

26th February 2016

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Review of corporate governance reporting requirements within NZX Main Board Listing Rules

Relationship of Submitter

The New Zealand Shareholders Association is the only nationwide organisation representing the “buy side” of the market. As such our submission is written from the perspective of a retail or smaller investor. This view is important. Clear, transparent and effective corporate governance is the framework for the interaction between all those active in the market, be they regulators, issuers or (retail) investors and has a direct effect on public perception of, and investor confidence in the capital markets.

Summary of Views

NZSA considers the NZX review of corporate governance guidelines to be timely and in general supports many of the proposals. The objectives are concise and should stimulate input that address the issues and provides outcomes that are a balance between disclosure, complexity and resourcing.

We agree that generally the FMA principles should be adopted as a basis for the new guideline regime. In particular we think this is a good opportunity to establish a common approach as currently there are various different guidelines available with varying standards. This is confusing to issuers and makes compliance more difficult. It will probably not be possible to get complete alignment as various interested parties have a slightly different emphasis depending on their perspective. Where practical we agree that alignment should be sought with ASX rules, but this needs to be tempered by the fact that the New Zealand market is much smaller as are many of our issuers. So to some extent it requires a New Zealand solution to address the resourcing issues that can otherwise arise in consequence.

We agree with the tiered approach that is proposed. In particular, we consider that where guidelines are expressed as recommendations, the “comply or explain” process will frequently be enough to encourage compliance while at the same time allowing a degree of flexibility for those issuers who have specific reasons for taking a different approach.

In some cases, we consider that recommendations go further than necessary and a commentary approach is more suitable. This is particularly the case where there is great diversity of requirement between different types of industry. In our view, being too

prescriptive or requiring complex explanations about why a different approach has been taken will consume too much issuer resource with little benefit to investors.

NZSA has definite views on some specific aspects including remuneration reporting, audit matters, representation at shareholder meetings and various others. We trust that these will be carefully considered given that they bring promote better information and comfort to investors and that this should be a prime consideration in the review.

NZSA's specific responses to the questions in the Discussion Document are set out in table format in Appendix A.

The NZSA would be pleased to clarify or expand on any matters contained in this submission. We have no objection to our submission being made public.

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Appendix A

The NZSA submission in response to the questions in the NZX Discussion Document

Question	Response
Objectives of review and proposed framework	
1. Do you agree with the above objectives for NZX's current review?	NZSA broadly agrees with the objectives which should set minimum standards and ensure companies that choose not to comply will have to explain their reasons.
2. Do you agree that NZX should adopt the FMA principles as the basis for an updated reporting regime?	We agree that the 9 principles is a good basis on which to model the guidelines. We would like to see unification of the various guidelines such as FMA, NZX, Corporate Governance forum and our own regime in order to simplify the complexity of compliance on companies. Where practical, given some underlying differences that are hard to resolve, we would also like harmonisation with the ASX corporate governance guidelines. At the same time, there needs to be care taken that changes do not result in reduced standards by virtue of adopting a lowest common denominator.
3. Do you agree with a tiered approach to a reporting regime?	We support the tiered approach that NZX proposes.
4. Do you agree that recommendations should be reported against on the basis of an approach of "comply or explain"?	<p>The use of "comply or explain" is particularly supported. We see this as allowing some degree of flexibility as it is unlikely that black letter rules will all be appropriate in all cases. The opportunity to add commentary supporting the guidelines should simplify compliance, particularly for smaller less well-resourced issuers.</p> <p>However, it will be important to find a way to ensure that "explanations" are concise and relevant to the needs of retail investors. It would defeat the purpose if important details were lost in a mass of unnecessary and complex verbiage.</p>

