



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

Discussion Document

2 November 2015



# CONTENTS

1. Introduction .....	3
2. Background .....	5
3. Objectives of review and proposed framework.....	7
4. Specific areas for review .....	10
Principle 1: Ethical Standards .....	10
Principle 2: Composition and Performance .....	11
Principle 3: Board Committees .....	14
Principle 4: Reporting and disclosure .....	16
Principle 5: Remuneration .....	18
Principle 6: Risk Management.....	20
Principle 7: Auditors .....	22
Principle 8: Shareholder relations.....	23
Principle 9: Stakeholder interests .....	25



# 1. Introduction

Good corporate governance is important for listed issuers because it promotes investor confidence and provides the mechanisms by which companies, and those in control, are held to account. This will also be important to issuers because strong corporate governance leads to a lower cost of capital for issuers and higher valuations. Regulation has an important role to play in maintaining and improving corporate governance standards.

NZX imposes corporate governance obligations on equity issuers listed on its Main Board via the NZX Main Board Listing Rules (Listing Rules). These obligations fall into two broad categories: mandatory requirements and reporting requirements.

NZX proposes to review and update the current reporting requirements within the Listing Rules. This review will not cover the mandatory requirements, although the two sets of obligations are inter-related and NZX welcomes comments on the mandatory rules with a view to a proposed broader review of the Listing Rules targeted for 2016.

Further information in relation to NZX's existing requirements, the objectives of the current review and the areas for proposed amendment are outlined in the sections which follow.

This review will be conducted in two stages. NZX seeks initial feedback from interested parties on the matters outlined in this discussion paper before developing detailed proposals for further consultation prior to implementing rule changes.

In addition to the feedback received, an important input to this review will be a survey that NZX will conduct to capture the views of small to medium sized issuers to ensure that these views are considered as part of the review process. Smaller issuers are often unable to meaningfully engage in consultation processes due to resource constraints, which is why NZX is adopting this approach.

The proposed timeline for the review is as follows:

- Publication of discussion document 2 November 2015
- Deadline for feedback to discussion document 29 January 2016
- Publication of consultation paper with proposed rule changes Q2 2016
- Deadline for feedback on proposed rule changes Q2/3 2016
- Proposed implementation of amended rules<sup>1</sup> Q 3/4 2016

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<sup>1</sup> This will follow a period for approval of proposed rule amendments by the Financial Markets Authority under section 331 of the Financial Markets Conduct Act 2013

**Request for comments**

In order to receive feedback, NZX seeks answers to the questions outlined in Sections 3 & 4 of this discussion document. NZX may publish comments received. Please indicate in your submission if you have any objection to the release of information contained in your submission. Please provide comments in electronic format.

Please send your submission before 29 January 2016 to [consultation@nzx.com](mailto:consultation@nzx.com)

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## 2. Background

### NZX's current corporate governance requirements

NZX recognises that regulation has an important role to play in improving corporate governance standards and that this can lead to a lower cost of capital and higher valuations for issuers. This is why NZX considers that it is important to review its current corporate governance reporting requirements to ensure that they remain fit for purpose.

The mandatory corporate governance requirements are outlined in chapter 3 of the Listing Rules, including in relation to board composition, independence and rotation requirements.<sup>2</sup> Separately, NZX requires issuers to report on their corporate governance practices by disclosing the following within their annual reports or public website:

- A statement of any corporate governance policies, practices and processes, adopted or followed by the issuer;
- A statement on whether and, if so, how the corporate governance principles adopted or followed by the issuer materially differ from the Corporate Governance Best Practice Code<sup>3</sup> (NZX Code) or a clear reference to where such statement may be found on the issuer's public website;
- a quantitative breakdown, as to the gender composition of the issuer's directors and officers as at the issuer's balance date and including comparative figures for the prior balance date of the Issuer;
- A statement from the board of the issuer providing its evaluation of the issuer's performance with respect to its diversity policy (if applicable);
- A statement as to which of its directors are independent directors and which of its directors are not independent directors, as at the balance date of the issuer; and
- Details of any director who has been appointed pursuant to provisions of the constitution complying with rule 3.3.8 and the security holder which appointed that director.<sup>4</sup>

The primary reporting obligation noted above requires issuers to report whether and, if so, how the corporate governance principles adopted or followed by the issuer materially differ from the NZX Code. Although some specific provisions within section 10 of the Listing Rules relating to reporting of gender diversity have been introduced relatively recently, the reporting provisions contained within the NZX Code have not been updated since their introduction in 2003.

An overview of the corporate governance regimes of other bodies (such as the Financial Markets Authority and ASX) is outlined below. These regimes are discussed in more detail in section 4. NZX's general observation in relation to the guidelines and expectations of these other bodies is that there are many similarities between the various regimes. However, they highlight that the NZX Code should be updated to bring it into line with expected best practice, including where appropriate international best practice.

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<sup>2</sup> Related matters are contained in other sections of the Listing Rules e.g. sections 7 and 9, relating to shareholder voting rights

<sup>3</sup> Appendix 16 of the Listing Rules (NZX Code), available [here](#)

<sup>4</sup> Sections 10.4.5(h) - (m) of the Listing Rules, respectively

## **The Financial Markets Authority (the FMA)**

The FMA has published a document titled, 'Corporate Governance in New Zealand Principles and Guidelines' in December 2014 which is described as a handbook for directors, executives and advisers (FMA Handbook). The FMA Handbook updates the previous handbook produced by the Securities Commission published in March 2004. It outlines nine principles for entities to apply and a number of guidelines and commentary in relation to each principle.

