

Australian Council of Superannuation Investors

# ACSI GOVERNANCE GUIDELINES

A guide to investor expectations of  
listed Australian companies



October 2019

acsi

# ABOUT ACSI

Established in 2001, the Australian Council of Superannuation Investors (ACSI) exists to provide a strong, collective voice on environmental, social and governance (ESG) issues on behalf of our members.

Our members include 39 Australian and international asset owners and institutional investors. Collectively, they manage over \$2.2 trillion in assets and own on average 10 per cent of every ASX200 company.

Our members believe that ESG risks and opportunities can have a material impact on investment outcomes. As fiduciary investors, they have a responsibility to act to enhance the long-term value of the savings entrusted to them.

Through ACSI, our members collaborate to achieve genuine, measurable and permanent improvements in the ESG practices and performance of the companies in which they invest.

Our staff undertake a year-round program of research, company engagement, voting advice and advocacy:

- **Research**  
We identify the most significant ESG issues for long-term investors.

- **Company engagement**  
We engage directly with the boards of ASX listed companies to discuss, understand and improve ESG management on behalf of our members.
- **Voting advice**  
We provide our members with voting recommendations on how to vote their shares consistent with the principles set out in these Guidelines.
- **Policy advocacy**  
We engage with government, regulators and other system-wide market participants to ensure markets are focused on the long term and best serve our members' beneficiaries.

These activities provide a solid basis for our members to exercise their ownership rights.

Further details about us, our publications, policy positions and membership are available on our website at [www.acsi.org.au](http://www.acsi.org.au).



If you are a company representative seeking to engage with ACSI or would like to request a copy of our voting advice relating to your company:

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# INTRODUCTION

ACSI's Governance Guidelines (Guidelines) are a clear statement of our members' expectations about the governance practices of the companies in which they invest.

Positively influencing the way business is conducted by providing guidance to companies on how to cultivate policies and practices that enshrine good governance is one way our members maximise investment outcomes for their beneficiaries.

The purpose of these Guidelines is to provide insights about governance issues which are of material concern to our members. The Guidelines articulate the issues that we focus on in our engagement work with companies and the factors we take into consideration when determining our voting recommendations.

The Guidelines assume that companies are aware of, and are complying with, all relevant aspects of Australian corporate law, including the *Corporations Act 2001* (Cth), the ASX Listing Rules and the ASX Corporate Governance Council's *Principles and Recommendations*. These Guidelines build upon rather than duplicate these requirements.

Each chapter takes a topic and begins by discussing the key overarching principles followed by more specific guidance on good governance practices. Where relevant, the Guidelines include 'break out' boxes that highlight the factors we take into account when determining our voting recommendations.

These Guidelines are updated every two years in consultation with our members and a broad group of stakeholders, to reflect the evolving regulatory and governance landscape.

Trust in corporate Australia has deteriorated in recent times. We see an opportunity to restore that trust through better governance and better management of ESG risks and opportunities.

**One principle underpins everything we do. We are focussed on financially material ESG risks and opportunities over the long-term, to protect and enhance the retirement savings that are entrusted to our members.**

## CORE PRINCIPLES

The following core principles underpin the Guidelines:



### Board oversight of all material risks

Good governance requires boards to consider and manage all material risks facing their company, including ESG risks.



### Sustainable, long-term value creation

Effective board governance contributes to shareholder value and creates the conditions in which sustainable long-term investment can prosper.



### Active ownership

Active ownership seeks to use ownership rights to influence the governance, policies, practices and management of the investee entity, in order to improve investment outcomes. Material ESG factors form part of our members' analysis in deciding whether to invest in a company and when deciding how to exercise their ownership rights.



### Transparency

Companies should properly disclose their performance in relation to material ESG factors which could impact shareholder value. Companies are more likely to attract long-term capital if they disclose sufficient information to give investors confidence in the identification and management of key ESG risks.



### Social licence to operate

Companies rely on a range of stakeholders to operate and succeed, including: governments, employees, communities, investors, consumers and suppliers. Effectively engaging with stakeholders is key to maintaining this social licence to operate.

## ACSI'S APPROACH TO COMPANY ENGAGEMENT AND VOTING ADVICE

We do not approach ESG with a 'one-size-fits-all' mindset, nor do we regard ESG monitoring as a 'box ticking' exercise.

We recognise that every company is different, and we expect that each board will have considered and adopted the most appropriate policies and practices and clearly articulate its rationale for doing so.

We take a pragmatic and commercial approach that considers the specific circumstances of each company on a case-by-case basis. We have around 250 meetings with directors from ASX300 companies each year, in addition to other ad hoc meetings where required.

When assessing a company's performance against these Guidelines to determine our voting advice, we take into account a broad range of factors including the materiality of the issue, the context in which the issue arises and the size of the company. We also consider the length of time over which any shortcomings have occurred, any history of dialogue with the company on the issue, and whether there have been any improvements in company behaviour.

We are transparent about our voting advice. In addition to publishing these Guidelines:

- We engage with the company's board to understand the company's position before providing voting advice.
- A company can request a copy of our voting advice after we have distributed it to our members.
- We notify companies of 'against' voting recommendations.

## REFERENCE TO OTHER STANDARDS

We recognise that there is a range of principles and frameworks that investors have regard to when considering governance and broader ESG issues. Common examples of other initiatives and organisations that Australian asset-owners may have regard to include:

- The United Nations supported *Principles for Responsible Investment* (PRI)
- *International Corporate Governance Network* (ICGN)
- *Investor Group on Climate Change* (IGCC)
- *Australian Securities Exchange (ASX) Corporate Governance Council*
- *Australian Institute of Company Directors* (AICD).

## WHAT'S NEW IN THIS EDITION OF THE GUIDELINES?

In our ninth edition of the Guidelines, we have kept the existing format and provided further guidance on contemporary issues.

In this edition, we address some of the themes and recommendations from the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, as we believe the Final Report contains lessons for all entities. Other updates are in response to issues we see across the market or observations made through our engagement work.

The themes underpinning the key updates to the Guidelines are outlined below. While the information is divided into sections (for the purpose of clarity), we encourage companies to consider their practices holistically and assess impact overall. In the words of Justice Hayne:

*Culture, governance and remuneration march together. Improvements in one area will reinforce improvements in others; inaction in one area will undermine progress in others.*<sup>1</sup>

### Accountability

We have included updates to reinforce the importance of the board demonstrating accountability (section 1). Accountability promotes ongoing effectiveness, encourages performance and instils confidence and trust.

### Risk Management

We have added focus on ensuring ESG risks are incorporated into risk frameworks, including risk appetite, and updates to highlight the board's role in ensuring management is operating within the risk profile (sections 1.1 and 5.1).

### Culture

We have updated the Guidelines to reflect the importance of corporate culture, including highlighting that companies should articulate and disclose their values to underpin their desired culture, and form a basis to demonstrate alignment between expected and actual behaviour. We also emphasise the board's role in overseeing the company's culture (sections 1.2 and 5.5).

### Social Licence to operate

We reinforce our view that acting in the best interests of the company requires considering the interests of a broad range of stakeholders, and we ask companies to articulate how they do so (section 5.1 and 5.2).

### Diversity

We state our view that companies should set a time frame within which they will achieve gender balance on their boards (section 2.2).

### Remuneration

One of the key issues is the apparent disconnect between how investors and some companies consider variable remuneration. We query whether payment for performance 'at target' is genuinely at risk. While we have no preference for one particular structure over another, we do expect that remuneration arrangements are explained fully and fairly, are reasonable overall and implemented appropriately.

We note the trends on combined incentive plans, as well as the broader dialogue on whether incentive plans are actually effective. Against this backdrop, we outline the principles we use to consider these issues holistically, with a focus on assessing 'reasonableness', within each company's particular circumstances (section 3.1).

We outline our views that boards should regularly assess the effectiveness of remuneration structures and make meaningful disclosures regarding the assessment (section 3.1 and 3.3).

We emphasise that remuneration reports provide an opportunity for the company to explain its approach to the link between remuneration, strategy, and culture (section 3.3).

<sup>1</sup> Justice Hayne in Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019 Volume 1 Page 412.

