15 November 2013

PRIVATE & CONFIDENTIAL

Ms Mavis Tan
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Dear Ms Tan

SUBMISSION ON PROPOSED CHANGES TO ASX LISTING RULES - CORPORATE GOVERNANCE DISCLOSURES

3 degrees consulting provides the following submissions in relation to the proposed changes to the ASX Listing Rules (**Listing Rules**) issued on 16 August 2013.

While only recently established, 3 degrees consulting draws on the decades of experience of its principals to consult to boards of directors and senior executives in the areas of governance, board effectiveness and remuneration.

These submissions have been prepared in consultation with a number of listed entities.

1 PROPOSED LISTING RULE 3.19B

Proposed Listing Rule 3.19B requires entities to file a disclosure with ASX within 5 business days of any on-market purchases of securities under the terms of a scheme that provides for the purchase of securities by or on behalf of employees or directors or their related parties. The rule is proposed to be effective from 1 January 2014.

We have two key concerns with this proposal.

1.1 First issue – administrative cost for broadly based regular purchase employee share schemes

We are concerned about the administrative burden imposed by such a requirement.

A large number of companies choose to purchase shares on market to satisfy obligations under a wide range of employee share schemes, including their broadly based employee share schemes (operated under the current $1000 exemption in the tax laws) and salary sacrifice schemes (currently limited to $5000 per employee under the tax laws), which often involve the purchase of shares for non-management employees on a regular basis – whether monthly or quarterly. These often operate on the basis of acquiring $83 of shares for employees every month (under the $1000 plans) or $416 of shares every month (under

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the $5000 plans). Many companies choose to buy on market to avoid dilution of existing shareholders.

This presents a further administrative issue where shares are purchased over a period of time which is greater than 5 days. This would, based on the current proposal, require numerous disclosures over that one purchasing period.

SUBMISSION

We submit that ASX consider limiting the application of new Listing Rule 3.19B to share schemes established predominantly for the purposes of KMP, including directors (ie not general employee share plans in which KMP participate). These are the schemes under which large quantities of shares are bought for a small group of people (usually in a concentrated timeframe).

If ASX is concerned to ensure transparency in relation to broadly based employee schemes that involve regular or periodic purchasing, ***we submit*** that the requirement be altered to require one filing at the beginning of each share scheme year (which in the case of the tax structured plans normally operate from 1 July to 30 June) requiring them to indicate to the market that the scheme is in operation, the periodicity of purchases to be made under the scheme (eg monthly, quarterly, etc), the broker or market participant who will be buying on behalf of the scheme and the value of shares intended to be purchased over the year (based on the number of employee participants at the beginning of the year). We submit that this would meet the object of the proposed Listing Rule without overly increasing the administrative burden on listed companies.

At the very minimum, the period of time for disclosure after share acquisitions should be extended (eg within 20 Business Days of the acquisition) in order to address the issue outlined above where shares are purchased over a period.

1.2 Second issue – timing of the operation of the new Listing Rule

A number of companies are considering reviewing the operation of their plans in light of the increased administrative burden that the new Listing Rule would impose. However, as the vast majority of entities operating regular purchase share schemes (and many short term deferred equity and long term incentive schemes) operate on a tax year and financial year basis, the share schemes have buying arrangements in place for director and employee shares schemes that cannot be altered until the 2014 tax/financial year.

As the new rule comes into effect from 1 January 2014 as proposed, these entities will be required to make disclosures in relation to schemes, the operation of which were put in place prior to 1 July 2013 and which, in many cases, cannot be easily amended (because of elections made prior to 1 July).

SUBMISSION

In order to allow companies time to review and, where appropriate, restructure the operation of these plans to manage their administrative and disclosure obligations, ***we submit*** that it would be optimal to defer the commencement of the reporting obligation to 1 July 2014.

We note that several other ASX Listing Rule changes proposed in the consultation are indicated to be effective from 1 July 2014. Accordingly, this deferral of the operative date of the requirement would not be incongruous.

Additionally the proposed third edition of the *ASX Corporate Governance Principles and Recommendations* are also envisaged to be effective from this later date.

2 LISTING RULE 3.16.4

Listing Rule 3.16.4 requires an entity to immediately provide ASX with the material terms of any employment, service or consultancy agreement it ***or a related entity*** enters into with; its chief executive officer (or equivalent), any of its directors, or any other person or entity who is a related party of its chief executive officer or any of its directors, and of any material variation to such an agreement.

Our concern is not with the intent of the Rule but with the use of the term 'related entity'.