The primary focus of the FMA Handbook is on issuers of securities and entities providing financial services. However, it is pitched at a broad range of entities, including state owned enterprises, community trusts, public sector entities and non listed companies. The FMA Handbook is not legally binding but sets standards of corporate governance that the FMA expects boards to observe and to report on to their investors and other stakeholders. The FMA Handbook focuses on principles, rather than taking a prescriptive approach, because it says that a "one size fits all" approach is not appropriate for the broad range of entities the handbook applies to.

FMA's principles cover the following nine topics: ethical standards, board composition and performance, board committees, reporting and disclosure, remuneration, risk management, auditors and shareholders relations. Discussion of the guidelines and commentary under each principle is provided in section 4 below.

A full copy of the FMA Handbook can be found [here](#).

## **ASX**

In Australia, ASX's Corporate Governance Council was formed in August 2002 comprising various businesses, shareholder and industry groups.

The ASX Corporate Governance Council published its Corporate Governance Principles and Recommendations, which apply to issuers listed on ASX. The latest version is the third edition dated March 2014 (ASX Corporate Governance Council's Principles and Recommendations). These are particularly relevant in the New Zealand context for any issuers listed on both NZX and ASX.<sup>5</sup> The ASX Corporate Governance Council's Principles and Guidelines are discussed in more detail in section 4.

See a copy of the ASX Corporate Governance Council's Principles and Guidelines [here](#).

## **Other guidelines and expectations**

The G20/OECD has also recently published updated corporate governance principles [here](#).

The New Zealand Institute of Directors also publishes commentary on governance best practice for New Zealand directors, including 'The Four Pillars of Governance Best Practice.'

NZX notes that other bodies have also released guidelines and expectations aimed at listed companies, including the guidelines released by the NZ Corporate Governance forum in July 2015 ([here](#)). Finally, corporate governance requirements are also prescribed by legislation, such as the Companies Act 1993.

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<sup>5</sup> Noting that ASX's recent amendments to its 'Foreign Exempt' regime will likely result in an increased number NZX issuers listed on ASX who will not be required to comply with ASX's corporate governance requirements.

### 3. Objectives of review and proposed framework

#### Objectives of review

There is a significant amount of commentary in relation to what good corporate governance practices should look like and in relation to the appropriate level of disclosure of these practices by issuers. Given this background, NZX outlines below the key objectives it is seeking to achieve as part of its current review:

- The reporting regime should be flexible because corporate governance practices will vary for issuers depending on their size, industry and stage of development
- The reporting regime should be appropriate for the size and structure of the New Zealand market
- The reporting regime should take a holistic approach because specific governance objectives or principles can be addressed in multiple ways
- The reporting regime should deliver value for shareholders and stakeholders, and should enhance investor decision making
- Reporting requirements should strike an appropriate balance between effective disclosure and the cost to issuers

NZX has noticed that existing reporting practices by NZX Main Board issuers in this area are quite varied. This is perhaps a reflection of a lack of clarity of NZX's existing reporting expectations and the fragmentation of the different reporting regimes currently in operation in New Zealand. NZX is seeking to address these issues as part of the current review.

#### Adopt principles within FMA handbook as a basis for NZX's reporting regime

As noted above, there are already a number of corporate governance guidelines and requirements targeted at issuers in New Zealand. Some of these are formal obligations imposed on issuers via either the NZX or ASX Listing Rules (or via legislation) and others are contained in the form of guidelines or expectations of other bodies.

NZX wants to ensure an appropriate level of consistency between NZX's requirements and the range of other guidelines and expectations targeted at listed issuers. NZX therefore proposes to use the principles outlined in FMA's handbook as a basis for a revised reporting regime. These principles are outlined in full in section 4 below and are generally accepted principles of good corporate governance. The intention of using the FMA principles as a basis for reporting is so that a single set of high level principles is in operation in the New Zealand context. These are already in operation via the FMA Handbook (formerly the Securities Commission handbook) and they have also been used as a basis for the guidelines released by the NZ Corporate Governance Forum. These principles are also broadly consistent with ASX's principles.

#### Tiered approach to reporting requirements and expectations

Another key feature of most corporate governance reporting regimes is that they are generally tiered according to principles, recommendations (or guidelines) and commentary. The principles outline the overarching concept for each topic and are supplemented by recommendations which outline in more detail the particular matters which are expected of issuers in relation to the principle discussed. These recommendations are more prescriptive and must be met on a "comply or explain" basis, which is explained further below. The final layer outlines commentary in relation to application of the relevant recommendations and additional best practice commentary in areas where issuers may choose, but are not required, to report against.