# 1. DIRECTOR RESPONSIBILITIES

Corporate governance describes ‘the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account’.<sup>2</sup>

The influence of individual directors is central to achieving high standards of corporate governance and delivering improved shareholder returns. The existence of policies and procedures for good corporate conduct is necessary but not sufficient. The leadership of directors on the importance of governance issues for the company is fundamental.

We do not recommend or encourage the adoption of a single set of governance standards or templates for companies. We encourage directors to be innovative in their approach, recognising that each company will necessarily differ on the details. What we do expect is for directors to explain why their company’s approach to governance is the most suitable in the circumstances.

An integral responsibility of the board is to review, ratify and oversee the implementation of the company’s business strategies. The board must maintain oversight of the Chief Executive Officer (CEO) and senior management. As such, the board is as accountable for the strategy as the CEO and executives. The selection, appointment and performance management of non-executive directors must, therefore, be aligned and relevant to company strategy.

Directors must have the requisite experience, skills, capacity, ethics and independence of mind to provide effective leadership and stewardship.

Directors are elected by shareholders to act in the best interests of the company. Shareholders are a diverse group whose interests may not always align, and to whom directors should be responsive. As Justice Hayne outlined:

*The longer the period of reference, the more likely it is that the interests of shareholders, customers, employees and all associated with any corporation will be seen as converging on the corporation’s continued long-term financial advantage. And long-term financial advantage will more likely follow if the entity conducts its business according to proper standards, treats its employees well and seeks to provide financial results to shareholders that, in the long run, are better than other investments of broadly similar risk.*<sup>3</sup>

We believe that directors will make decisions in the best interests of the company where decisions emphasise long-term financial sustainability.

## Board accountability

Accountability promotes ongoing effectiveness, encourages performance and instils confidence and trust. A demonstration of corporate accountability acknowledges responsibility for actions and decisions and the importance of stakeholder views.

Boards must demonstrate accountability for their organisations. This includes a preparedness to seek the right information, the character, confidence and strength to challenge management, and take appropriate remedial action when things go wrong. Directors must be adequately informed about key business issues and properly equipped to oversee management’s delivery of the company strategy.

Our view is that annual director elections drive better accountability and allow a regular and timely opportunity for boards and investors to consider director performance. We believe that annual director election assists in furthering the culture of engagement with investors and promotes responsiveness.

This chapter focuses on the individual responsibilities of directors as board members. The following chapter focuses on board composition factors.

<sup>2</sup> Justice Owen in the HIH Royal Commission, The Failure of HIH Insurance Volume 1: A Corporate Collapse and its Lessons, Commonwealth of Australia, April 2003 at page xxxiv.

<sup>3</sup> Justice Hayne in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019 Volume 1 at page 403.

## 1.1. DIRECTOR RESPONSIBILITIES

Directors are entrusted to oversee the company's business and to formulate, in conjunction with management, the company's strategies and policies. Directors must therefore ensure they are adequately informed about key business issues and are properly equipped to encourage management to optimise the delivery of company strategy.

In discharging these duties, directors must critically analyse the advice of management and external advisers. This responsibility was highlighted by Justice Middleton in the *Centro Case*:

*What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.<sup>4</sup>*

In practice, this means that directors must not blindly follow the advice of experts and should critically assess all matters put before them. Although there is long-standing law and guidance for directors, evidence persists that this approach is not always implemented in practice, and that continued vigilance is required. As Justice Hayne observed:

*The evidence before the Commission showed that too often, boards did not get the right information about emerging non-financial risks; did not do enough to seek further or better information where what they had was clearly deficient; and did not do enough with the information they had to oversee and challenge management's approach to these risks.<sup>5</sup>*

Some responsibilities of a director include:

- exercising independent judgement over the company's business strategy, performance, financial statements, resources, standard of conduct and ethics
- the selection, appointment and performance management of the CEO and other senior executives
- determining appropriate remuneration arrangements for the CEO and relevant executives
- determining appropriate authorities of the CEO and relevant executives
- maintaining CEO succession plans
- reviewing the company's accounts and certifying that they comply with Australian accounting standards and represent a true and fair view of the affairs of the company
- setting the company's risk appetite and seeking assurance that management is operating within that risk appetite, including in respect of ESG risks
- ensuring the maintenance of financial integrity, including the approval of budgets
- overseeing the company's commitment to environmental and social standards
- establishing and reviewing key performance benchmarks
- overseeing the company's system of internal controls and disclosure
- ensuring that proper accountability mechanisms and systems are in place, and that shareholders and stakeholders are informed in accordance with continuous disclosure obligations
- involvement and participation in board subcommittees.

<sup>4</sup> ASIC v Healey & Ors [2011] FCA 717 at 20.

<sup>5</sup> Justice Hayne in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019 at page 395.



## ASSESSING DIRECTOR ELECTION OR RE-ELECTION PROPOSALS

When we assess director election or re-election proposals, we consider factors relating to the performance and accountability of the individual candidate, along with factors that relate to overall board composition. Both sets of considerations impact the appropriateness of the individual's candidacy.

In relation to the individual, we consider:

- skills, qualifications and experience
- performance of the director on the company's board or other boards (as evidence of their skills and experience)
- engagement with shareholders on material governance issues
- evidence of the exercise of independent judgement
- the director's attendance at board and committee meetings

- capacity and workload
- the length of the director's tenure on the company's board, in light of average overall board tenure
- any relevant, publicly-known conduct of the director.

In relation to board composition, we consider:

- performance of the company under the incumbent board and its committees
- oversight of management process and remuneration arrangements
- how the director fits within the board's skills matrix and diversity considerations (for example, gender)
- the proportion of independent non-executive directors
- how the board undertook the process to identify and select new board members.

These issues are not considered in isolation. In all cases, our recommendation will be made on the basis of what we believe will produce the best outcome for the company.

## 1.2. PROMOTING GOOD GOVERNANCE

Investors expect the board of directors to formulate and apply high standards of governance. To this end, directors should:

- articulate the company's commitment to governance by developing a publicly-disclosed charter, or code, on governance and ethics (including compliance with all relevant laws, regulations, listing rules and generally accepted practices and standards). This charter should be subject to regular review
- establish a process to ensure that governance issues and risks are properly and regularly identified, evaluated and managed by the company and integrated into its strategy
- articulate and disclose the company's values to underpin the desired culture and demonstrate alignment between expected and actual behaviour
- ensure that the constitution, which is a significant governing document, does not include any features or proposed changes that may diminish or impinge upon the rights of shareholders
- provide opportunities for shareholder engagement at regular intervals throughout the year, not only at Annual General Meetings (AGMs), and adequately address shareholder questions. This applies particularly to non-executive directors.

## 1.3. INVESTOR EXPECTATIONS OF NON-EXECUTIVE DIRECTORS

Directors should ensure that they are personally familiar with the company's operations and do not rely solely on information provided by executives or external advisers.

With regard to director capacity, we expect that:

- each director should devote sufficient time and effort to their duties as a director
- the board should convey to prospective and current directors their expectations about the workload associated with a directorship on the board
- prospective or current directors should inform the board of any external commitments which may impact on their capacity to properly fulfil board responsibilities. The board must review the workload of their directors as part of their appointment and in annual performance assessment processes. A director's capacity to properly discharge their responsibilities will be assessed by investors on a case-by-case basis

- the board, when appointing a director, should ultimately have due regard to the reasonable expectations and commercial interests of the company. It must determine whether a prospective or existing director is capable of discharging their duties to the company, in light of any other directorships they hold. This will involve considerations such as time constraints, work complexity and workload
- the nature of any legal proceedings (past, present or anticipated) that the director is involved in or otherwise implicated should be disclosed. This disclosure should occur prior to appointment or when the board becomes aware of such an issue
- a serving CEO of a listed company may add value as a non-executive director of another listed company board, subject to their ability to manage their primary responsibilities as an executive. This can also enhance their understanding and insight into directors' duties and board responsibilities of the company where they serve as an executive.

We assess the independence of directors according to the factors discussed in section 2.1.

## 1.4. ROLE OF THE BOARD CHAIR

The chair must ensure that the board functions effectively and should provide leadership to all directors in the governance of the company. The chair also ensures that appropriate board procedures and structures are in place, so that all relevant issues are considered by the board.

### Separation of the chair from CEO or executive director roles

The chair should be selected from the pool of independent non-executive directors on the board.

