New Zealand Shareholders Association Inc.

NZSA®

Many Investors, One Voice

June 21st, 2024

NZSA response to NZX Consultation
NZX Director Independence – Second Consultation

The NZ Shareholders' Association (NZSA) appreciates the opportunity to comment on the Consultation paper related to the Director Independence settings contained within the NZX Corporate Governance Code (the "Code") and the NZX Listing Rules (the "Rules").

NZSA Context

NZSA has been vocal in its support for a minority investors voting regime in recent times, given the nature of the New Zealand market and the number of listed companies that include a major shareholder (>30%). Data to support this can be viewed at this link on the NZSA website.

We have also recently reviewed our own Independent Director policy, following a period of feedback and consultation. The policy can be found at this link.

Last, NZSA also made a submission on the initial round of consultation in June 2023.

General Commentary on NZX Consultation Document and recent NZSA statements

1. **Minority Interests Voting Regime (MIVR):** We are disappointed that the NZX has chosen not to progress with further consideration of a MIVR. We believe this would add no compliance costs to potential issuers, while offering a significant point of differentiation with other listed markets in support of investor confidence.

    a. We note the disclosure proposals to be considered by NZX within this Consultation. NZSA support these proposals, considering them helpful in informing shareholders (existing and potential), but also that they offer little remedy to structural issues relating to controlling shareholders.

    b. We would consider that minority shareholders will be "well-informed targets" under the disclosure settings proposal, with limited recourse to preserve their (minority) interests.

While this may be considered an improvement from current settings where they are "ill-informed targets", NZSA considers that there is some risk they remain "targets" in either scenario.

c. We urge both NZX and the CGI to reconsider this position.

2. **Change in Corporate Governance Code Disqualifying Relationship Factors:** We are concerned at the proposal to adjust the threshold for a disqualifying relationship caused by share ownership from 5% to 10%, especially in the context of NZX unwillingness to consider a MIVR.

   Were a MIVR to be introduced by the NZX, it is likely that NZSA would look more favourably on the threshold settings for some disqualifying relationship factors contained within the Corporate Governance Code.

3. **Investor perceptions:** We note that the definition of disqualifying relationship contained in the Listing Rules, while referring to "*reasonably be perceived to influence*", does not define who is doing the perceiving.

   a. NZSA believes this has led to some inconsistency in how a disqualifying relationship is considered by listed company Boards.

   b. We contend that the simple insertion of "*by shareholders*" is likely to offer clarity for directors when undertaking assessments – on nominees, appointees and their impacts on existing directors.

4. **NZX Proposals:** NZSA is generally supportive of other proposals contained within the Consultation, including:
   a. The inclusion of a purpose statement.
   b. Independence assessment disclosures and settings.
   c. Committee composition proposals.

   We hold some concern as to proposals to amend the director residency requirements of listed issuers, as we believe this would hamper shareholder access and engagement with directors of NZX-listed companies.

Consultation Questions – Inclusion of a Purpose Statement

As noted in our submission of June 2023, NZSA is "*broadly supportive of introducing a 'purpose' statement within the NZX Listing Rules related to director independence. We believe that this will offer clarity to investors and issuers alike and set clear expectations for all participants."*

NZSA believes the ultimate purpose of director independence is to instil confidence amongst investors within capital markets. This level of confidence is supported by

a) management of conflicts of interest across shareholder interests and/or management.
b) independence of thought from management.
c) ongoing improvement in governance quality and judgements.

NZSA recognises that all directors are bound to act in the best interests of the company – however, **investor perceptions** remain relevant in achieving this aim (see Question 2 below).

1. **Do you have any comments in relation to the proposed amendments to the Code commentary in relation to the purpose of the director independence requirements?**

   NZSA believes that the purpose statement supports NZSA's own statements on the purpose of independent directors.

   We note and support the language in the proposed purpose statement includes direct reference to the potential for conflict between different shareholder groups:

   > *"…directors on an issuer's board who do not have relationships or interests that would reasonably cause them to be, or perceived to be, aligned with management or a* ***particular shareholder group in a material way****."*

   In that context, it is somewhat surprising that NZX has not considered minority investor protections more explicitly for consultation.

2. **Do you consider that any amendments should be made to the definition of the term 'Disqualifying Relationship' in light of the proposed purpose statement?**

   In the context of these proposals, NZSA is broadly comfortable with the current definition of 'disqualifying relationship'.

   However – we note that the 'influence' limb includes the words "*reasonably be perceived*". There is no clear statement on who is 'doing the perceiving'.