<p>5. Do you have any other suggestions in relation to the proposed structure of NZX's updated reporting regime (i.e. feedback on the proposed output of the current review process)?</p>	<p>We would suggest that some limit be put on the space that can be devoted to a corporate governance report in annual reports. This could be a page limit (as used in the production of PDS documents), a template approach or a requirement for certain key disclosures with others being web based (similar to the MBIE "Disclose" website).</p>
<p>6. Should any other steps be taken by NZX to address the fragmentation of corporate governance guidelines and expectations applying to issuers in New Zealand?</p>	<p>As noted above, the current fragmentation is unhelpful and we would expect this review to closely address the harmonisation issue.</p>
<p>7. Should the other corporate governance reporting requirements currently covered in section 10.4.5 of the Listing Rules be incorporated into an updated NZX Code?</p>	<p>The matters covered under this rule should remain mandatory in our view. We have no problem in incorporating them into the code so as to provide a single source for companies to access, providing they remain so. It is not entirely clear to us whether this could be achieved and in the event that it cannot we support the retention of rule 10.4.5, noting also that some aspects, for example diversity reporting, are in our view too narrow and should be reviewed.</p>
<p>Principle 1: Ethical Standards</p>	
<p>8(a). Should NZX include additional recommendations within its NZX Code: Explicitly stating that application of a code of ethics extends beyond just the board to senior managers and employees (this is probably implied already)?</p>	<p>While this is probably implied, we see no downside in spelling it out as an explicit requirement.</p>
<p>8(b) Should NZX include additional recommendations within its NZX Code: For disclosure of a code of ethics and reporting of compliance with a code of ethics?</p>	<p>Ethical behaviour goes to the very heart of shareholder confidence in the markets. Therefore we support disclosure of a code of ethics. Reporting compliance with that is essential or there would be no point having it in the first place. In our view, the very need to report compliance and the impact of reported non-compliance would be a powerful motivation for individuals and companies to comply. We accept that there may be some issues around commercially sensitive information, but believe that reporting of the broader issue should be achievable. We are also concerned about whether publication may affect willingness of staff to report issues as is often the case with whistleblowing. It may be that a more general reporting structure detailing the number and nature of breaches without</p>

	identifying individuals may be sufficient. Investors would then have the opportunity to decide if a particular company benchmarks well against its peers in this area.
9. In addition to the matters outlined in section 1.3 of the NZX Code which NZX currently suggests should be considered for inclusion in a code of ethics, NZX considers it appropriate to suggest that a code of ethics cover procedures for dealing with whistle blowing. What additional matters, if any, should NZX suggest (through best practice commentary) be included within a code of ethics?	We agree that whistle blowing needs strong rules and guidance. Companies should be able to demonstrate that they have an effective and efficient process that allows for the reporting of illegal and unethical behaviour and also affords the appropriate protections to the genuine whistle blower. A recent Australian case has shown that as things stand, the odds are stacked against individuals who attempt to blow the whistle and this is unsatisfactory.
10. Should NZX address anything else in this area, including within best practice commentary?	No additional comment.
Principle 2: Composition and Performance	
11. Should NZX introduce additional recommendations or best practice commentary covering the matters outlined in paragraphs i - iv?	
11(i) Issuers should disclose the respective roles and responsibilities of the board and management, including any formal delegations to management.	We support some generic commentary around respective roles and responsibilities of the board and management but consider that disclosing the formal delegations to management is a step too far as this is essentially an operational matter. Additionally, responsibilities are often moved between roles and compliance would be potentially onerous for little gain.
11(ii) Issuers should conduct appropriate checks before appointing, or proposing for election, a director, and should provide all material information in relation to proposed appointments.	We would be disappointed if Issuers do not conduct appropriate checks before appointing, or proposing for election, a director, and provide all material information in relation to proposed appointments. We are aware of some instances where negative information relating to past roles has not been disclosed. Therefore we believe this proposal should be a comply or explain requirement.