Combining the roles of chair with CEO or executive director positions generally creates an unacceptable concentration of power and diminishes the degree of accountability that would usually result from a separation of the two roles. Therefore, the roles of chair, CEO and executive director should be separated.

Where the chair is an affiliated or executive director, the independent non-executive directors should nominate a lead independent non-executive director, or equivalent, to perform the chair's responsibilities where there are real or perceived conflicts arising from the chair's position as an affiliated or executive director.

## Chair workload and capacity

The chair's role is more time intensive than any other board position. To ensure the chair has adequate capacity to do the job, the board should consider:

- limiting the number of chair roles to a single listed entity
- limiting the number of overall board positions held by the chair
- any other commitments that may compromise the chair's capacity to fully engage in periods of high workload (such as significant corporate action).

We will consider, on a case-by-case basis, the capacity of a chair in light of the above considerations.

## 1.5. RISK MANAGEMENT

Risk oversight is a critical responsibility of the board. We will engage with companies about the company's risk framework, including its risk appetite, and the processes for identification, monitoring and oversight of all material risks, whether current or emerging. Our focus is ensuring that the board has effective oversight of ESG risks and opportunities. We expect the board to demonstrate effective management through corporate reporting and public disclosure. Chapter 5 discusses the oversight of ESG risks and opportunities in more detail.

## 1.6. BOARD OVERSIGHT OF RELATED-PARTY TRANSACTIONS

Oversight of related-party transactions is a critical role of the board. The board should disclose its policy for managing potential related-party transactions and may need to form specific committees to assess related-party transactions.

The actions taken to manage all material related-party transactions should be disclosed by the company. This includes disclosing the means by which the relevant director(s) managed any conflict(s) of interest during the board's consideration and decision making relating to the transaction. Investors are entitled to seek an explanation in order to satisfy themselves that the board's decision in the matter was made in the best interests of the company.

Rather than a legalistic and narrow interpretation of what constitutes a related-party, the board should not only observe the law but also its underlying purpose. Transparency around these transactions is critical, even where transactions are conducted on arm's length terms.

## 2. BOARD COMPOSITION AND PROCESSES

The board should be comprised of individuals who are able to work together effectively to steer a viable, profitable, efficient and sustainable company.

A properly structured board should include a diverse range of appropriately skilled and experienced directors who bring diversity of thought to board decision making. This is more likely to occur when directors are drawn from sufficiently diverse backgrounds which take into account gender, ethnicity and age, in addition to core skills and experience.

A board should consist of a majority of independent non-executive directors who are sufficiently motivated and skilled to provide independent oversight of the company's activities.

Boards must ensure that the following factors are considered in director appointment, succession and nomination processes:

- any skill gaps and the experience of current directors relevant to the company and its strategy
- the size of the board should be sufficient to ensure that there is an adequate number of skilled and independent non-executive directors, without being so large as to be unworkable
- ensure sufficient overlap in director succession so that gaps in skills, experience, subject matter expertise or corporate memory do not occur.

The board should disclose its processes for renewal and composition, including its skills matrix. We encourage entities to provide meaningful information on the mix of skills and experience the board has, and is looking to achieve, along with how the board's composition aligns to the company's strategy and key risks, including material ESG risks.

### 2.1. INDEPENDENCE

The board fulfils its supervisory and advisory functions by bringing an independent perspective to bear. A person who is regarded as an independent non-executive director is expected to be able to make decisions in the best interests of the company, and in a manner that is independent of management and free of any business (or other) relationships that could materially interfere with their judgement. This is particularly the case where there is a potential conflict of interest arising in a board decision, be it actual or perceived.

#### Assessment of independence

Investors recognise that independence is determined predominantly by an individual's character and integrity. While independence indicators are useful to highlight potential constraints to a director acting in the best interests of the company over the long-term, written guidelines will not always address particular circumstances. For example, a director may not meet strict independence guidelines but may have a proven record of exercising independent judgement. In such cases, they should not be deemed inappropriate to serve on the board, however the board should explain why they are an appropriate candidate.

We encourage companies to disclose how potential conflicts of interest or affiliations are mitigated by the board. Investors cannot make informed judgements on these issues without adequate company disclosure. As a guide, the following table outlines some circumstances where directors would be considered to be affiliated and non-independent. We evaluate each factor on a case-by-case basis.

A non-executive director should be independent...	Factors that may compromise independence
... of executives and advisers	<p>Employment within the company in the past three years.</p> <hr/> <p>Senior employment by a significant professional adviser in the past three years.</p> <hr/> <p>Concurrent service between a non-executive director and executive or adviser.</p>
... of substantial shareholders	<p>Ownership of more than five per cent of the voting rights in the company's shares.</p> <hr/> <p>Being, or having been, an officer, director, representative or employee of such a shareholder.</p>
... of customers, suppliers and other service providers	<p>Being a major supplier or customer to the company (or their representative or executive).</p> <hr/> <p>Having a material contractual relationship with the company.</p> <hr/> <p>Receiving fees for services to the company at a level indicative of either significant involvement in a company's affairs, or significant in relation to the salaries received by directors.</p>
... of relationships which may impact decision-making	<p>Relationships (including other directorships past or present).</p> <hr/> <p>Benefiting from a related-party transaction.</p>
... of incentive pay	<p>Participation in performance incentive schemes, including options that are also granted to executives.</p>
... from a relationship with a related-party	<p>Being a spouse, de facto spouse, parent or child of affiliated directors, executive directors, senior executives or advisers.</p>
... in a takeover bid	<p>Participating in the bid for the counterparty (either as buyer or seller).</p>
...which may be affected by length of tenure	<p>Where the director has served for a significant period on the board, independence may be affected. Individual tenure will be considered in light of broader board renewal.</p>
<p>Any other factor that we may consider as materially affecting independence having regard to the specific circumstances of the board's composition, the company and the individual director concerned.</p>	

## Independence and substantial shareholders

Substantial or founding shareholders who are members of a board or nominate specific persons as directors may perform an important role in the oversight of a company and can make important contributions.

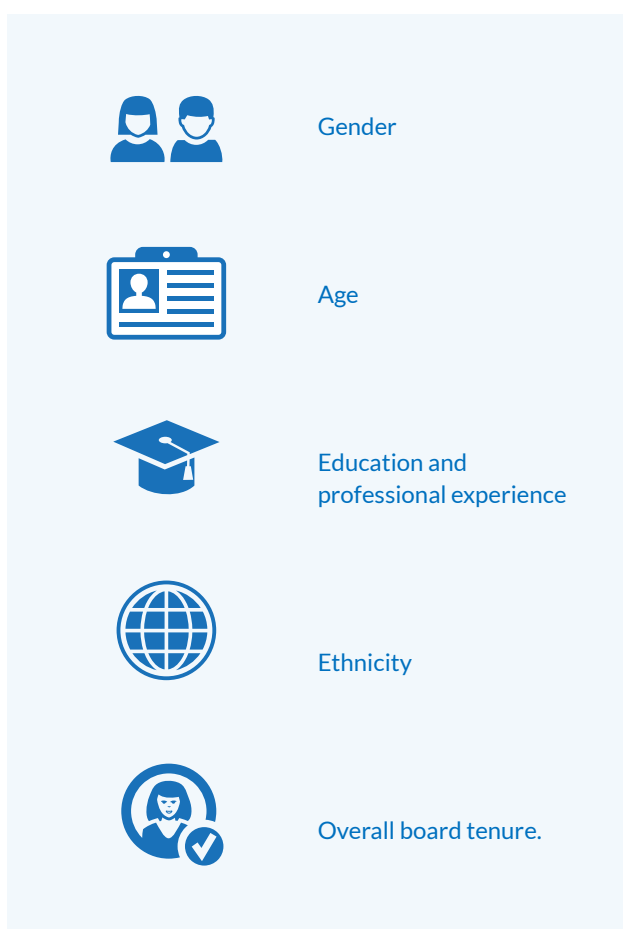
To provide evidence that all shareholder interests are considered, the following is generally expected of the board:

- that it clearly articulates the checks and balances in place
- where potential conflicts of interest arise at the board level, directors with material conflicts of interest should be excluded from decision making and independent non-executive directors should be assigned the lead. This process is particularly important when the board considers related-party transactions
- that it has the character, confidence and strength to question matters raised by substantial shareholders and not merely 'rubber stamp' proposals.