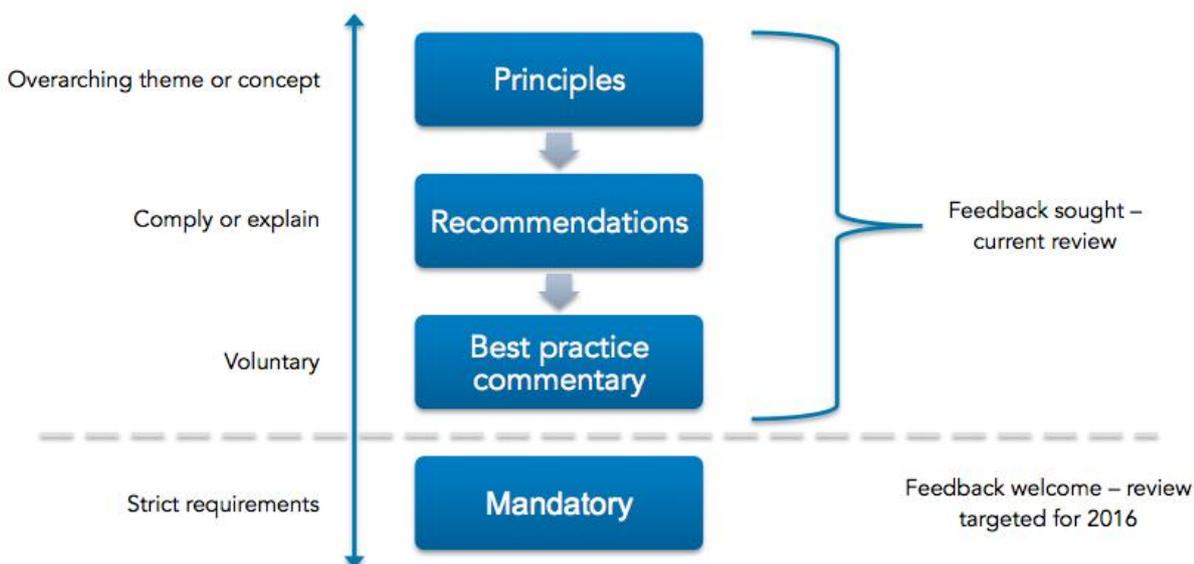
## Comply or explain

As noted above, the currently the Listing Rules require issuers to explain whether and, if so, how the corporate governance principles adopted or followed by the issuer materially differ from the best practice recommendations. In Australia, ASX's Listing Rules require issuers to compare their corporate governance practices with the ASX Corporate Governance Council's recommendations and, where they do not conform, to disclose that fact and the reasons why. This is subtly different from the current approach under NZX's Listing Rules, which requires an explanation of how practices materially differ but not necessarily an explanation why. The United Kingdom also adopts an approach of "comply or explain" similar to Australia.<sup>6</sup> The FMA Handbook has an approach of requesting that entities explain how they comply with the principles and guidelines outlined, reflecting the non mandatory nature of that regime.

NZX proposes to adopt an approach of "comply or explain" as applies in Australia, the UK and other contexts. Under the proposed tiered reporting structure of the regime, as described above, the requirement to "comply or explain" would apply to the recommendations (or the mid tier) outlined under each principle. These recommendations would effectively form the updated NZX Code. Therefore if an issuer meets each of the recommendations, they could state that they meet all of the recommendations of the NZX Code. However, an approach of "comply or explain" also allows issuers to explain why certain recommendations may not be appropriate for them and to explain the alternative measures they have in place to address the identified issue.

The additional best practice commentary under each principle would explain each recommendation and suggest other matters that an issuer may choose to report against, but it would not be mandatory to do so. This allows NZX to identify additional areas which have been identified as important to shareholders and stakeholders for those issuers wishing to meet best practice in all areas, or which may be of particular relevance to certain industries or issuers. Issuers meeting these suggestions in addition to the recommendations would be able to state that they meet all of the recommendations of the NZX Code and the best practice commentary.

An illustration of how the regime is intended to operate is as follows:



<sup>6</sup> UK Corporate Governance Code – see page 4 [here](#)

## Summary of proposed framework

The above features are intended to deliver an updated reporting regime which has common features with other existing regimes (i.e. a tiered framework with “comply or explain” reporting) and to move towards a more consistent approach between the respective regimes in New Zealand (i.e. by adopting the FMA principles as a basis for reporting and seeking feedback from all interested stakeholders in relation to updated recommendations to report against).

The proposed structure is intended to set expected minimum standards and also be flexible enough to apply to all issuers, whilst also ensuring that there are appropriate stretch targets for those issuers who wish to illustrate best practice in all areas by disclosing information which investors and stakeholders have indicated is of most value to them.

NZX seeks feedback in the section which follows in relation to the appropriate settings for updated recommendations and best practice commentary. The reporting regimes of the FMA Handbook and the ASX Corporate Governance Council have been used as a basis for this discussion, given that these already have relevance in the New Zealand context. This is because issuers listed on both NZX and ASX will already be required to report against the ASX Corporate Governance Council’s principles and recommendations. However, NZX notes that recent amendments to ASX’s Foreign Exempt listing requirements is likely to mean that more NZX issuers (if they attain ‘Foreign Exempt’ status) will no longer be required to separately meet the ASX corporate governance reporting requirements.

## Questions for submitters to consider on objectives and proposed framework:

1. Do you agree with the above objectives for NZX’s current review?
2. Do you agree that NZX should adopt the FMA principles as the basis for an updated reporting regime?
3. Do you agree with a tiered approach to a reporting regime?
4. Do you agree that recommendations should be reported against on the basis of an approach of “comply or explain”?
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)?
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?
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?

## 4. Specific areas for review

The specific areas for review follow the format of the principles outlined in the FMA Handbook. Each section will commence with a restatement of the relevant principle from the FMA Handbook and a discussion of the approach taken to that principle under NZX's current requirements, the FMA Handbook and the ASX Corporate Governance Council's Principles and Recommendations. Following this discussion, NZX seeks feedback on how to update its current requirements.

The discussion of NZX's current mandatory requirements under the Listing Rules has been included for context. Although NZX is not seeking to update these requirements as part of the current review (because this review focuses on the reporting requirements), NZX welcomes feedback in relation to these with a view to a broader review of the Listing Rules planned to commence in 2016.

In each section where feedback is sought, please indicate in your response whether you consider a matter should be addressed by a recommendation (which must be reported against on a "comply or explain" basis) or via best practice commentary (which will not be required to be reported against on a "comply or explain" basis).

### Principle 1: Ethical Standards

"Directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation."