<p>11(iii) Issuers should enter into written agreements with each senior executive and board member establishing the terms of their appointment.</p>	<p>We would expect that Issuers should enter into written agreements with each senior executive and board member establishing the terms of their appointment. This is basic practise and should be subject to comply or explain rules.</p>
<p>11(iv) Reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests.</p>	<p>For many investors, the people running the company are a key investment criteria. Therefore we believe reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests and should be on a comply or explain basis.</p>
<p>12. Should NZX consider introducing a recommendation in future that boards contain a majority of independent directors and/or an independent chairperson?</p>	<p>Yes. We believe both matters generally result in better outcomes and strongly support both concepts. However there are some situations with more closely held companies where one or other may present difficulties - for example family controlled or relatively recently retired very high performing executives joining the board who may not be considered independent. So some flexibility is necessary. We think this can be addressed by a comply or explain requirement.</p>
<p>13. Do you consider the current definitions within the Listing Rules of “Independent Director”, “Disqualifying Relationship” and “Associated Person” are appropriate? If not, what amendments should NZX consider in future</p>	<p>The current definitions are inadequate in our view. The problem is that companies can and do appoint recent employees (usually the ex CEO) to the board and classify them as independent immediately. There is a perception that in such appointments the person concerned will be unable to take a truly independent view. This is exacerbated if they are made Chair where they may have considerable influence over the CEO and effectively interfere in operational matters. We believe that a disqualifying period of say three years should be introduced in such situations. This should also apply to long-term advisors who have been appointed to the board. The best way to address the issue is via a comply or explain rule.</p>
<p>14. Should NZX address anything else in this area, including within best practice commentary?</p>	<p>We would like to see a comply or explain rule that there should be no more than one executive director on the board.</p>
<p>Principle 3: Board Committees</p>	
<p>15. Should NZX introduce additional recommendations or best practice commentary in relation to publication of committee</p>	<p>Yes. We support this a comply or explain recommendation.</p>

charters, committee membership and meeting attendances?	
16. Should the existing recommendations within NZX's Code in relation to nomination and remuneration committees continue to be subject to the "unless constrained by size" exception?	We are not in favour of compromising governance simply because of size. All boards of public listed issuers should have the capacity and expertise to form these subcommittees.
16(a) Should NZX continue to recommend issuers have a remuneration committee?	Yes. For the reason above and to ensure that these types of consideration do not detract from the strategic and financial emphasis that should dominate full board discussions.
17. Should NZX address anything else in this area, including within best practice commentary?	No further comment.
Principle 4: Reporting and Disclosure	
18(a) Should NZX introduce additional recommendations or best practice commentary that issuers should have a written policy for complying with their continuous disclosure obligations. If so, should issuers be required to publish these policies?	Yes. This is already common. Disclosure is a critical investor protection and this should definitely be a comply or explain recommendation. We note that continuous disclosure breach is an area where cases are often referred to the NZ Markets Disciplinary Tribunal
18(b) Should NZX introduce additional recommendations or best practice commentary that all boards should maintain an effective system for internal control for reliable financial reporting and accounting records?	All boards should maintain an effective system for internal control for reliable financial reporting and accounting records. This is basic to any company's affairs and is subject to numerous black letter rules and significant oversight. We cannot envisage any situation where a solvent company would not comply. There is no downside in making it a recommendation, but it will not add additional protection.
19. Should NZX introduce any additional recommendations or best practice commentary in relation to non-financial reporting matters, including ESG disclosures?	A general best practise commentary taking into accounts our notes in Q 19a. To go further will add to resourcing pressures at smaller companies.
19(a) If so, which issues (and metrics) should be reported?	There are significant problems in trying to promote a specific set of guidelines in this area due to the diversity of companies operations. What is relevant to one