## 2.2. DIVERSITY

Companies are likely to be most successful when they harness collective intelligence and approach problems with cognitive diversity. Diversity of thought assists boards to set and challenge company strategy and to better understand the markets in which they operate.

In selecting directors, the board should consider a range of diversity factors that could add value to board decision making by bringing different perspectives to bear, such as:



The board should also recognise that the benefits of diversity only flow when diverse views are properly heard and considered.

### Gender Diversity

Gender diversity has been a major challenge for Australian boards. We strongly support efforts to improve gender diversity on boards and in management teams.

Our members have endorsed a gender diversity target and expect that at least 30 per cent of the board positions in ASX-listed companies be occupied by women. In addition, companies should set a time frame within which they will achieve gender balance (40:40:20)<sup>6</sup> on their boards.

We work with companies to understand their plans to meet their targets. Our preference is for companies to reform their board's composition in line with the target on a voluntary basis.

Our members are also taking action by voting against the election of directors in companies that have made no progress to improve board gender diversity.

Our gender diversity voting policy is updated periodically and available on our website at [www.acsi.org.au](http://www.acsi.org.au).

<sup>6</sup> Gender balance typically refers to a minimum of 40 per cent of either gender, with 20 per cent unallocated to allow flexibility for appropriate renewal.

## 2.3. BOARD PROCESSES

### Board evaluation

A process for evaluating the board should be established and a formal board evaluation should be conducted to evaluate group and individual performance, with key findings disclosed.

Board evaluation should:

- assess the board's ability to provide strategic direction and objectives for the company
- determine effectiveness and composition of the board
- identify gaps in skills and experience to promote overall board effectiveness and company performance over the long term
- evaluate performance in managing shareholder and stakeholder expectations.

As a guide, the company should consider using external facilitators to conduct board evaluations periodically (e.g. every two years).

### Director skills and performance assessment

The assessment of director skills and performance should:

- contribute to the effective and cohesive operation of the board
- be relevant and aligned to the company strategy, including the material risks
- be robust and independent. Directors should not be solely responsible for assessing their own skills
- be communicated to shareholders (a skills matrix is an effective tool to demonstrate to shareholders how skills across the boardroom link to the oversight of company operations and strategy).

### Board succession

Board succession should be planned and ongoing. Robust succession processes ensure that boards are regularly renewed with new expertise and thinking.

As part of the succession process:

- There should be sufficient overlap in director succession so that gaps in skills, experience, subject matter expertise or corporate memory do not occur.
- Any future skill gaps should be identified by the board evaluation process.
- When considering a director who holds, or has held, other directorships, the past performance of the director at those companies should be considered.

- On appointment, directors should receive an outline of their rights and obligations arising out of their service contract, the company's constitution, law, rules, regulations and other relevant instruments.
- Directors should communicate their intentions to retire from the board as soon as possible, to assist with succession.
- Directors should disclose their involvement in any legal proceedings (past, present or anticipated).
- The board should not limit the ability of shareholders to nominate and elect additional directors.

### Length of service as a director

We believe that a mix of directors with varying lengths of tenure improves board decision making.

The fact that a director has served on a board for a substantial period does not necessarily mean that she or he has become too close to be considered independent. Many boards consider the impact on independence where a director has served a period of 10 years or more – a standard also reflected in the ASX Corporate Governance Council's *Principles and Recommendations*.

Where a company has long serving directors, we encourage the board to disclose the board renewal process.

### Board committees

The board should ensure that it establishes audit, risk, remuneration and nomination committees, and any other committees as appropriate for the nature of its business.

The board should develop terms of reference outlining the scope and responsibilities of each committee. This includes a policy regarding board expectations about the number of meetings that should occur each year and the obligations on each director to attend. This information should be disclosed in annual reports and revised periodically.

Board committees perform an important role in dealing with matters where executive directors could face a conflict of interest. In general, the following expectations apply:

- A committee should be a reasonable size taking into account the size of the board but should not be so large that it comprises a majority of the board.
- The chair of any board committee should be an independent non-executive director other than the board chair.
- Committees should be majority independent, except the audit committee which should have only independent directors.
- Although it may be appropriate for committees to invite executives and executive directors to be present at meetings, committees should meet regularly without executives present.
- Committees should have the opportunity to select their own service providers and advisers, at a reasonable cost to the company.
- Companies are encouraged to disclose which material service providers the board and/or committees have appointed, the types of services those service providers have supplied, and the types of services supplied by the same service providers to other parts of the company.
- During takeovers and related-party transactions, all committees formed should only comprise directors that are not associated with the counterparty to the transaction.

## Existence of controlling shareholders

Where companies have controlling shareholders, adequate safeguards for minority and non-controlling shareholders should be built into board structures and the company constitution as follows:

- There should be disclosure in the annual report and accounts of all connections and relationships (past and present) between directors and controlling shareholders.
- The existence of any relationship agreements between a company and its controlling shareholder should be disclosed.
- The chair should not have any connection to the controlling shareholder.

Where the controlling shareholder owns or controls, singly or jointly, more than 50 per cent of the voting rights, the controlling shareholder should abstain from voting on the election of any director related to the controlling shareholder.



# 3. REMUNERATION

Executive remuneration should be aligned to the delivery of company strategy, company values, the desired company culture and the company's risk appetite. Executive remuneration should be designed to promote sustainable long-term performance and shareholder value creation.

In setting remuneration structures, the board should identify the long-term value drivers for the company and how these can be best reflected in the remuneration structure and performance hurdles. We support companies taking a bespoke approach that suits the specific needs of the company.

The board should make minimal adjustments, which are consistent over time, in measuring performance outcomes. The board should regularly assess the effectiveness of their remuneration structures, including in respect of managing risk, promoting the desired culture, and reducing the risk of misconduct.

The overall quantum of remuneration should be reasonable and not excessive. Excessive pay, persistently high variable reward outcomes, and lack of alignment with shareholders can each adversely affect a company's reputation and social licence to operate. The board is encouraged to consider internal pay relativities, as unfair treatment can negatively affect employee engagement. Companies should regularly assess gender pay parity and meaningfully disclose findings and action taken.

We support disclosure of the CEO's pay ratio to that of their Australian workforce's median, 25<sup>th</sup> and 75<sup>th</sup> percentile pay, with accompanying explanation of any changes over time, along with why the ratios are reasonable (including considering how the ratio is consistent with company's values, strategy and culture).

The manner in which executives are remunerated can provide investors with an insight into the relationship between the board and executives. Shareholders expect remuneration arrangements to be cost effective for the company and outcomes should be the result of bona fide commercial negotiations between the board and key executives.

The board, through the remuneration committee, has a responsibility to develop, implement, monitor and evaluate remuneration processes and outcomes. While the board may seek input from external advisers, the responsibility for remuneration structures, and an assessment of the overall reasonableness of outcomes, remains with the board. To encourage robust oversight of remuneration policy, a remuneration committee should be comprised of only independent non-executive directors of the company, and the committee should actively seek investors' views.

We support the use of 'non-financial' measures. Like financial measures, the hurdles must be objective, transparent, measurable and truly at risk. We refer to 'non-financial' measures as it is a generally understood term, even though we agree with the APRA Capability Review which stated "This Review is careful not to make the distinction between financial and non-financial risks common in discussion of governance, culture and accountability (GCA). Weaknesses in GCA frameworks feed directly into financial safety and stability. Failures of GCA have often been at the heart of financial failures and systemic instability."

We believe that the vote on the remuneration report and the two strikes rule should be supplemented with a binding vote on pay policy every three years. We recognise the importance of the board retaining discretion (and the accompanying accountability) to formulate a pay policy that is appropriate to their company. Nonetheless a company's pay policy should describe certain components so that investors have appropriate information to form a view on how the policy might work in practice, and potential outcomes. The current vote on remuneration outcomes remains important to provide feedback to a company's board on how the pay policy is implemented and we would continue undertaking a careful review to assess implementation and outcomes.

Investors seek information on the rationale underpinning companies' remuneration practices. The board should be ready to justify why remuneration is fair and commercially reasonable having regard to company performance and be able to clearly explain, in plain language, why particular remuneration metrics were considered suitable.