#### NZX's current requirements

Section 1 of the NZX Code requires issuers to develop a code of ethics which:

- establishes compliance standards and procedures
- provides mechanisms for reporting unethical behaviour
- covers prescribed matters (e.g. conflicts of interest, use of company property)

#### Treatment under other regimes and jurisdictions

##### FMA Handbook

The FMA Handbook expands on NZX's requirements in the following areas:<sup>7</sup>

- Recommending that a code of ethics apply to senior managers and employees
- Suggesting recording and evaluation of compliance with an issuer's code of ethics, and measures for dealing with breaches
- Suggesting that issuers publish and report against their code of ethics, and the steps undertaken to address serious breaches

##### ASX Corporate Governance Council's Principles and Recommendations:

ASX Corporate Governance Council recommends that issuers should have a code of conduct for its directors, senior executives and employees, and publicly disclose this code of conduct, or

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<sup>7</sup> Pages 9 and 10 of the FMA Handbook

alternately a summary of it. ASX notes that this should be a “meaningful statement of the company’s core values”, as opposed to adopting a boilerplate model.

The ASX Corporate Governance Council also includes commentary in relation to the suggested content for a code of conduct, such as the use of the organisation’s information and property, and dealing with conflicts of interest. This broadly aligns with the current requirements of section 1.3 of the NZX Code.<sup>8</sup>

### **Discussion and feedback sought**

8. Should NZX include additional recommendations within its NZX Code:<sup>9</sup>
  - a. Explicitly stating that application of a code of ethics extends beyond just the board to senior managers and employees (this is probably implied already)
  - b. For disclosure of a code of ethics and reporting of compliance with a code of ethics
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?
10. Should NZX address anything else in this area, including within best practice commentary?

### **Principle 2: Composition and Performance**

“To ensure an effective board, there should be a balance of independent, skills, knowledge, experience and perspectives.”

#### **NZX’s current requirements**

The following mandatory requirements are contained in the Listing Rules:

- Boards must comprise at least a minimum of two, or where there are eight or more directors, three or one third, independent directors
- The board must determine whether a director is independence and disclose this to the market following appointment and prior to publication of its annual report
- At least a third of directors should retire from office at the annual meeting<sup>10</sup>

Section 2 of the NZX Code recommends the following:

- A director should not simultaneously hold the positions of CEO and Chairman of that issuer
- Formal, transparent processes for nomination and appointment of directors to the board
- Directors should undertake appropriate training
- A formal procedure to regularly assess individual and board performance

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<sup>8</sup> See recommendation 3.1 at pages 19-20 of the ASX Principles and Recommendations

<sup>9</sup> Please note that NZX proposes to deal with staff share dealing under principle 6, but it could also be addressed here

<sup>10</sup> Listing Rule 3.3, noting that only the key obligations have been highlighted above

The Listing Rules also include the following additional reporting requirements:

- The annual report of an issuer should contain a quantitative breakdown of the gender composition of the issuer's directors and officers as at the issuer's balance date
- The annual report of an issuer should contain a statement from the board providing its evaluation of the issuer's performance with respect to its diversity policy (if applicable)<sup>11</sup>

### **Treatment under other regimes and jurisdictions**

#### [FMA Handbook](#)

The FMA guidelines expand on NZX's requirements as follow:

- Every board should have a formal charter that sets out the roles and responsibilities of the board and directors, including any formal delegations to management
- Directors should be selected and appointed through rigorous, formal processes designed to give the board a range of relevant skills and experience
- The chairperson of an issuer should be independent
- Boards should set out their specific expectations of non-executive directors, including those who are independent
- Boards should be comprised of a majority of non-executive directors
- Boards should provide appropriate induction (and ongoing) training for each new director
- Performance reviews should extend to specific roles and bodies such as the audit committee and the chairperson
- Reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests<sup>12</sup>

#### [ASX Corporate Governance Council's Principles and Recommendations:](#)

Principles 1 & 2 include the following recommendations:

- Issuers should conduct appropriate checks before appointing, or proposing for election, a director, and should provide all material information in relation to proposed appointments
- Issuers should enter into written agreements with each senior executive and board member establishing the terms of their appointment
- The company secretary should be accountable to the board in relation to board functions
- Issuers should adopt a diversity policy and establish measureable objectives for achieving gender diversity and report progress against these objectives in their annual reports
- Issuers should disclose the skills matrix relevant to board appointments

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<sup>11</sup> Listing Rule 10.4.5(j) & (k) and footnotes. Note also NZXR's [Guidance Note](#) in relation to Gender Diversity Policies and reporting.

<sup>12</sup> See page 12 of the FMA Handbook, together with a discussion of the factors influencing independence at pages 13 - 14

- Issuers should disclose any known director conflicts and why these do not impact independence
- The chairperson should be an independent director and the board should be comprised of a majority of independent directors
- Issuers should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain their skills<sup>13</sup>

### **Discussion and feedback sought**

This is an important topic covering key areas such as director appointments, training and induction, independence requirements, diversity and performance. NZX's current requirements are not as extensive as other regimes. NZX seeks feedback on whether to introduce additional recommendations or best practice commentary covering the following:

- i. Issuers should disclose the respective roles and responsibilities of the board and management, including any formal delegations to management
- 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
- iii. Issuers should enter into written agreements with each senior executive and board member establishing the terms of their appointment
- iv. Reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests

NZX is aware of a number of very strong arguments for increased gender diversity on boards and in senior executive roles. NZX has relatively recently introduced new requirements in this area and considers that it is too early to fully assess the impact of these measures. However, NZX welcomes feedback on whether any additional matters should be considered as part of the current review. NZX does not support the use of quotas.

NZX proposes to amend its existing recommendation in relation to director appointments to more closely align with the FMA guideline noted above.<sup>14</sup>

### **Independence requirements**

The argument for separating the roles of chair and CEO is that this promotes independent leadership of the board, to facilitate more effective monitoring and oversight of management. NZX proposes to maintain this recommendation. NZX does not currently recommend chairperson independence and is conscious that this could be a particular issue for small to medium sized issuers in New Zealand. NZX seeks feedback on this issue.

