HESTA consultation submission

Corporate Governance Principles and Recommendations Fifth Edition

May 2024

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About HESTA

HESTA is a profit-to-member industry super fund investing more than $82 billion on behalf of more than 1 million members, around 80% of whom are women. Our purpose is to invest in and for people who make the world better. We bring that purpose to life through Super with Impact™, which is the positive outcome we create by supporting our members to face the future with confidence, being a gutsy advocate for a fair and healthy community and delivering investment excellence with impact.

We recognise the importance of pursuing a growing, sustainable, and inclusive economy and the foundational role of a strong corporate governance framework in supporting that objective. By managing systemic risks, integrating responsible investment factors and pursuing impact, we believe we can deliver strong, long-term returns for our members while accelerating our contribution to a more sustainable world. This approach to investment underpins our response to this consultation.

Introduction

HESTA welcomes the opportunity to make a submission to the consultation on the Corporate Governance Principles and Recommendations 5th Edition.

HESTA is committed to investing our members retirement savings responsibly to deliver strong, long-term returns for our members and help accelerate our contribution to a more sustainable world. We have an absolute interest in ensuring Australian listed companies apply consistent and robust corporate governance standards through policies, practices and disclosures that purposely support long-term value creation and a growing, sustainable and inclusive economy that benefits our members.

We strongly support the review to update the Corporate Governance Principles and Recommendations. This work is essential in promoting continuing high standards of corporate governance among Australian listed companies and ensuring the principles and recommendations are adapting in response to evolving practices and expectations, as well as instances of corporate governance failure.

Overall, we welcome and commend the high standards of corporate governance reflected in the proposed amendments and updates to the Corporate Governance Principles and Recommendations.

HESTA endorses the detailed submissions of the Australian Council of Superannuation Investors (ACSI) and the Australian Sustainable Finance Institute (ASFI).

In this submission, we support 16 of the 18 recommendations to the consultation questions and have provided additional commentary to strengthen our recommendations in matters concerning gender diversity, corporate conduct and culture and risk management in **Table 1**.

Recommendations we do not support are the proposed deletion of the anti-bribery and corruption policy and CEO and CFO declaration for financial statements under questions 1 and 7.

HESTA recommends:

1. Recognising the value of high standards of ASX corporate governance among Australian listed companies to help create long term shareholder value.

2. Implementing a gender diversity target of 40/40/20 for the Executive Leadership Team and workforce, in addition to Board, and a reasonable target timeframe to achieve this for all levels.

Recommendation 1: The Value of High Standards of ASX Corporate Governance

HESTA has long been a proponent of high standards of corporate governance by listed (and unlisted) companies, globally and on the ASX, that promote integrity, independence, accountability and transparency. Together, these build trust and shareholder confidence and help to create long term shareholder value.

The benefits of effective corporate governance are empirically strong. Companies that demonstrate good corporate governance deliver strong financial performance (including total shareholder returns, EBIT and liquidity), when compared with companies with weak governance[1]. Strong corporate governance also provides the foundations for effective and efficient capital markets.

Strong corporate governance is more than structures, controls and target setting objectives, it is mutually supported by and reinforces a positive corporate culture. Our key areas of corporate governance focus (which are reflected in our active ownership priorities) include expectation that companies:

- create and enhance value for the long-term;
- foster inclusive and supporting corporate culture that values diversity and skills to meet current and future needs;
- balance their interests with those of shareholders and stakeholders;
- act in a responsible way, considering how they contribute to systemic issues;
- identify and manage material risks and opportunities now and over the long-term;
- have effective systems and processes to ensure clear accountability for strategy, capital allocation, risk management and performance;
- engage with stakeholders to maintain their social license to operate, which is a valuable intangible asset; and

[1] GrantThornton (2019), Corporate governance and company performance. https://www.grantthornton.global/globalassets/1.-member-firms/united-kingdom/pdf/documents/corporate-governance-and-company-performance.pdf

- provide timely and complete disclosure of material information, including on any material environmental, social or governance issues.

While HESTA acknowledges that the corporate governance standards of ASX listed companies are relatively strong and have improved over time, further work is needed to ensure companies are held to account for emerging, contemporary governance issues.

This was reinforced by research completed by KPMG in 2022 on behalf of the ASX following the adoption of the fourth edition Corporate Governance Principles and Recommendations published in 2019. The report found diversity, equity and inclusion among ASX listed companies had stalled, as well as many entities claiming no material exposure to environmental or social risks[2].

These findings are to an extent reflected in recent Australian examples of corporate governance failure - Rio Tinto's actions in the destruction of 46,000 year old Juukan Gorge rock shelters in Western Australia in 2020, and the more recent governance crisis faced by the Qantas Board in the misalignment of remuneration and customer experience and shareholder outcomes.