### 3.1. EXECUTIVE REMUNERATION

We do not prefer one particular remuneration structure over another, rather we focus on how the remuneration structures support long-term success. The reasonableness of executive pay will be a function of structure, quantum and application in practice.

We will assess each company's remuneration practice on the information available.

As fixed and variable remuneration are commonly used across different remuneration structures, our expectations are outlined below.

#### Fixed remuneration

Once the amount is set, fixed remuneration is paid without a direct link to individual or company performance. Fixed remuneration should be set at a level that is reasonable and reflect an executive's core duties. Companies should explain why fixed remuneration amounts are appropriate.

Increases in fixed remuneration have the potential to significantly inflate total remuneration, particularly where other components of pay are determined as a ratio to fixed remuneration. For example, a fixed pay increase may also increase respective variable remuneration sizes, termination entitlements and superannuation contributions.

Companies should avoid creating perverse incentives for executives by linking fixed pay to company size or simply following benchmarks provided by external advisers. A clear rationale should be provided for any material increase in fixed remuneration.

#### Variable remuneration

Variable remuneration may include short-term incentives (such as an annual payment in cash or shares) and long-term incentives (such as share options or share-based incentives).

When using variable remuneration, companies need to clearly explain:

- the purpose of the variable component(s)
- the relevant performance indicators or hurdles, including the use of gateways where applicable
- the rationale and expectations for payment at the relevant levels of performance (such as threshold, target, and exceptional performance or their equivalent measures)

- the proportion of the variable component that is genuinely at risk (for example where 'at target' performance achieves an 80 per cent pay out of maximum variable opportunity, that would suggest that only the remainder of the opportunity is a true 'bonus' component for outperformance and only that 'bonus' component is genuinely at risk)
- the minimum and maximum payment amounts
- how the variable pay component(s) is aligned with the company's strategy and values and the interests of long-term investors.

We see evidence in the market of short-term incentives being paid for performance 'at target'. Payment for performance 'at target' can be considered similar to fixed pay – on the basis that it is reasonable to expect 'at target' performance. While we recognise that different models can be appropriate in different circumstances for different companies, they must be reasonable and accurately disclosed.

We expect companies to explain the rationale for their choice of remuneration practice and explain how the short-term incentive is at risk. We expect to see fluctuation in pay out from year to year, in particular in respect of payment for true outperformance. There should also be genuine potential for zero outcomes, (including for the 'at target' component) where performance indicates that this is appropriate.

Quantum should be assessed and benchmarked based on the expected pay for 'at target' performance (whether or not this includes some short-term incentive component).

Notably, vesting of incentives should not commence when performance is below the median percentile of its peer group.

## ASSESSING REMUNERATION ARRANGEMENTS

The need for alignment between remuneration and the delivery of company strategy means that we will consider whether remuneration practices are designed to reward sustainable long-term performance and shareholder value creation. We will consider the reasonableness of remuneration arrangements holistically, with no single element taking priority over another, by assessing:

- **Benchmarking:** This should take into account remuneration 'at target' (or equivalent), including both fixed and variable components (along with other benefits) where relevant. Pay for 'at target' performance may simply be fixed pay but could also include any variable pay component that is payable for performance at target. Regardless of structure, quantum should be reasonable.
- **Board discretion:** The board's record over time of applying its discretion is relevant in assessing remuneration proposals as persistently high variable remuneration outcomes imply either performance hurdles are not sufficiently demanding or the board is reluctant to use its discretion. The board is encouraged to apply discretion in pay outcomes, in particular during periods of poor performance or in other circumstances where a perverse outcome would eventuate.
- **Quantum:** The fixed pay, expected pay for 'at target' performance and the maximum total pay (both actual and potential) should be reasonable. Beyond benchmarking, pay quantum should be set with consideration to the company's sector, peer group, industrial obligations, the ratio to the company's median Australian worker, employee engagement, community expectations and reputational implications. There should also be evidence of arm's-length negotiation and pay should reflect the degree of complexity of the company's operations.
- **Alignment:** The remuneration structure as a whole (as well as each component) should align with company strategy, values, risk appetite and the interests of long-term investors. This should include continued alignment for a period after the executive has departed the organisation, in respect of decisions made during the executive's tenure.
- **Disclosure of performance hurdles:** Performance hurdles are thresholds above which variable remuneration vests for executives. We will consider what constitutes sufficiently demanding hurdles on a case-by-case basis. Companies need to explain how performance thresholds operate and why they are appropriate. Variability in outcomes over time suggests that incentives are genuinely at risk and hurdles are appropriate. As a first principle, performance hurdles should be disclosed. Where a board believes that commercial confidentiality applies, companies should disclose a detailed summary of the performance conditions adopted during the financial year for variable remuneration arrangements and disclose the relevant performance conditions retrospectively.
- **Long-term incentives (LTIs):** Grants of long-term incentive instruments should incorporate stretch performance hurdles that are appropriate to the company and its strategy. Hurdles should minimise the potential for perverse incentives for executives and incorporate a performance measurement period that is aligned with business strategy and cycle with a minimum of at least three years, and longer performance periods encouraged. Rather than adopting what is seen as an 'acceptable' measure, boards should aim to select the most appropriate hurdles for the company.
- **'Combined' incentive plans:** Combined incentive plans need to strike an appropriate balance between simplicity and encouraging performance over the long-term. If performance targets are measured over a shorter period, then the deferral period should be longer, to act as a balance and encourage long-term performance. Quantum should be adjusted to reflect any reduction in risk to the executive.
- **Use financial and other appropriate measures:** Companies should consider how to incentivise executive performance across a range of material business areas. Financial measures should be supplemented by 'non-financial' measures which, while not directly measured in short-term financial accounts or share price metrics, can be material drivers for long-term financial performance. Some examples include strategic or project-based targets, safety performance, customer satisfaction, employee turnover and achievement of ESG performance targets. 'Non-financial' measures should be quantitative and objective.

- **Re-testing of performance hurdles:** Where performance conditions or hurdles have not been met at the vesting date, we are opposed to the re-testing of performance hurdles without a good reason to do so.
- **Cash and equity mix:** Companies should minimise cash payments and seek to deliver the bulk of executive pay in equity that vests over time, based on the achievement of demanding performance targets. Deferred equity should also be considered for the delivery of annual variable remuneration.
- **Complexity:** Companies should clearly explain their remuneration arrangements so that investors can assess how remuneration is encouraging performance over the long-term. If this is not possible, companies should consider whether their remuneration arrangements are too complex.
- **Shareholder approval for equity grants:** Any use of equity in senior executive or director remuneration should only occur with prior approval from shareholders. This includes shares purchased on-market for the remuneration of directors (outside of salary sacrifice). Equity grants should be put to shareholders for consideration on an annual basis. Companies should respect the views of the majority of their shareholders' wishes and avoid settling awards (in cash or via on-market purchase of securities) if a grant has not been approved.
- **Claw-back mechanisms:** While not appropriate to all incentive schemes, the board should be able to claw back all variable pay in the event of poor performance or excessive risk-taking.
- **Variable remuneration deferral:** If suitably structured, the deferral of variable remuneration can increase the company's alignment with shareholders and retention of executives.
- **Sign-on awards:** Generous sign-on awards to new executives should be avoided. In assessing sign-on awards, we will consider the evidence of a bona fide negotiation to secure the executive, the weighting of the grant to long-term performance-based components, and the quantum of the grant.

## REMUNERATION PRACTICES WE OPPOSE

We generally oppose the following practices:

- incentive pay, including options, for non-executive directors
- the payment of incentives for making acquisitions, rather than as a measure of the value delivered to shareholders over time
- fixed pay increases which simply represent a 'catch up' for executives in cases where a pay freeze has been applied
- the use of normalised or adjusted, earnings figures in incentive plans which shield executives from costs incurred by the company. We will assess the board's rationale for adjustment on a case-by-case basis, including whether adjustments are applied consistently over time and transparently disclosed
- the payment of dividends to executives on unvested (and therefore unearned) incentive shares
- retention payments made without a clear and robust rationale
- waiving of performance requirements and time conditions on a change of control. We are, however, prepared to consider vesting pro-rata for the length of the performance period completed
- long-term incentives without performance hurdles (tenure is not considered an appropriate hurdle), even where the grant includes options with a premium exercise price. These will be assessed on a case-by-case basis, taking into account the company's particular circumstances.