There is evidence that independent directors are more effective on boards when they form part of a majority. However, NZX is aware of commentary that the size of the New Zealand market is too small to insist on majority board independence.

<sup>13</sup> See pages 8 – 18 of the ASX Corporate Governance Council's Principles and Recommendations

<sup>14</sup> Section 2.3 of the NZX Code

The definition of “Independent Director” within the Listing Rules is particularly relevant in this context.<sup>15</sup> This definition currently contains both an overarching test together with prescriptive elements. The overarching test disqualifies a director from being independent if they have “any direct or indirect interest or relationship that could reasonably influence, in a material way, the Director’s decisions in relation to the Issuer.” The prescriptive elements of this test deem certain relationships to be a “Disqualifying Relationship”, for example if a director is a Substantial Product Holder.

The definition of an “Associated Person”<sup>16</sup> is also relevant in this context because Associated Persons of a director are also caught by the Disqualifying Relationship deeming provisions in some contexts. The definition of Associated Persons is particularly broad in some areas.<sup>17</sup> NZX seeks feedback on whether to amend these definitions as part of the planned broader review of the Listing Rules in 2016.

#### Questions for submitters to consider:

11. Should NZX introduce additional recommendations or best practice commentary covering the matters outlined in paragraphs i - iv above?
12. Should NZX consider introducing a recommendation in future that boards contain a majority of independent directors and/or an independent chairperson?
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?
14. Should NZX address anything else in this area, including within best practice commentary?

### Principle 3: Board Committees

“The board should use committees where this will enhance its effectiveness in key areas, while still retaining board responsibility.”

#### NZX’s current requirements

NZX’s current requirements in this area are reasonably comprehensive. The recommendations in the NZX Code in relation to audit, remuneration and nomination committees are supplemented by the mandatory requirements in relation to audit committees outlined in section 3 of the Listing Rules. The mandatory requirements require issuers to establish an audit committee which:

- Comprises at least 3 directors of the issuer
- Which has a majority of members that are independent directors
- Has at least one member with an accounting or financial background<sup>18</sup>

The Listing Rules also prescribe the responsibilities of the audit committee, which include the appointment/removal of the external auditor, monitoring and reviewing the independent and

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<sup>15</sup> This is addressed via the definition of “Disqualifying Relationship”, see section 1.6 of the Listing Rules

<sup>16</sup> Section 1.8 of the Listing Rules

<sup>17</sup> In particular, section 1.8.3 (c) of the Listing Rules

<sup>18</sup> Listing Rule 3.6.1 and 3.6.2

internal auditing practices and ensuring rotation of the external auditor at least every five years.<sup>19</sup> Specific auditor requirements are discussed under principle 7 below.

The NZX Code recommends the following in relation to the functioning of the audit committee:

- it should comprise solely of non-executive directors of the issuer
- it should operate under a written charter and the board should review its operation in accordance with this charter
- non members should only attend by invitation
- the audit committee should address issues of independence
- Issuers should identify the members of the audit committee in their annual report
- the chair of the audit committee should not also be chair of the board

The NZX Code recommends the following in relation to remuneration and nomination committees:

- an issuer should establish a remuneration committee to recommend remuneration packages for directors for consideration by shareholders and to recommend to the board a policy for CEO and senior management remuneration
- an issuer should establish a nomination committee to recommend director appointments to the board and at least a majority should be independent
- both of these committees should have written charters, outlining the authority, duties/responsibilities and relationships with the board and disclose their members
- the board should regularly review the performance of these committees in accordance with their written charters

### **Treatment under other regimes and jurisdictions**

#### **[FMA Handbook](#)**

The FMA Handbook is broadly consistent with NZX's current requirements, except as follows:

- FMA recommend that the written charters and membership of each committee should be published on an issuer's website and should be easily accessible
- Proceedings of committees should be reported back to the board – this is only addressed in NZX's mandatory requirements in relation to audit committees

#### **[ASX Corporate Governance Council's Principles and Recommendations:](#)**

Under principle 2 the ASX Corporate Governance Council recommends that issuers should have a nominations committee and that issuers disclose the written charter, identity and attendances of committee members.

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<sup>19</sup> Listing Rule 3.6.3, noting that not all requirements have been highlighted above

The ASX Corporate Governance Council includes similar recommendations to NZX in relation to audit committees (under its principle 4) but also recommend disclosure of the charter of the committee and the relevant qualifications, experience and meeting attendances for committee members.

### **Discussion and feedback sought**

NZX's current requirements in this area cover most of the matters addressed by the other regimes noted above. It is notable that the NZX Code recommends issuers have a remuneration committee. NZX seeks feedback on whether this remains an appropriate recommendation or would be better as best practice commentary.

A common theme of other regimes is to expect disclosure of written committee charters and of details in relation to members and attendances by members at committee meetings. NZX views these as sensible recommendations.

### **Questions for submitters to consider:**

15. Should NZX introduce additional recommendations or best practice commentary in relation to publication of committee 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?
  - a. Should NZX continue to recommend issuers have a remuneration committee?
17. Should NZX address anything else in this area, including within best practice commentary?

### **Principle 4: Reporting and disclosure**

"The board should demand integrity in financial reporting and in the timeliness and balance of corporate disclosures."