These examples, and their potential effect on company share price, demonstrate the importance of upholding strong corporate governance standards to sustainable value creation, through the protection and enhancement of long-term shareholder value.

We welcome this review as a timely opportunity to promote high standards of corporate governance among Australian listed companies that support the delivery of strong financial returns and mitigation of material risks that can negatively impact returns for our members.

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[2] KPMG, ASX Corporate Governance Council. https://assets.kpmg.com/content/dam/kpmg/au/pdf/2022/asx-corporate-governance-principles-adoption.pdf

Recommendation 2: Implementing a gender diversity target of 40/40/20 to be achieved within a reasonable target timeframe

HESTA believes board diversity plays an integral part to improving company decision making, and helping avoid group thinking, to drive sustained and long-term financial performance for investors. Diversity should also be holistically embedded across all levels of a company from the Board, The Leadership Team and the broader workforce.

HESTA recommends the target for gender diversity across at the Board level increase from 30% to 40% and that the target be aligned to a reasonable timeframe. It also recommends the same target and timeframe be applied to the Executive Team and the broader workforce.

By setting an objective target and timeframe, HESTA strongly believes that this will hasten progress to closing the gap in gender leadership and pay across all levels of the workforce.

HESTA also recommends ASX company reporting to the Workplace Gender Equality Agency (WGEA) on its gender diversity and pay gap be applied to all ASX listed companies, irrespective of whether companies meet the reporting threshold of 100 or more employees. This is intended to improve reporting accountability with some smaller ASX listed companies falling below the reporting threshold and not required to report annually to WGEA.

More broadly, HESTA believes boards should actively consider how they foster a diverse range of skills to meet its present business needs, and skills for the future with input be sought from shareholders on the composition of board skills required.

Table 1: HESTA response to ASX consultation questions

Consultation Question	HESTA Response	Further Notes
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)? Recommendation 6.5 (offering electronic communications to security holders)? d. Recommendation 8.2 (separate disclosure of remuneration policies for non-executive directors, other directors and senior executives)? e. Recommendation 8.3 (policy on hedging of equity-based remuneration)?	Does not support (deletion of recommendations 3.4 and 4.2)	HESTA does not support the proposed deletion of Recommendation 3.4 (disclosure of anti-bribery and corruption policy). While bribery is prohibited under existing legislation, we consider deletion of this recommendation premature until there is also a requirement for entities to have policies in place to safeguard against and remediate in cases of bribery and corruption. HESTA does not support the proposed deletion of Recommendation 4.2 (CEO and CFO declaration for financial statements) since Recommendation 4.2 requires the statement to be based on a system of risk management and internal controls, where the Corporations Act does not.
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?	Prefer to retain	HESTA would prefer to retain Recommendation 3.3 (disclosure of whistleblower policy) to encourage strong market practices. While whistleblower policies are covered elsewhere, ASIC research has found current market practices and policies are falling short.

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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	Support and propose enhancements	HESTA support the proposed change to Recommendation 2.2 (director skills). Further, HESTA notes that current board skills disclosure varies substantially in the level of detail provided. HESTA therefore also advocates inclusion of the following: a. a requirement that boards skills include both skills for the present (relevant industry experience) as well as skills for the future (strategic, climate transition, organisational transformation) necessary to drive long-term sustainable value creation; b. a requirement that boards seek input from shareholders regarding the mix of board skills required.
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?	Support and propose enhancements	HESTA supports the proposed change to Recommendation 2.3 (to include a measurable objective for board diversity of gender balance – 40/40/20). Further, capture the benefits of diverse boards, HESTA recommends that a reasonable target timeframe should be included for achievement of this objective.

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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?	Support and propose enhancements	HESTA supports the proposed change to Recommendation 2.3c regarding the disclosure of characteristics in addition to gender. Further, to capture the benefits of diverse boards, HESTA recommends that this recommendation be strengthened – from a suggestion that board's "may consider" to "should consider".
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?	Support and propose enhancements	HESTA supports the proposed change to Recommendation 3.4c regarding disclosure of the effectiveness of an entity's diversity and inclusions practices. Further, to capture the benefits of diversity at all levels of an organisation, HESTA advocates inclusion of the following: a. a measurable objective for diversity at the executive level of gender balance – 40/40/20 - to be achieved within a reasonable timeframe; b. a measurable objective for diversity across the workforce of gender balance – 40/40/2020 - to be achieved within a reasonable timeframe; and c. a requirement to report the gender pay gap (irrespective of whether the company meets the threshold for WGEA reporting) and set a measurable objective to closing any gender pay gap and a target timeframe for achievement of that objective, together with

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		description of the actions taken to close the gap (to complement WGEA reporting).
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)?	Does not support	HESTA does not support changes to Recommendation 2.4 as the change in threshold would likely mean that for most ASX companies with a diversified shareholder register, no individual shareholder would be captured by the proposed amended threshold. There is a risk that this could have unintended consequences. Further, the current definition and use of 'substantial' shareholder is well understood would be a departure to current legislation under the *Corporations Act 2001*.
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?	Support	HESTA supports the proposed changes to Recommendation 3.2(c), noting that these disclosures would support assessment by investors of culture-related risks. We also observe that there already several strong instances of this type of disclosure in the market.