## Termination payments

We do not support termination pay outcomes that can be regarded as a reward for mediocre performance or failure. Termination benefits awarded must be consistent with the termination benefits previously disclosed by the company.

We do not support guaranteed termination payments that exceed 12 months' fixed pay. We will assess other termination payments in light of the surrounding circumstances.

## ASSESSING TERMINATION PAY RESOLUTIONS

We will consider the terms of all termination benefits or long-term incentives, which exceed the statutory threshold of 12 months' fixed pay, on a case-by-case basis. Termination payments are a cost to the company. The board should therefore seek to limit termination payments – particularly in cases where an executive is terminated for poor performance.

Where approval is being sought for the continuation of long-term incentives for 'good leavers' on termination or genuine retirement, our general expectation is that incentives will be tested on a pro-rata basis with the board maintaining discretion to reduce or cancel incentives, depending on the circumstances.

## Two strikes

The introduction of the 'two strikes' rule has been successful in increasing engagement between Australian boards and their shareholders on issues of executive remuneration.

We support the 'two strikes' rule as a mechanism to assist shareholders to hold the board and/or individual directors accountable for remuneration decisions and general company performance where a company has received substantial 'against' votes on remuneration reports in consecutive years.

We expect all companies that have received a first strike, or a high vote against (but falling short of a strike), to respond to investor concerns by engaging with investors to address material remuneration issues. We will assess remuneration reports independently of board spill resolutions at companies which have received a first strike.

## ASSESSING BOARD SPILL RESOLUTIONS

We consider each board spill resolution on a case-by-case basis. We will assess board spill resolutions with regard to:

- company performance and the performance of the board and management
- shareholder engagement and changes made by the board to address investor concerns

- the materiality of underlying remuneration issues at the company.

In all cases, our recommendation will be based on our assessment of what will provide the best outcome for shareholders, taking into account all known circumstances at the company.

## 3.2. NON-EXECUTIVE DIRECTOR REMUNERATION

Non-executive directors should generally be remunerated by way of reasonable fixed fees only. Remuneration in shares is acceptable but we do not support the payment of share options and other incentives which introduce leverage into non-executive remuneration.

We support policies that require non-executive directors to hold a significant amount of company shares. Such policies should also require that directors participate in capital raisings on a pro-rata basis only. Companies should disclose their policies, and compliance by directors.

## 3.3. REMUNERATION DISCLOSURE

Remuneration reports should facilitate investor understanding of a company's remuneration policies and practices. Remuneration reports provide an opportunity to explain the company's approach to remuneration and the link between remuneration, strategy and culture. Disclosure should clearly explain the company's approach to the principles set out in these Guidelines.

In addition to statutory reporting requirements, companies should use the remuneration report to explain how remuneration drives and rewards company performance and manages risk, with reference to strategic goals and returns to shareholders. Disclosure should also include information on how the board assesses the effectiveness of remuneration structures. We encourage a narrative approach to remuneration reporting, where a company explains in plain language why its remuneration practices are appropriate.

# 4. VOTING RIGHTS AND COMPANY MEETINGS

Participation in company meetings is a fundamental right of shareholders and a cornerstone of corporate governance practice.

Corporate governance structures and practices should protect and enhance the board's accountability to shareholders. Companies should not take any actions which disenfranchise shareholders or inhibit shareholder participation in company meetings.

We support a 'one share, one vote' capital structure. We do not support the existence of non-voting shares.

## 4.1. VOTING

Voting is an important means by which shareholders can hold directors accountable for their actions and the future direction of the company.

Voting is a key mechanism by which shareholders play a role in the governance of the company. Accordingly, shareholders have a legitimate expectation that companies will provide them with efficient access to the voting process.

We support company initiatives designed to overcome impediments and constraints to more active shareholder involvement.

In relation to the meeting process, we are guided by two core principles:

- Shareholders should not have to meet unduly difficult thresholds to call general meetings, propose resolutions or otherwise exercise their shareholder rights.
- We favour the use of technology to improve shareholder participation.

### Voting rights and meeting process

All directors, senior executives and the external auditor should attend AGMs and be available, when requested by the chair, to answer shareholders' questions.

We support:

- confidential shareholder voting
- voting separately where issues are unrelated – resolutions should not be bundled
- chairs exercising proxies in accordance with the way they are directed
- secure electronic voting, not paper-based voting
- the creation of an audit trail by which shareholders can receive confirmation that their votes have been processed
- shareholders having the right to vote on corporate governance decisions, such as director election or re-election, executive and director remuneration policy, appointment of external auditor and all constitutional changes
- shareholder approval for the acquisition of securities in the company by a director, unless it is under a bona fide salary sacrifice arrangement from an executive's fixed remuneration
- all votes being decided by poll. Polls should not be declared at shareholder meetings until all agenda items have been discussed and shareholders have had the opportunity to ask and receive answers to questions concerning them
- procedures to ensure votes are properly counted and recorded. If over-voting has occurred, the company should trace individual shareholder votes. If they cannot trace the source, they should disclose that a block of shares was excluded because of over-voting.

## Information disclosure

In relation to company meetings, we support:

- provision of adequate, accurate, unbiased and timely information to enable informed decisions by shareholders
- additional information regarding a general meeting item being made available upon request
- shareholders, including beneficial owners of shares, being able to receive documents directly from the company
- shareholders having reasonable access to minutes of general meetings
- detailed announcements of results within 24 hours of the closure of the meeting. This should include the total votes cast, for and against, and abstentions for each resolution. It should also include the actions that the company intends to take when a significant proportion of votes have been cast in opposition to the board's recommendation
- appropriate disclosure in relation to how undirected proxies have been voted by the chair.

## Adjournment of company meetings

Appropriate notice of shareholder meetings, including notice concerning any change in meeting date, time, and place or shareholder action, should be given to shareholders in a manner and within time frames which will ensure that shareholders have a reasonable opportunity to exercise their vote. We support the retention of a 28-day notice of general meeting for listed companies.

Companies should not adjourn a meeting for the purpose of soliciting more votes. Adjourning a meeting should only be done for compelling reasons, such as security, vote fraud, problems with the voting process or lack of a quorum. If there is evidence that a company meeting has been adjourned for improper reasons, we may recommend against the re-election of the chair and any non-executive directors up for re-election who were present at the relevant meeting.

We encourage companies to hold shareholder meetings by remote communication (i.e. electronic meetings) only as a supplement to traditional in-person shareholder meetings, and not as a substitute.

## 4.2. BOARD ACCOUNTABILITY TO SHAREHOLDERS AT COMPANY MEETINGS

Corporate governance structures and practices should protect and enhance board accountability. As such, the board should submit, for prior shareholder approval and action, any proposal that alters the fundamental relationship between shareholders and the board.

For example, major corporate changes, which in substance or effect may impact shareholder equity or erode share ownership rights, should be submitted to a vote by shareholders.

Sufficient time and information should be given to shareholders (including balanced assessment of relevant issues) to enable them to make informed judgements on these resolutions.

All director election and re-election resolutions should be decided by a majority shareholder vote. The board should not employ a 'no vacancy' policy or seek to utilise a statutory board-limit resolution where the size of the board is below the maximum size defined in the company's constitution.

## 4.3. ASSESSMENT OF SHAREHOLDER RESOLUTIONS

The ability to propose resolutions at a company meeting is an important shareholder right. In practice, shareholder resolutions often require a proposal to amend a company's constitution. This process is not the most effective means for shareholders to comment on a range of matters including governance or ESG issues.

We support the development of a right for shareholders to bring a non-binding proposals in the Australian market, subject to appropriate controls or support (such as the five per cent or 100 member rule). Such a policy change could see shareholder proposals which are not framed as constitutional amendments, and due to their non-binding nature, would not disrupt the board's role.

Any shareholder proposal approved by a majority of votes should be adopted by the board or a detailed explanation of the board's progress towards implementing the proposal included in the company's next annual report.



## ASSESSING SHAREHOLDER RESOLUTIONS

We will assess shareholder resolutions on a case-by-case basis, in the context of how they support value creation over the long term. We will generally favour proposals that result in the disclosure of information which is useful to shareholders and not overly prejudicial to the company's commercial interests.