### **NZX's current requirements**

The NZX Code currently contains no specific requirements in relation to reporting and disclosure practices. However, the Listing Rules include the following mandatory requirements:

- Continuous disclosure obligations – the requirement for issuers to immediately disclose material information to market, subject only to limited exceptions
- Periodic reporting obligations – including to publish annual reports, preliminary announcements and half year reports
- Other ad hoc disclosure requirements<sup>20</sup>

### **Treatment under other regimes and jurisdictions**

#### **FMA Handbook**

The guidelines within the FMA Handbook cover the following areas:

- All boards should have a rigorous process for ensuring the quality and integrity of financial statements and should provide financial reporting which is clear, concise and effective

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<sup>20</sup> See section 10 of the Listing Rules in relation to these requirements

- All boards must maintain an effective system of internal control for reliable financial reporting and accounting records
- Directors should explain their responsibility for preparing the annual report, including the financial statements that comply with GAAP
- Each board should have a written internal process in relation to continuous disclosure
- Every entity should make its code of ethics, board committee charters and other governance documents available to interested investors and stakeholders

### ASX Corporate Governance Council's Principles and Recommendations

Disclosure and reporting matters are covered under ASX Corporate Governance Council's principle 5. ASX Corporate Governance Council recommends:

- A listed entity should have a written policy for complying with its continuous disclosure obligations and disclose that policy or a summary of it

Related matters are also covered in ASX Corporate Governance Council's principle 6, discussed under the shareholder relations subheading below.

### Discussion and feedback sought

This is a key area for issuers given the fundamental importance of the disclosure regime underpinning the Listing Rules. Issuers should have appropriate processes in place to meet their reporting and disclosure obligations, which are a key source of information for investors and stakeholders. NZX has released a [guidance note](#) discussing these continuous disclosure requirements, including arrangements for board involvement.

NZX seeks feedback on whether to include additional recommendations or best practice commentary in relation to continuous disclosure and financial reporting. NZX has already sought feedback on whether to include a recommendation that key corporate governance documents are published under the discussion of principles 1 & 3 above.

NZX notes that there is a growing trend for exchanges to include guidance/requirements in relation to ESG reporting.<sup>21</sup> ESG stands for environmental, social and corporate governance factors. These are sustainability factors which, if evident, may lead to longer term performance advantages for issuers. NZX seeks feedback on whether to introduce additional recommendations or best practice commentary in relation to disclosure of non financial performance measures, such as strategy or ESG disclosures, and in relation to the appropriate metrics to be reported (where applicable).

### Questions for submitters to consider:

18. Should NZX introduce additional recommendations or best practice commentary that:
  - a. Issuers should have a written policy for complying with their continuous disclosure obligations. If so, should issuers be required to publish these policies?
  - b. All boards should maintain an effective system for internal control for reliable financial reporting and accounting records

<sup>21</sup> [http://acsi.org.au/images/stories/ACSIDocuments/esg\\_reporting\\_guide.pdf](http://acsi.org.au/images/stories/ACSIDocuments/esg_reporting_guide.pdf) and [http://www.sseinitiative.org/wp-content/uploads/2015/09/SSE-Model-Guidance-on-Reporting-ESG.pdf?dm\\_i=1PCE.3P3WD.9MQD3N.DATSP.1](http://www.sseinitiative.org/wp-content/uploads/2015/09/SSE-Model-Guidance-on-Reporting-ESG.pdf?dm_i=1PCE.3P3WD.9MQD3N.DATSP.1)

19. Should NZX introduce any additional recommendations or best practice commentary in relation to non financial reporting matters, including ESG disclosures?
- a. If so, which issues (and metrics) should be reported?
20. Should NZX include anything else in this area, including within best practice commentary?

### **Principle 5: Remuneration**

“The remuneration of directors and executives should be transparent, fair and reasonable.”

#### **NZX’s current requirements**

The NZX Code currently recommends:

- Every issuer should have a formal and transparent method to recommend director remuneration packages to shareholders
- Directors are encouraged to take a portion of their remuneration under a performance based equity security compensation plan and/or to invest a portion of their cash director remuneration in the issuer’s equity securities
- The remuneration committee should recommend remuneration packages for directors to be approved by shareholders and recommend to the board a policy for CEO and senior management remuneration<sup>22</sup>

Separately, under the mandatory Listing Rule requirements issuers must have director remuneration approved by shareholders.<sup>23</sup> Recommendations in relation to the establishment and operation of remuneration committees are discussed under principle 3 above.

#### **Treatment under other regimes and jurisdictions**

##### **FMA Handbook:**

The FMA Handbook covers the following additional areas:

- The board should have a clear policy for setting director remuneration that is fair and reasonable, and should differentiate executive and non executive director remuneration
- Listed issuers should publish their remuneration policy
- Executive remuneration should have entity and individual performance based components
- Non-executive directors should not receive a retirement payment unless eligibility for such payment has been agreed by shareholders and publicly disclosed during tenure

##### **ASX Corporate Governance Council’s Principles and Recommendations:**

The ASX Corporate Governance Council notes that this issue is a key focus for investors and recommends:

- Issuers should separately disclose its policies and practices for remunerating non executive directors and executive directors and other senior executives

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<sup>22</sup> Sections 2.5-2.7 and 3.8 - 3.10 of the NZX Code

<sup>23</sup> Section 3.5.1 of the Listing Rules

- An issuer that has an equity based policy should have a policy on whether participants are permitted to enter into arrangements to hedge that risk and disclose such policy

ASX listed companies established in Australia are also subject to additional requirements under the Corporations Act 2001, including a requirement to prepare annually a remuneration report addressing prescribed matters and to outline the board policy for determining remuneration of key management personnel.<sup>24</sup> The remuneration report is also subject to a shareholder vote and if more than 25% of shareholders vote against the remuneration report at two consecutive annual general meetings there can be a vote for re-election of the board (this is known as the “two strikes rule”).<sup>25</sup>

There are also requirements in Australia in relation to the use of remuneration consultants. If used, remuneration consultations must be approved by the directors or remuneration committee (as opposed to being directly engaged by management) and must provide their recommendations to the directors of the company or the members of the remuneration committee, as opposed to management.<sup>26</sup>

### **Discussion and feedback sought**

NZX proposes to maintain most of its existing requirements in this area. The exception to this is the recommendation at section 2.7 of the NZX Code that directors should take a proportion of their remuneration under a performance based equity scheme.