   NZSA would support an amendment to clarify that the perception relates to that of shareholders and/or investors, rather than perceptions derived from the Board and its advisors. I.e.;

   > *…means any direct or indirect interest, position, association or relationship that could reasonably influence, or could reasonably be perceived* ***by shareholders*** *to influence in a material way the Director's capacity to…*

3. **Do you consider that there would be merit in re-naming the definition of 'Disqualifying Relationship' to better reflect that non-independent directors are able to act in the best interests of an issuer? If so, do you have a preferred term (e.g. 'Restricting Relationship', 'Constraining Relationship')?**

   Yes – NZSA believes this would support better balance on the skills and capabilities offered by non-independent directors.

   Our preferred term is **Non-Independent Relationship**.

Consultation Questions – Independence assessment and Code factors

NZSA Feedback on proposed change to 5% ownership threshold.

We note that there is no question asked by NZX in relation to an amendment to increase the level of personal shareholding from 5% to 10% as part of a review of factors leading to a disqualifying relationship.

We also note that NZX does not propose to advance any proposal for the introduction of a minority interests voting regime.

NZSA does not support an increase in the shareholding threshold from 5% to 10% as a disqualifying factor.

We would be more likely to support this change where a minority interests voting regime is in place.

1. **Do you consider that a factor relating to a director's personal financial exposure to an issuer, such as an investment exposure should be included in the Code, noting that Code factor 2 addresses revenue derived from an issuer?**

   Yes – within the consideration of their own personal wealth.

   A director holding <5% of a company, but where that shareholding comprises >25% of their wealth, is in a different position to a director who owns 10% of a company, comprising only 5% of their wealth. While we recognise the right to privacy, we believe that this should form part of the assessment made by a Board in assessing director independence.

   NZSA notes that an investment exposure (i.e., 'equity') is materially different to any revenue derived from an issuer as defined in Code factor 2.

2. **Should we propose a Rule requirement or include in the Code that long tenured (12 years or more) directors stand for re-election on an annual basis? Should this only apply to directors who have been determined to have no Disqualifying Relationship?**

   As per our first submission, NZSA does not consider tenure, in and of itself, to be a barrier to independence. However, we temper this commentary by noting that the risk of 'capture' by management increases as tenure increases and that a Board should consider its board composition (including tenure) in a manner that minimises director succession risks for shareholders.

   Given the increasing risk factor associated with long-tenures, we would consider supporting a proposal for long-tenured independent directors (>12 years) to stand for election each year. Any such proposal should not be applied to non-independent directors.

3. **Is it a common practice for issuers to seek a self-attestation from directors, or director candidates, in relation to whether or not the director or director candidate has a Disqualifying Relationship?**

   NZSA cannot comment as to whether this is a common practice amongst Boards.

However, we would expect that any evidence utilised by a Board in assessing independence would be able to stand up to public scrutiny. Therefore, we would consider it good practice for the director in question to attest to those factors considered by the Board.

Please note that NZSA's revised Independent Director Policy refers to this in Section 1 of the policy statement. In our original submission on NZX Director Independence in June 2023, we also noted that we supported additional disclosure "*as to the nature of a director's interests and their ability to maintain independent judgement, that have formed the decision-making and Board assessment as to independence.*" NZSA continues to support this position, whether self-attestation is in place or not.

Consultation Questions – Composition Settings

1. **What would the benefits be to the integrity of an Audit Committee if the member who has an accounting or financial background, was also an independent director rather than a non-independent director?**

   NZSA supports the proposal by NZX to amend Recommendation 3.1 of the Corporate Governance Code, such that an issuer's Audit Committee would contain at least one member who is both independent and has an accounting or financial background.

   We believe that this would strengthen the capability of the Audit Committee and reduce the probability of a conflict of interest within the Committee.

2. **How difficult would it be for issuers to adopt the amended recommendation 3.1 so that one member was both an independent director and had an accounting or financial background, noting this would operate on a 'comply or explain' basis?**

   NZSA does not believe this would form a barrier for most issuers. For some issuers, it may be prudent to consider wider Board Composition, with a view towards improving independence. NZSA believes this is in the interest of the wider market and would support improved confidence of investors.

3. **Do you consider that NZX's current audit committee composition settings are appropriate from a market integrity perspective?**

   Broadly, yes – however, we note recent Market Disciplinary Tribunal (MDT) decisions that have highlighted areas for improvement amongst both issuer practice and to the Code.

   We consider that some elements of Audit Committee composition requirements should be given greater consideration for inclusion within the Listing Rules, particularly as relates to the Audit Committee Chair being both independent and a different individual to the Board Chair.