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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?	Support and propose enhancements	HESTA supports the proposed amendment to Principle 3 to include references to an entity's stakeholders. In particular, in the context of our participation in the Dhawura Ngilan Business and Investor Initiative, we welcome reference to Aboriginal and Torres Strait Islander stakeholders, though this could be strengthened. Further, HESTA advocates inclusion for there to be a requirement to disclose the feedback of stakeholders (a strong example of this is Rio Tinto's Communities and Social Performance Report).
10. Recommendation 3.3: Does this new Recommendation appropriately balance the interests of security holders, other key stakeholders, and the listed entity?	Support	HESTA supports the proposed changes to Recommendation 3.3 and believes these appropriately balance the interests of security holder, other key stakeholder, and the listed entity. In particular, HESTA supports the reference to creation of long-term sustainable value and the implicit reference to the need to preserve trust with a range of stakeholders, as these inclusions align strongly with HESTA's Active Ownership Priorities.
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)?	Support	HESTA supports the proposed change to Recommendation 4.2 which now covers any periodic report. HESTA also welcomes reference to the appropriate assurance standards for these reports.

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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?	Support	HESTA supports the proposed disclosure of entity's auditor tenure and review as we believe this supports strong audit quality standards. Further, we believe this change would complement existing audit partner rotation requirements.
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?	Support and propose enhancements	HESTA supports the proposal that entities identify and disclose their material risks and specifically, welcomes the reference to governances as well and environmental and social risks. HESTA also welcomes specific reference to cyber security and climate risks. Further, HESTA advocates inclusion of the following: a. materiality should be from both the perspective of potential impact of risk to that entity but also that entity's contribution to a systemic risk information on the timeframe for resolution, and assessment of materiality should include a requirement for stakeholder engagement; b. while organisations should identify and disclose risks on the basis of materiality, it may be helpful to reference a broader range of potential risks inclusive of but not limited to – nature and biodiversity, workforce, supply chain, and artificial intelligence.

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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?	Support	HESTA strongly supports Recommendation 8.2 that non-executive directors not receive performance-based remuneration or retirement benefits as these risk impacting the independence and decision-making of directors.
15. Recommendation 8.3: Do you support the following proposed clawback Recommendations? Recommendation 8.3(a): remuneration structures which can clawback or otherwise limit remuneration outcomes for senior executive performance-based remuneration? Recommendation 8.3(b): disclosure of the use of those provisions (on a de-identified basis) during the reporting period?	Support and proposed enhancements	HESTA supports the proposed inclusion of clawback provisions within Recommendation 8.3, noting that these are important to ensure that remuneration is aligned to shareholder experience particularly in instances of reputation damage to an entity arising from an executive's action or inactions. It is not clear to investors which companies have clawback provisions and in what circumstances these can be used. This recommendation would bring greater consistency across entities. Noting there have been multiple instances of reputation and shareholder harm where a company Board has indicated through engagement that they would have considered using clawback but did not have adequate provisions, HESTA particularly advocates the following: a. the circumstances in which clawback can be used should be relatively broad and should include failure to take action (rather than being limited to instances of misconduct or malice).

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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? (Recommendations 9.3, 9.4, 9.5, 9.7)	Support	HESTA supports the new recommendations, as we believe it is important to uphold a consistent set of standards across listed companies.
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?*	Support and proposed enhancements	HESTA supports *The application of the Recommendations to externally managed listed entities?* We believe it is important to uphold a consistent set of standards for externally managed entities, noting the requirement for differentiation in some instances. We note, however, that in instances where a responsible entity manages the affairs of another listed entity, it can be difficult for shareholders and stakeholder to engage with the responsible entity. HESTA therefore advocates the following: a. clear disclosure of the contact details of the responsible entity.
18. Do you support an effective date for the Fifth Edition of the first reporting period commencing on or after 1 July 2025?	Support	HESTA support the proposed effective date.

Consultation Question	HESTA Response	Further Notes
19. Do you wish to provide any other comments on the content of the Consultation Draft, including any other changes you would propose?	Yes	HESTA notes the prominent rise and use of artificial intelligence technology necessitates that companies have robust governance frameworks in place to protect digital assets and data. Governance would need to be actively reviewed by the board and embedded within an organisations risk management framework and management and reporting of material breaches and supports recommendations 3.3 and 7.4.

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