This term is not defined in the Listing Rules. It is, however, defined in extremely broad terms in section 9 of the *Corporations Act 2001* to include:

"***Related entity****, in relation to a body corporate, means any of the following:*

(a) *a promoter of the body;*

(b) *a relative of such a promoter;*

(c) *a relative of a spouse of such a promoter;*

(d) *a director or member of the body or of a related body corporate;*

(e) *a relative of such a director or member;*

(f) *a relative of a spouse of such a director or member;*

(g) *a body corporate that is related to the first-mentioned body;*

(h) *a beneficiary under a trust of which the first-mentioned body is or has at any time been a trustee;*

(i) *a relative of such a beneficiary;*

(j) *a relative of a spouse of such a beneficiary;*

(k) *a body corporate one of whose directors is also a director of the first-mentioned body;*

(l) *a trustee of a trust under which a person is a beneficiary, where the person is a related entity of the first-mentioned body because of any other application or applications of this definition.*"

The use of this very broad term will have unintended consequences, either requiring disclosure of things that are not intended or that are not within the control of the listed entity. As an example, take a listed entity that has appointed an executive of another listed

entity as a non-executive director on its board (which often happens in the case of CEOs). Should the two listed entities have a common director (including in fact that person), then technically the first company would need to disclose details regarding its NED that included the employment contract (and any material variation of the employment contract) of that director as CEO of the second entity. We assume that this was unintended. Not only does the first company not have anything to do with the employment of the person with the second company, it would have no right to details of that contract (unless it included such a requirement in its appointment letter or constitution) to enable it to comply with this requirement. This would also be highly likely to confuse shareholders (at least retail ones) by implying that the two companies had some relationship (or at least one could influence the other) relating to the directors arrangements.

In specific point, as the MD and CEO of ASX is also a NED of Tabcorp – this definition would require Tabcorp to disclose to the market the terms of his employment agreement with ASX. Clearly this is non-sensical where Tabcorp has no control over (and in fact no interest in) the terms of his employment with ASX.

SUBMISSION

In our view, Listing Rule 3.16.4 should either:

(a) be amended to remove the term 'or a related entity' and replace it with 'or a related party' – which would be consistent with the use of the term 'related party' later in the Listing Rule; or

(b) clearly define 'related entity' rather than rely on the incredibly broad definition in the Corporations Act to include any entity that controls or is controlled by the listed entity or its directors'.

3 PROPOSED GOVERNANCE CHANGES – GENERAL COMMENTS

The ASX Corporate Governance Council Recommendations introduced in 2003 shone an important spotlight on governance in Australia.

Presented as 'guidelines designed to produce an efficiency, quality or integrity outcome', and not intended to be a 'one size fits all' approach to governance, the Recommendations set out a 'best practice' framework for companies to use as a 'focus for re-examining their corporate governance practices and to determine whether and to what extent the company may benefit from a change in approach, having regard to the company's particular circumstances'.[1]

For various reasons, since their introduction corporate practice has seen the 'recommendations' interpreted as 'requirements'.

Companies report as to whether they 'comply' with the Recommendations, and proxy advisers recommend votes against various resolutions where Recommendations are not followed.

[1] ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations, March 2003, page 5.

Ten years on, our experience is that we have (despite the ASX Corporate Governance Council's original best intentions) arrived at a 'one size' governance framework. Which in our view is unfortunate. And which, in our view, the most recent proposed changes support.

In particular, the reporting framework that has evolved offers very little to enable a reader to make an informed decision about the governance of the company.

Today, we see the majority of companies providing boilerplate disclosures in relation to the governance *framework* that they have in place, rather than providing any insight into the governance *mindset* or *activities* of the company.

In the view of former Perpetual fund manager, the pages of governance disclosures provide nothing more than a 'false sense of security'.[2]

Two very different companies – with vastly different levels of commitment to governance – can tick all of the 'governance boxes'. Indeed, their Corporate Governance Statements will often read very similarly – setting out details of the Company's continuous disclosure policy, share trading guidelines and Committee composition.

Instead, in our view the better approach (and one that the ASX should be looking to promote) is to encourage companies to report meaningfully on what they are doing on a regular basis to support a strong corporate governance culture. It does not help investors to read of Committee composition requirements that are in fact now a requirement under the ASX Listing Rules. What *would* assist investors is to better understand the key activities undertaken by the Committee during the year – did it undertake a comprehensive review of remuneration arrangements? was management succession planning the focus in the context of the company being led by a long serving CEO? did it consider a change in auditor?

We have ***serious concerns*** about further changes that encourage a 'tick the box' approach to corporate governance. In our view, this is exactly what the proposed changes do.

In our view, these changes will send us backwards, and will exacerbate, rather than address, the issue that the ASX has (quite rightly) raised in relation to advisers preparing 'pro forma' compliance documents.

3.1 Proposed changes to listing rule 4.10.3

The proposed changes to Listing Rule 4.10.3 provide greater flexibility to listed entities to make their corporate governance disclosures either in their annual report or on their website.

While we welcome the intention of this proposed amendment (ie to provide more flexibility), in our view, it does not go far enough in order to facilitate any meaningful change.

[2] Noted by Peter Morgan at Ownership Matters conference on 3 April 2012.

The proposed amendment would encourage more relevant governance disclosures if it provided for a corporate governance statement in relation to 'static' disclosures to be included on the Company's website, and for governance activities, changes or developments relevant to the reporting year to be included in the annual report.

In addition, the proposed amendment to require the corporate governance statement to state that it has been approved by the Board imposes an additional procedural requirement that is, in our view, unnecessary on the basis that the corporate governance statement forms part of the annual report which is approved by the Board.