4. Are there any changes that you would propose to NZX's current audit committee composition settings? If so, how would those changes support market integrity, and enable greater compliance?

See Question 3 above.

5. What would the benefits be to the integrity of the director appointment and independence assessment process if the Code recommended that an issuer's Nomination Committee was solely comprised of independent directors?

NZSA supports any proposal to the Code recommending that a Nomination Committee is comprised solely of independent directors.

NZSA also believes that a Managing Director and/or CEO who serves on the Board should not form a part of the Nominations Committee (we recognise this is not proposed in the Consultation Document).

Both provisions would allow an independent and unfettered judgement as to the assessment of director independence. The NZSA proposal related to the exclusion of Managing Director and/or CEO would ensure that there is a reduced probability of management interests influencing the Board appointment process.

6. What are the difficulties that would be faced by issuers in adopting a recommendation that the Nominations Committee was comprised solely of independent directors?

NZSA recognises that in some smaller issuers, they are unlikely to have the breadth/depth of functional requirement to support a separate Nominations Committee.

We believe that the "comply or explain" regime will allow issuers to highlight their alternative arrangement. To support this, NZX could consider a purpose statement relating to the need for independence on the Nominations Committee (as expressed by NZSA in Question 5 above).

7. Do you agree with the proposed changes to the Code commentary to recommendation 3.6 relating to the composition of takeover committees?

Partly – much of the NZX proposal is in line with earlier NZSA submission statements.

However, we do **not** support the inclusion of any non-independent directors on a Takeover Committee, as we believe that there is a greater likelihood of a conflict of interest. There are numerous examples of independent director Takeover Committees that have determined an outcome materially different to the interests of non-independent directors (for example, Tilt Renewables in 2018).

Consultation Questions – Disclosures

NZSA supports the additional disclosures proposed within Rule 2.6.4 (related to the reasons for a Board's assessment of independence) and Rule 7.8.3 (where a Board has determined a director to be independent despite the presence of a Code factor).

We also support the original proposal by the Listed Companies Association (LCA) to include details of the Financial Product Holder who has nominated a director. We note this is now proposed within 7.8.3(d) of the Listing Rules.

1. **Are there any practical concerns about this proposal from an issuer's perspective. What, if any, changes to existing processes and practices would issuers need to make in order to comply with the increased proposed disclosure obligations?**

   NZSA is not an issuer, so cannot comment from an issuer's perspective.

   Nonetheless, we do not believe that there is any practical impediment to this disclosure proposal.

2. **Are there any practical concerns from a director or candidate perspective around the proposals to include greater disclosure requirements on issuers in relation to the assessment of a director's independence as described above?**

   NZSA does not represent directors, so cannot comment from a director's perspective.

   Nonetheless, we do not believe that there is any practical impediment to this disclosure proposal.

3. **If NZX introduces requirements for greater disclosure as set out above, for notices of meetings and market announcements, should Recommendation 2.4(c) be elevated to a Rule requirement to require this information also to be included in a notice of meeting, rather than reported against on a 'comply-or-explain' basis which is the current setting.**

   Yes. This is in line with statements made in our original submission in June 2023.

   NZSA believes that this will allow shareholders to fairly consider the assessment made by their directors and vote accordingly.

   Furthermore, we believe that in the absence of NZSA alternative proposal to separate a shareholder vote between director election and their independence status, this proposal at least allows shareholders to consider a more fulsome set of information relevant to the Resolution to elect / re-elect a director.

Consultation Questions – Director Residency

1. **Do you consider that it would be helpful for NZX to develop additional guidance as to how the term 'ordinarily resident' should be interpreted? If so, do you consider the proposed factors to be appropriate?**

Yes.

NZSA believes this would help to clarify expectations between shareholders and their directors.

2. **Do you consider that the residency requirements should be amended so that an issuer is required to have two directors who are resident in New Zealand or Australia?**

   No.

   Where the residency requirement was satisfied through Australian-based directors, NZSA believes this would reduce access of shareholders or their representatives to directors, and therefore restrict the ability of New Zealand-based shareholders to engage effectively with an issuer's Board.

   This is already a factor amongst those issuers whose Board is comprised of non-New Zealand resident directors where the company's business is mainly transacted outside of New Zealand.

3. **Do you consider that the residency requirements should be amended so that an issuer is required to have only one director who is ordinarily resident in New Zealand?**

   No – as outlined in Question 2 above.

Oliver Mander

CEO, NZ Shareholders' Association

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