engaging to improve the quality of governance and stewardship, and embracing the flexibility offered by the Code. Achieving this depends crucially on the way boards and companies apply the spirit of the Code. It is the responsibility of boards to use the Code wisely, and of investors and their advisors to assess differing company approaches thoughtfully. Equally, investors and their advisors must consider explanations for departures from the Code thoughtfully, taking full account of company circumstances…*
>
> *Investors should engage constructively and discuss with the company any departures from recommended practice. In their consideration of explanations, investors and their advisors should pay due regard to a company's individual circumstances. While they have every right to challenge explanations if they are unconvincing, these must not be evaluated in a mechanistic way. Investors and their advisors should also give companies sufficient time to respond to enquiries about corporate governance.*[9]

Our members encourage the Council to include this message in the Principles and Recommendations either in the section 'The basis of the Principles and Recommendations' or the section 'Disclosing the reasons for not following a Recommendation' and to communicate this message publicly and clearly. As we have observed on many occasions, some users of corporate governance information treat Commentary, particularly when considering the governance practices of larger listed companies, as if it were a reporting requirement. Highlighting the 'if not, why not' approach in more than one place in the document also assists the market to counteract the tendency to assume that entities must 'comply' with the Recommendations or be 'marked down' on their governance practices.

[9] UK Corporate Governance Code, Financial Reporting Council, January 2024 at pages 3 and 4.

- **Footnotes and references**

Our members consider the Consultation Draft still contains a large number of references to external sources. It would be helpful to clarify that references to sources other than legislation are for information only and are not intended to suggest that the Council endorses this material or consider it should be adopted in part or in full by listed entities. Our members also encourage the Council to review the list of material referred to in footnotes to ensure all references are necessary.

- **Recommendation 3.4 – Diversity and inclusion**

Our members support improving diversity and inclusion practices in companies, listed and unlisted. However, the Workplace Gender Equality Agency and others now produce substantial bodies of guidance and other materials about diversity and inclusion. In addition, the work of the Sex Discrimination Commission and the enactment of the positive duty in legislation as well the focus in state jurisdictions and the issuance of guidance on management of psychosocial risks means that there is now a substantial body of material available to companies about these issues. Our members question whether the Principles and Recommendations is the appropriate vehicle for these issues. For this reason, our members encourage the Council to review the length of the Commentary under this Recommendation to focus on the key areas.

- **Proposed Recommendation 4.3 – Commentary**

The final paragraph of the Commentary to the proposed Recommendation reads 'The audit committee should consider whether a recommendation should be made to the board to seek removal of the auditor by shareholders, to put the audit to tender or for rotation of the external audit partner.' This is at odds with the auditor's ability under section 329 of the Corporations Act, to resign with ASIC's consent. To seek shareholder approval in these circumstances would seem unnecessary. If the Recommendation proceeds, we recommend adjustment of the Commentary to read 'seek a change in auditor, whether through resignation with ASIC's consent or removal by shareholders'.

- **Recommendation 7.3 – Internal audit function – Commentary**

Our members question the need for two references to the role of internal audit standards in paragraphs 2 and 3 and suggest that this could be consolidated into one sentence: '.

- **Recommendation 7.4 – Commentary**

Given that the shape of climate-related financial disclosure is likely to be clear once the new edition is finalised our members consider that the final paragraph of the Commentary needs review and would also encourage the Council to consolidate some of the other Commentary under the Recommendation to be more precise.

- **Appendix 4G Statements**

While not addressed in this consultation and a matter for the Listing Rules our members report that in their experience the requirement to announce lodgement of Appendix 4G Statements adds little value for investors and in fact is not used by them when they engage with listed companies. The way the form is drafted also suggests a tick the box approach to corporate governance disclosures. Given that the form requires board and disclosure committee approval our members consider this adds to the burden of compliance without increasing the information available to those wanting to use corporate governance information to make investment decisions. Our members recommend removal of the requirement.