Performance based plans are generally not considered appropriate for non executive directors so NZX does not currently support this recommendation. It may be appropriate for non executive directors to receive remuneration in the form of equity securities of the issuer but this should be at an issuer’s discretion and should not be performance based. Issuers also need to be mindful of the impact of large holdings upon director independence.

Discussion of remuneration committees is included under principle 2 above, and these proposals are broadly consistent with the expectations of the FMA and the ASX Corporate Governance Council.

NZX notes that the requirements for remuneration reporting in Australia are significantly more onerous than in New Zealand, particularly given the legislation noted above. NZX seeks feedback on whether additional recommendations or best practice commentary are appropriate for reporting of CEO and senior executive remuneration in New Zealand e.g. for such disclosure to be “clear, concise and effective” or for prescribed matters to be disclosed (such as CEO short term incentives and long term incentives).

NZX proposes to remove the existing recommendation at section 2.7 of the current NZX Code and seeks feedback on whether to introduce new recommendations (or best practice commentary) addressing the matters highlighted below.

### **Questions for submitters to consider:**

21. Should NZX introduce recommendations as follows:

- a. Issuers must publish a remuneration policy dealing with remuneration of directors and senior executives?

<sup>24</sup> Section 300A of the Corporations Act 2001

<sup>25</sup> Sections 250R, 250U-Y & 300A of the Corporations Act 2001

<sup>26</sup> Sections 206 K & 206L of the Corporations Act 2001

- b. Senior executive remuneration (including CEO remuneration) should include an element that is dependent on entity and individual performance?
22. Should NZX introduce additional recommendations or best practice commentary for reporting of CEO and senior executive remuneration? If so, what should be introduced?
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?
24. Should NZX address anything else in this area, including within best practice commentary?

### **Principle 6: Risk Management**

“Directors should have a sound understanding of the key risks faced by the business. The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.”

#### **NZX’s current requirements**

The current NZX Code does not specifically cover the area of risk management. This is a significant gap in the current reporting regime.

The only relevant coverage in this area is at section 4.1 of NZX’s Code, which states that “a Board should establish a formal and transparent procedure for sustaining communication with the Issuer’s independent and internal auditors.”

#### **Treatment under other regimes and jurisdictions**

##### [FMA Handbook:](#)

FMA guidelines cover the following areas:

- There should be rigorous processes for risk management and internal controls
- The board should receive and review regular reports on the operation of the risk management framework and internal control processes
- Issuers should report at least annually to investors on risk identification, risk management and internal controls

##### [ASX Corporate Governance Council’s Principles and Recommendations:](#)

ASX Corporate Governance Council’s principle 7 states that “a listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.” It recommends:

- Issuers should have a risk committee to oversee its risk management function and should disclose the charter of the committee, its members and meeting attendances
- Boards should review (and report on) the risk management framework annually
- Issuers disclose details of an internal audit function or the alternative arrangements in place in the absence of an internal audit function
- Issuers disclose whether it has any material exposure to economic, environmental and social sustainability risks and how it manages or intends to manage those risks

## Discussion and feedback sought

NZX considers it appropriate for issuers to report how they manage the key risks facing their businesses because this will be important information for shareholders and other stakeholders. For larger issuers, this may include having a separate risk committee, although smaller issuers may take a different approach to oversight of risk management. NZX seeks feedback on the appropriate expectations in this area. NZX proposes to include best practice commentary suggesting issuers have a risk committee (or that this function forms part of a joint audit and risk committee) but does not currently propose to recommend that this is appropriate for all issuers.

The recent amendments to health and safety legislation in New Zealand may be a particular concern for issuers in certain industries. NZX seeks feedback on whether it is considered appropriate to have specific recommendations or best practice commentary in relation to health and safety and, if so, for what categories of issuers. In addition, NZX seeks feedback on whether it would be useful for issuers to report health and safety metrics and, if so, which ones. There is specific guidance in this area from institutional investors in Australia which focuses on 'lost time injury frequency rates' (LTIFR) and 'total recorded injury frequency rates' (TRIFR).<sup>27</sup>

NZX considers it appropriate that issuers disclose details of their internal audit functions, where applicable, or to provide an explanation of the alternative measures in place and to explain the policies and procedures in place to manage staff share dealing.

Finally, NZX seeks feedback on the appropriate expectations (and metrics) for reporting of economic, environmental and social sustainability risks or ESG disclosure. Although NZX encourages issuers to report on these matters, existing practices are likely to vary between issuers. NZX seeks feedback on whether to introduce specific recommendations in this area or for these matters to be addressed via best practice commentary. This is also raised in the context of a broader discussion of reporting and disclosure at principle 4.

### Questions for submitters to consider:

25. Should NZX introduce recommendations or best practice commentary covering the following matters:
  - a. Issuers should have appropriate policies and procedures in place to identify and manage the key risks facing their businesses.
  - b. Issuers should disclose details of their internal audit function, where applicable, or to provide explanation of the alternative measures in place.
  - c. Issuers should have a staff share dealing policy and disclose details of this
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?
27. Should NZX recommend/suggest that issuers specifically report on economic, environmental and social sustainability (or ESG) risks?
28. Should NZX address anything else in this area, including within best practice commentary?

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<sup>27</sup> See pages 18 - 19 of the [report](#) from the Australian Council of Superannuation Investors and Australian Financial Services Council

## Principle 7: Auditors

“The board should ensure the quality and independence of the external audit process.”