Resolutions should be linked to improved governance or transparency within the company and promote effective management of risk over the long-term. We will judge each resolution based on what is in the best interests of shareholders over the long-term and a thorough assessment of any potential impacts on the company.

We expect the board to reasonably consider the substance of shareholder resolutions and to offer to engage with their proponents. If the board recommends an 'against' vote, we expect the board to publicly explain why its position better serves shareholders' long-term interests.

We will take the following considerations into account when evaluating shareholder proposals:

- Would adopting this proposal protect or increase long-term shareholder value or increase shareholder rights?
- Does the proposal address a material issue?
- Has the company already responded adequately to the shareholder concerns outlined in the proposal?
- Can the issue be dealt with more effectively through legislation or regulation?
- How does the company's approach to addressing the issue compare with its peers or standard industry practice?
- In instances where the proposal is seeking increased disclosure or transparency:
  - Is there already adequate information publicly available from the company?
  - Would adopting the proposal require the company to reveal commercially sensitive information?

### Stapled and externally-managed entities

Stapled and externally-managed entities should:

- Have boards that comprise a majority of directors who are independent of the external manager and are not appointed by the external manager.
- Appoint auditors who are separate from the auditors of the external manager.
- Ensure that remuneration arrangements for the external manager are aligned with shareholder interests and disclose the basis on which management fees are calculated - including the potential termination fees which would be payable.

# 5. MANAGING ESG RISKS AND OPPORTUNITIES

Companies that are well governed and effectively manage their environmental and social impact are more sustainable over the long term.

Accordingly, consideration of ESG issues and the management of these issues, alongside other risk and return factors, form part of our members' analysis when evaluating the operational performance and financial prospects of investee companies.

Companies are more likely to attract equity finance if they provide investors with accurate, timely, and relevant information that demonstrates ESG risks and opportunities material to the business are being well managed.

## 5.1. BOARD ESG OVERSIGHT

We expect the board to maintain robust oversight of all ESG issues that materially affect the business. We expect that the board will:

- ensure ESG risk is integrated into the company's risk frameworks, including ensuring that ESG risks are included in the company's risk appetite
- recognise that companies rely on a range of stakeholders to operate and succeed, including employees, communities, governments, regulators, investors, consumers and suppliers and that acting in the best interests of the company over the long-term requires considering the interests of the range of stakeholders
- clearly identify their key stakeholders and have a strategy for effective engagement
- ensure that it receives quality information to impartially identify and assess environmental and social risks and opportunities material to the company's short and long-term value. Does the board receive regular briefings or advice from internal and external topic experts? Is knowledge of ESG issues considered in the selection and training of directors?
- regularly assess the significance of current or emerging social and environmental issues relevant to the business and ensure there is adequate time to discuss ESG risks and opportunities at board meetings

- ensure the company has effective governance, oversight and management systems in place for environmental and social issues. For example, audit and performance assessment systems, as well as appropriate remuneration incentives
- ensure ESG risks are included in the board's monitoring whether management is operating within the mandated risk appetite.

## 5.2. ESG DISCLOSURE

Disclosing information on a range of ESG issues provides an opportunity for the company's board and management to demonstrate strategic thinking in relation to long-term financial sustainability beyond the achievement of short-term financial targets.

Companies are required to disclose their material ESG risks. ASX listed companies must disclose on an 'if not, why not' basis whether they have any material exposure to environmental or social risks and, if so, how they manage or intend to manage those risks.<sup>7</sup> Further, a company's operating and financial review should include a discussion of environmental and other sustainability risks where those risks could affect the company's achievement of its financial performance or outcomes disclosed, taking into account the nature and business of the company and its business strategy.<sup>8</sup>

We believe that most listed entities will have some material ESG risks. Effective ESG disclosure should:

- identify the environmental and social issues that may have a material impact on the company's value over the short, medium and long term
- provide both data and a supporting narrative explaining why the issue is material and where the material impact occurs in the value chain
- recognise the impact that the company has on stakeholders such as employees, communities, governments, regulators, investors, consumers and suppliers and articulate how the company takes into account the views of its stakeholders

<sup>7</sup> ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th Edition, Recommendation 7.4.

<sup>8</sup> ASIC, *Regulatory Guide 247 'Effective disclosure in an operating and financial review'*, issued 4 March 2013.

- describe policies and procedures for managing the environmental or social impact over the short and long term and demonstrate how policies and procedures are implemented by the company
- include information about how the company evaluates whether its ESG management systems are effective, including performance against metrics and targets.

Companies should update investors regularly throughout the year on material ESG issues in engagement meetings, corporate reporting and on the company’s website.

### Reference guides

ESG issues are generally company or industry specific. Every company is expected to have processes for identifying ESG issues relevant to its operations. Some leading frameworks that can help guide companies in the identification of material ESG issues for management and reporting include:

- Global Reporting Initiative’s *Sustainability Reporting Standards*
- International Integrated Reporting Council’s (IIRC) *International <IR> framework* for integrated corporate reporting
- guides prepared by the United Nations’ *Global Compact Network Australia*, the *Sustainability Accounting Standards Board*, the *Principles for Responsible Investment*
- the *OECD Guidelines for Multinational Enterprises*
- the *Sustainable Development Goals*
- ACSI and the Financial Services Council’s *ESG Reporting Guide for Companies 2015*.

On the pages that follow, we discuss four ESG issues that impact the majority of ASX200 companies. The issues are not dealt with comprehensively and are included in these Guidelines by way of example. The issues are:

	Climate change
	Workforce and human rights
	Corporate culture
	Tax practice.

### 5.3. CLIMATE CHANGE

In late 2015, Australia, along with nearly 200 other countries, signed up to the Paris Agreement, which sets out the goal of limiting global warming to well below 2°C and moving towards 1.5 °C, which will require a shift to net zero emissions by 2050.

We believe a planned transition to a low carbon economy is preferable to a disorderly transition on the basis that a planned transition will result in better economic outcomes, is better able to take account of the needs of various stakeholders, and better manage uncertainty and volatility.

Financial system participants and regulators around the world have acknowledged the significant financial risks associated with climate change.<sup>9</sup> There is an expectation that boards should consider the risks associated with climate change and form a view on the materiality of these risks for the company.

#### Sources of investment risk and opportunity

Climate change presents financial risks and opportunities for business and investors. There are physical risks and opportunities, associated with rising mean global temperatures, rising sea levels and increased severity of extreme weather events, and transitional risks and opportunities as the economy adjusts to a lower carbon future.

Examples of climate change risks and opportunities	Potential financial impacts
Regulatory: standards, taxes, carbon pricing.	Increased operating costs, write-offs and early retirement of assets due to policy change, impaired assets, increased insurance premiums.
Technology: substitution of existing products and services with lower emissions options.	Impairments and early retirement of existing assets, upfront capital investments in technology development.
Market: changing consumer preferences and changing capital flows.	Reduced demand for high carbon intensive products with decreasing capital availability; increased demand for low-carbon intensity products, with increasing capital availability.
Reputation: increased stakeholder concern or negative stakeholder feedback.	Board and management attention diverted from operational activities to respond.
Physical: extreme weather events, rising sea levels.	Physical damage to assets, insurability, impact on economic growth and markets.

<sup>9</sup> For example, the Network for Greening the Financial System 'Climate Change as a source of financial risk' April 2019; Australian Prudential Regulation Authority 'Information Paper: Climate Change: Awareness to Action' March 2019; Australian Securities and Investments Commission 'Climate Risk disclosure by Australian listed companies' Sept 2018; Mark Carney, Governor, Bank of England Speech: 'A new Horizon' March 2019; Dr Guy Debelle; Deputy Governor Reserve Bank of Australia Speech 'Climate Change and the Economy' March 2019

## Our expectations

We expect to understand whether a company can:

- successfully identify and manage the climate change risks and opportunities it faces
- demonstrate future viability and resilience by testing business strategy against a range of plausible but divergent climate futures, including at a minimum: a Paris-aligned scenario and a scenario equivalent to the IPCC's Representative Concentration Pathway (RCP) 8.5 physical risk scenario
- achieve cost savings through efficiencies and identify low carbon opportunities.