	<p>will not be relevant to another.</p> <p>We note that many companies are already reporting to some extent in this area and those with higher risk factors are moving to international best practise standards. For small companies without significant exposures to ESG matters, it could be argued that resourcing may be unduly onerous. On the other hand, it may be totally appropriate for a small start-up mining company and is simply a stay in business cost to have systems and compliance procedures in place. Commentary would be more appropriate in our view and this should stress the need for companies to address issues relevant to their business or their risks, rather than a tick box approach.</p>
20. Should NZX include anything else in this area, including within best practice commentary?	No further comment.
Principle 5: Remuneration	
21(a) Should NZX introduce recommendations as follows: Issuers must publish a remuneration policy dealing with remuneration of directors and senior executives?	<p>Yes. We believe that investors expect to see a degree of alignment between remuneration and performance (particularly for executives). By publishing a policy, it is much easier to see if the reality matches the rhetoric.</p> <p>We believe this should be a comply or explain recommendation.</p>
21(b) Should NZX introduce recommendations as follows: Senior executive remuneration (including CEO remuneration) should include an element that is dependent on entity and individual performance?	Yes. For the reasons in Q 21a
22. Should NZX introduce additional recommendations or best practice commentary for reporting of CEO and senior executive remuneration? If so, what should be introduced?	We support a concise document that outlines the key CEO and senior executive remuneration. However we do not want to see the long winded and confusing reporting common in Australia. The local situation varies between a two line comment which says nothing about how remuneration is decided through to 8 or 10 page explanations that appear designed to confuse rather than inform -

	<p>particularly around multiyear options and vesting periods.</p> <p>NZSA has produced a two page CEO remuneration reporting format that we are currently beta testing with interested companies. We believe that if NZX introduced a generic requirement that sought the middle ground, our proposal or some iteration of it would likely become a voluntary standard.</p>
<p>23. NZX seeks feedback on whether remuneration consultants are widely used in New Zealand. If so, should NZX recommend or suggest via best practice commentary that such consultants be approved by, and report directly to, the board or remuneration committee?</p>	<p>In our view the issue is wider in that there is an inherent conflict with the current process. The quality of reports varies enormously and some are misleading. For example we have seen a report that justified a large increase in directors fees on the basis that the company concerned had a below average fee pool. There was no analysis of the number of directors!</p> <p>There is also a problem that benchmarking does not separate out committee fees and by its very nature creates an upward spiral in fees.</p> <p>However, we do consider it should be a requirement that consultants advising on executive remuneration should be appointed by the board or remuneration committee.</p>
<p>24. Should NZX address anything else in this area, including within best practice commentary?</p>	<p>No further comment.</p>
<p>Principle 6: Risk Management</p>	
<p>25(a) Should NZX introduce recommendations or best practice commentary covering the following matters: Issuers should have appropriate policies and procedures in place to identify and manage the key risks facing their businesses?</p>	<p>NZSA considers risk management and mitigation to be a key investor protection and supports this proposal. It is important that it require companies to address the "key" risks pertaining to their business and not just be a tick box regime. Significant flexibility is required as the identified risks and how they can be addressed will vary widely.</p> <p>This should be a comply or explain requirement and would benefit from an explanatory commentary outlining what is appropriate. This would particularly benefit smaller companies in understanding the matters that should be included</p>

	<p>we would like to see the ASX requirement that "Boards should review (and report on) the risk management framework annually" as forming the basis of any guidelines in this area.</p>
<p>25(b) Should NZX introduce recommendations or best practice commentary covering the following matters: Issuers should disclose details of their internal audit function, where applicable, or to provide explanation of the alternative measures in place?</p>	<p>Issuers should disclose details of their internal audit function, where applicable, or to provide explanation of the alternative measures in place.</p> <p>We agree and would make this a recommendation. We acknowledge that many smaller companies will not have such a function, but the disclosure would clarify whether there is any ongoing external provision or whether systems are less developed. This is helpful information when investors do a risk and pricing assessment.</p>
<p>25(c) Should NZX introduce recommendations or best practice commentary covering the following matters: Issuers should have a staff share dealing policy and disclose details of this?</p>	<p>Issuers should have a staff share dealing policy and disclose details of this. We note that these are commonplace and often disclosed in issuer websites</p> <p>We believe all companies should have such a policy and it should be a comply or explain requirement. As much as anything, this would address perceptions that company insiders may have an advantage.</p>
<p>26. Should NZX include specific recommendations or best practice commentary in relation to managing (and reporting of) health and safety risks? If so, which metrics should be reported?</p>	<p>The advent of new law has to some extent superseded this suggestion. This is compounded by companies in different sectors having dramatically different risk profiles. We consider that some commentary around H and S is appropriate in annual reports.</p> <p>For high risk businesses we would expect to see a comprehensive summary using industry specific metrics. This may all be better addressed by way of NZX commentary.</p>
<p>27. Should NZX recommend/suggest that issuers specifically report on economic, environmental and social sustainability (or ESG) risks?</p>	<p>See Q 19 reply.</p>