### NZX’s current reporting requirements

NZX’s current requirements in this area are reasonably comprehensive, recommending:

- a procedure for sustaining communication with the issuer’s independent and internal auditors
- a framework for the issuer’s relationship with its auditors, including procedures:
  - which ensure the independence of the statutory audit role
  - to address what, if any, other services may be provided by the statutory auditor
  - to provide for the monitoring and approval by the issuer’s Audit Committee of any service provided by the auditors to the issuer other than in their statutory audit role

As discussed under principle 3 above, the Listing Rules require issuers to have an audit committee, its responsibilities, and composition and independence requirements. The Listing Rules also require an external auditor or lead audit partner to change at least every five years.<sup>28</sup>

### Treatment under other regimes and jurisdictions

#### [FMA Handbook:](#)

FMA guidelines cover the following additional areas:

- The board should inform itself fully on the responsibilities for external auditors and be rigorous in its selection of audits on professional merit.
- Facilitate dialogue among its audit committee, the external auditors and management
- Issuers should report at least annually to shareholders on the fees paid to auditors and should differentiate between audit fees and fees for individually identified non-audit work
- Boards of issuers should also explain the following:
  - How they satisfy themselves on auditor quality and effectiveness
  - The board’s approach to tenure and reappointment of auditors
  - Any identified threats to auditor independence
  - How the threat has been mitigated

FMA also expect that an issuer’s audit should not be led by the same audit partner for more than seven consecutive years.

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<sup>28</sup> Listing Rule 3.6.3(f)

### ASX Corporate Governance Council's Principles and Recommendations:

ASX Corporate Governance Council's Principle 4 states that "a listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting."

The recommendations under this principle also cover composition and functioning of an issuer's audit committee, these requirements are consistent with the mandatory requirements covered in section 3.6 of NZX's Listing Rules. Additional recommendations cover the following:

- The CEO and CFO should provide a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the issuer
- The external auditor should attend an AGM to answer questions from shareholders in relation to the audit

### Discussion and feedback sought

Most of NZX's current requirements in this area are contained within the mandatory rules relating to the role and responsibilities of the audit committee.<sup>29</sup> NZX seeks feedback on whether it should strengthen its current requirements within the NZX Code.

NZX is aware of some feedback in relation to its existing mandatory requirement for auditor rotation every five years, noting that the ASX Corporate Governance Council recommends rotation every seven years. With a view to NZX's proposed broader review of its Listing Rules to commence in 2016, NZX welcomes feedback on whether the five year timeframe remains appropriate.

### Questions for submitters to consider:

29. Should NZX include recommendations or best practice commentary that:

- a. The external auditor should attend the AGM to answer questions from shareholders in relation to the audit
- b. Issuers should report to shareholders annually in relation to audit and non audit fees paid to the audit firm

30. Should NZX consider amending its current auditor rotation requirements in future?

31. Should NZX address anything else in this area, including within best practice commentary?

### Principle 8: Shareholder relations

"The board should foster constructive relationships with shareholders that encourage them to engage with the entity."

### NZX's current requirements

The NZX Code has no existing coverage in this area, although a number of mandatory Listing Rules deal with specific obligations relating to shareholder rights. NZX welcomes any

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<sup>29</sup> Listing Rule 3.6.3

preliminary feedback in these areas prior to the planned broader review of the Listing Rules next year.

### **Treatment under other regimes and jurisdictions**

#### **FMA Handbook:**

FMA guidelines cover the following:

- Issuers should publish policies for shareholder relations
- Issuers should maintain an up to date website providing a description of the business, goals/strategies, performance, corporate governance documents and copies of market releases
- Issuers should encourage participation in annual general meetings

#### **ASX Corporate Governance Council's Principles and Recommendations:**

ASX Corporate Governance Council's principle 6 states that "a listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively."

The recommendations and discussion under this principle are probably broader than the FMA Handbook. These recommend:

- A listed entity should provide information about itself and its governance to investors via its website
- A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors
- A listed entity should disclose the policies and processes it has in place to encourage participation at meetings of shareholders
- A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically

### **Discussion and feedback sought**

NZX considers that the ASX Corporate Governance Council's recommendations provide a sound basis for reporting in this area, although it may be appropriate for these matters to be addressed via best practice commentary as opposed to recommendations. NZX seeks feedback on whether to introduce best practice commentary to cover these matters.

NZX also proposes to include best practice commentary suggesting that CEO and senior executives of issuers attend annual meetings to address any questions from shareholders.

#### **Questions for submitters to consider:**

32. Do you agree with the proposed best practice commentary in these areas?
33. Should NZX address anything else in this area, including within best practice commentary?

## **Principle 9: Stakeholder interests**

“The board should respect the interests of stakeholders taking into account the entity’s ownership type and its fundamental purpose.”

### **NZX’s current requirements**

The NZX Code has no existing coverage in this area.

### **Treatment under other regimes and jurisdictions**

#### [FMA Handbook:](#)

The FMA Handbook includes the following guidelines in this area:

- The board should have clear policies for the entity’s relationship with significant stakeholders
- The board should regularly assess compliance with these policies to ensure that conduct towards stakeholders complies with the code of ethics and the law and is within broadly accepted social, environmental and ethical norms – generally subject to the interests of shareholders

#### [ASX Corporate Governance Council’s Principles and Recommendations:](#)

This topic is not directly covered in the ASX Corporate Governance Council’s Principles and Recommendations.

### **Discussion and feedback sought**

Although some commentary in this area may be helpful NZX notes that the reference to “ownership type” within the FMA principle will be of less relevance. The relevant stakeholders in this context would be employees of issuers, suppliers, regulators and government.

It is unclear whether additional recommendations are necessary in this area. However, NZX seeks feedback on whether best practice commentary is appropriate.

#### [Questions for submitters to consider:](#)

34. Do you consider it appropriate to adopt FMA’s principle 9 (potentially amended)?
35. What best practice commentary is appropriate for listed issuers in this area?