SUBMISSION

We submit that this Listing Rule should permit companies to:

(a) include a '**corporate governance statement**' on their website which sets out the Company's approach in respect of each of the Recommendations that relate to the company's governance framework and therefore do not change regularly and, at least in relation to larger companies, are essentially 'mandated' by either the Recommendations, market expectations or the Listing Rules (eg Committee composition requirements, continuous disclosure, share trading policy). We submit that this statement should only need to be updated on an as needs basis; and

(b) incorporate a '**corporate governance report**' in the company's annual report which we envisage as a 'one page' snapshot of the key governance matters and activities that are relevant to that particular year. For example, whether a board performance review was undertaken, board educational activities and site visits, specific risk management and disaster recovery activities undertaken or reviewed by the Board etc.

In our view, this would encourage companies to focus on, and communicate more effectively in relation to, the activities that truly make for a better performing board (and better governed company), rather than spending time reviewing and updating 'static' disclosures in order to meet a checklist of requirements.

The proposed requirement for the corporate governance statement (or corporate governance report) to be separately approved by the Board and to state this should be removed.

If this change is adopted, ***we submit*** that the ASX should expressly provide for early adoption (ie which would permit companies to provide their statement on the website instead of in the annual report in respect of the 2014 financial year).

3.2 Proposed Appendix 4G

Proposed Appendix 4G requires entities to file a very detailed 'checklist' as to where the company's various corporate governance disclosures can be found. Proposed Appendix 4G will need to be completed and given the ASX at the same time the company lodges its annual report with ASX.

We are ***strongly opposed*** to this change for the following reasons:

(a) it is contrary to the basis on which the Recommendations were originally introduced (ie not intended to be a 'one size fits all' model), by effectively presenting it as a 'checklist' approach to governance; and

(b) it places a significant additional administrative burden on companies for little additional benefit to investors.

In addition, in our experience the majority of ASX 150 companies have adopted corporate governance frameworks that are generally consistent with the Recommendations (or clearly explain reasons for departure) and are clearly communicated (albeit in different parts of the annual report).

In our view, this proposed amendment applies a 'lowest common denominator' approach to governance which will require companies' time and attention to be directed towards completing a checklist, rather than communicating more meaningfully with investors in relation to their corporate governance activities (see also our submission in section 1).

SUBMISSION

We ***strongly submit*** that ASX should abandon the proposal to introduce a checklist.

In relation to the examples referred to in the consultation paper (ie diversity disclosures, and disclosures around whether a review of executive performance has been undertaken during the year), if there is a real concern about readers of the report not being able to locate these disclosures, we submit that the better approach would be to require them to be included in the corporate governance statement itself (or by way of clear cross reference, in the case of companies who include, for example, a separate diversity report within their annual report).

The proposed checklist represents a very onerous 'solution' to a 'problem' that is, in respect of the majority of companies, unfounded. It will add significantly to the compliance cost of end of year reporting.

It also turns governance into a compliance exercise – rather that one where companies are encouraged to report on *what* they are doing to enhance their governance performance (rather than *what page* it can be found on).

If the ASX does proceed with the change to this Listing Rule, ***we submit*** that it should only apply to companies outside of the ASX 200. In our experience, ASX 200 companies do in fact have governance frameworks in place that are largely consistent with the Recommendations, and their Boards 'own' governance. The cost of this proposal (in terms of time, attention, and adviser fees) far outweighs any benefit to shareholders.

3.3 Other

A number of other changes that are proposed, including in relation to diversity and clawback which, ***we submit***, see the ASX purporting to 'overreach' in its role.

The introduction of clawback policies was considered by the government, which proposed to legislate in this regard. In our view, it is not the ASX's role to introduce legislation 'by the back door'.

Notwithstanding the draft legislation being shelved, a number of companies have considered and indeed adopted clawback policies. Others have considered and determined that their various incentive plan arrangements provide broad enough power to the Board in this regard. Quite rightly, this has been a company by company consideration – and not one that should be 'mandated' by the ASX Recommendations. It is also a matter that is currently addressed in companies' remuneration reports – in our view, to require disclosure in the corporate governance statement is unnecessary and overly complicates disclosures.

Similarly, we do not believe that the role of the ASX is to mandate 'outcomes' in respect of diversity. Indeed, from our perspective, the diversity reporting requirements have in some cases hindered companies' approach to diversity. Numerical targets can drive undesirable behaviours (including appointments and promotions based on gender alone), which can have a negative impact for both the appointee and the organisation.

We are strongly opposed to the ASX mandating reporting outcomes and 'numerical targets' – which does not take into account the industry in which the company operates or the talent pool available.

In our view, a better approach is to encourage reporting of the organisational objectives / measures that the company has put in place, and progress against these. For example, return to work initiatives and talent pool makeup (ie number of female candidates considered for the position – not whether or not they were appointed).

The fact remains that improving gender diversity will not happen overnight – while we welcome the focus on supporting female talent, it will take some time to develop the senior talent pool from the bottom up (ie by supporting flexible work practices etc). Introducing pressure on companies to report numerical targets seeks to impose an immediate 'fix' which we fear will do more harm than good.

We would be happy to discuss our submissions should this assist.

Yours sincerely

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