28. Should NZX address anything else in this area, including within best practice commentary?	No further comment.
Principle 7: Auditors	
29(a) Should NZX include recommendations or best practice commentary that: The external auditor should attend the AGM to answer questions from shareholders in relation to the audit?	Yes. The revised auditor commentary requirements mean that auditors are likely to face more questions in the future. We consider that the meeting attendee should be the senior audit partner who signed off the accounts wherever possible and a team member who worked on the specific audit where for good reason this is not possible. This should be a comply or explain recommendation.
29(b) Should NZX include recommendations or best practice commentary that: Issuers should report to shareholders annually in relation to audit and non-audit fees paid to the audit firm?	Yes. Comply or explain recommendation. Investors perceive potential "influence" when large amounts of non-audit fees are paid to other divisions of the audit firm. While there is in fact good separation, the effective way to deal with this is to encourage companies to consider the use of other firms by increasing the transparency around the issue. We understand that some disclosure of these payments is currently required under some accounting standards, but there is great variability in the information provided. We think there should be a reasonably detailed breakdown as some items make sense (for example, audit work on subsidiaries) and others are more problematic.
30. Should NZX consider amending its current auditor rotation requirements in future?	No. The 5 year rotation is appropriate in our view.
31. Should NZX address anything else in this area, including within best practice commentary?	We would like NZX to consider whether a 10 or 15 year audit firm rotation would be appropriate. We acknowledge difficulties given the small number of larger audit firms, and also that the large firms have robust systems to minimise conflicts of interest and maintain standards. However, while the audit partner may change it is likely that similar processes (and potentially many of the same staff) apply to a particular audit for long periods. There is a lack of a "new set of eyes".

Principle 8: Shareholders Relations	
<p>32. Do you agree with the proposed best practice commentary in these areas? I.e.:</p> <p>A listed entity should provide information about itself and its governance to investors via its website</p> <p>A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors</p> <p>A listed entity should disclose the policies and processes it has in place to encourage participation at meetings of shareholders</p> <p>A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically</p>	<p>We consider the provision of information, website completeness, electronic communications and attendance of the CEO at shareholder meetings should all be comply or explain recommendations. We do not consider that the last point (CEO attendance) is adequately addressed by way of commentary. Since most companies do meet this test (and have always done so), it is no imposition to formalise it for the benefit of the small number who have little regard for their shareholders.</p> <p>The investor relations program and encouraging shareholder participation are satisfactorily dealt with by commentary, as all companies are aware of the importance of these and the impact that poor relationships can have on their business and share price.</p>
<p>33. Should NZX address anything else in this area, including within best practice commentary?</p>	<p>No further comment</p>
Principle 9: Stakeholder interests	
<p>34. Do you consider it appropriate to adopt FMA's principle 9 (potentially amended)? (i.e. "The board should respect the interests of stakeholders taking into account the entity's ownership type and its fundamental purpose.")</p>	<p>We are not sure that adopting this principle into NZX guidance would add anything to the benefit of investors. Directors are by law required to act in the best interests of the company and maintaining appropriate relationships with other stakeholders (such as customers, community and suppliers) is implicit. Larger companies with developed ESG policies already and in effect address this issue to some extent in a formal way.</p>
<p>35. What best practice commentary is appropriate for listed issuers in this area?</p>	<p>No further comments.</p>
Other suggestions	
<p>None</p>	
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