We recommend the risk assessment and reporting framework in the Financial Stability Board's *Taskforce on Climate-related Financial Disclosure* (TCFD). The TCFD recommends companies disclose their governance and risk management processes for identifying, assessing and managing climate-related risks and opportunities.

Where companies identify climate change risks as material, disclosures should extend to discussing the strategy, as well as metrics and targets, used to manage the risk. The TCFD also recommends that companies consider describing how related performance metrics are incorporated into remuneration policies.

We expect companies materially exposed to climate change risk to make substantive climate-related disclosures, by reference to the TCFD recommended disclosures.

The table below is extracted from the TCFD recommended disclosures from June 2017:

Climate risk management themes	TCFD recommended disclosures
Governance	Describe the board's oversight of climate-related risks and opportunities. Describe management's role in assessing and managing climate-related risks and opportunities.
Strategy*	Describe the climate-related risks and opportunities the company has identified over the short, medium and long term. Describe the impact of climate-related risks and opportunities on the company's business, strategy and financial planning. Describe the resilience of the company's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.
Risk Management	Describe the company's process for identifying and assessing climate-related risks. Describe the company's processes for managing climate-related risks. Describe how processes for identifying, assessing and managing climate-related risks are integrated into the company's overall risk management.
Metrics and targets*	Describe the metrics used by the company to assess climate-related risks and opportunities in line with its strategy and risk management process. Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas emissions, and related risks. Describe the targets used by the company to manage climate-related risks and opportunities and performance against targets.

\* Subject to a materiality assessment

Where companies are members of industry associations that advocate on climate change, we expect companies to regularly compare their views with those of the industry associations and disclose the results. We expect

disclosure of any material policy differences (on an issue-by-issue basis) and how the company intends to respond to these differences.

## 5.4. WORKFORCE AND HUMAN RIGHTS

Traditionally, scrutiny of human rights issues has focused on workforce abuses such as discrimination, restrictions on freedom of association, slavery, child labour, trafficking, unfair wages or unacceptably poor or dangerous working conditions.

We expect companies to ensure that their workforce and human rights risks are mitigated, whether in the company's direct operations or in their supply chains.

We encourage companies to recognise other potentially relevant human rights impacts that can arise in complex supply chains such as rights related to displacement and resettlement, the rights of Indigenous peoples, and the right to personal safety and security.

An authoritative list of the core internationally recognised human rights is contained in the [International Bill of Human Rights](#) along with the International Labour Organizations' [Declaration on Fundamental Principles and Rights at Work](#).

We welcome the introduction of a Modern Slavery Act in Australia to require some companies to report on the steps they are taking identify and eradicate slavery from their supply chains. The Act defines modern slavery to include eight types of serious exploitation – trafficking in persons, slavery, servitude, forced marriage, forced labour, debt bondage, the worst forms of child labour and deceptive recruiting for labour or services.

Public reporting will allow investors to consider the relevant risks and influence business action on modern slavery. We expect companies to make disclosures in the spirit of the new Act, in particular to address both the identification of modern slavery risk, along with action to address the risks identified. As reporting progresses, investors will further develop their views on what constitutes meaningful action and disclosure in relation to modern slavery risk.

Our 2019 research '[ESG Reporting by the ASX200](#)' has highlighted deficiencies in safety reporting. In particular, there is no requirement for companies to report workplace fatalities to the market. However, safety data is material to our members. A lack of transparency may mask the extent of tragedies and slow the identification of systemic risk. Our view is that good practice safety reporting includes reporting any fatalities to the market.

### Sources of investment risk and opportunity

Examples of human rights risks	Potential financial impacts
Regulatory: standards, laws, exposure to litigation.	Increased costs associated with regulatory compliance; civil penalties, compensation, or criminal sanctions for workforce exploitation and human rights violations.
Operations: allegations of workforce exploitation or human rights abuses; serious injury or loss of life.	Increased chance of operational shut downs or disruptions; board and management attention diverted from operational activities to respond; sub-optimal productivity.
Reputation: greater consumer awareness and concern about workforce exploitation and human rights violations; increased shareholder scrutiny; increased pressure from concerned stakeholders.	Loss of market share as consumers move to purchase products from companies that respect human rights and that have appropriate monitoring systems in place.
Market: growth of global supply chains and Australia's significant economic reliance on imports from countries highly vulnerable to labour exploitation.	Increased likelihood that large companies business' inputs are implicated in forced labour through global supply chains.

## Our expectations

We expect companies to manage material workforce and human rights risks and:

- actively engage with its employees, customers, supply chains and other relevant stakeholders to understand and assess human rights impacts
- avoid causing or contributing to adverse human rights impacts in their own operations and to address such impacts when they occur
- mitigate the risks of adverse human rights impacts in their supply chains and, where possible, use their leverage to address impacts.

We expect companies to disclose material human rights risks and impacts including:

- how the company identifies, prevents, mitigates and accounts for workforce and human rights risks in its operations and supply chains, e.g. its risk assessment process, policies and procedures.
- how the company's due diligence processes are implemented and tested for effectiveness over time. Does the company incorporate the outcomes of its risk assessment in procurement decisions? Are independent third-party audits conducted and, if so, how far down the supply chain?
- if workforce or human rights risks are identified, how does the company respond to address the impacts? What remediation processes are in place?
- what accountability standards does the company have for employees or contractors that fail to meet company standards on workforce and human rights risk management?

For example, disclosures should reference the performance of the company on workplace safety (including any workplace fatalities); modern slavery and supply chains; culture, training and development; workplace diversity and discrimination; labour relations; and whistleblowing and grievance mechanisms.

## Further references

We refer companies to:

- the United Nations [Guiding Principles on Business and Human Rights](#) and the United Nations [Guiding Principles Reporting Framework](#).
- for extractive sector companies, the [Voluntary Principles on Security and Human Rights](#) are also relevant.

## 5.5. CORPORATE CULTURE

History demonstrates that corporate misconduct can have dire consequences for shareholder value. Poor corporate culture can facilitate misconduct, which can adversely affect a company's social licence to operate. In its most extreme form, misconduct can result in bankruptcy. Conversely, a robust corporate culture can contribute to the attraction and retention of talent, the development and maintenance of reputation and trust, as well as supporting the effectiveness and efficiency of operational management. All of these elements can contribute to financial strength and resilience.

### Sources of investment risk and opportunity

Corporate culture presents a set of unique (often intangible) risks and opportunities which can be challenging to identify, manage and measure. With this issue, the destruction of value is easier to demonstrate than the creation of value. Unhealthy corporate cultures can develop within departments or operational 'silos'. If high risk behaviours go unchecked, this can lead to major financial losses.

Policies and processes which influence corporate culture	Potential financial and reputation impacts
Remuneration	Remuneration structures serve to reward what the organisation treats as important and therefore must be aligned with an entity's values, strategy, desired culture and risk appetite. Remuneration structures can create perverse incentives. For example, they can incentivise an excessive drive for sales at the expense of customer outcomes, adversely affecting value over the long-term.
Bribery and corruption	Increased capacity of regulators to track financial transactions and gather electronic information about potentially illegal payments to third party agents or inappropriate payments to government officials has led to a higher level of fines for Australian companies in the United States and Australia. In addition to the regulatory issues, allegations or instances of bribery or corruption cause reputational harm that can adversely affect the long-term value for investors.
Whistle-blowing	Weak whistle-blowing processes mean that early detection of inappropriate corporate behavior may not occur and instead inappropriate behavior persists.

### Our expectations

We expect companies to:

- articulate and disclose their values to assist in setting the tone for behavioural expectations of employees, contractors, suppliers and other partners
- encourage a 'speak-up' culture where boards, executives, managers and employees raise concerns such that there is robust decision-making and corrective management steps where poor behaviours are detected and effectively addressed
- encourage a 'no blame' culture supported by the board and the CEO, where it is 'safe' to make mistakes and where the organisation is quick to learn.

Importantly:

- The board and senior management set the tone from the top and should monitor the drivers that shape culture and seek insights into how culture is aligned to the

organisation's values. The board should oversee regular assessments of corporate culture to identify any issues or opportunities and take action accordingly. The board should take into account a wide range of measures in overseeing culture, including external inputs.

- When selecting a CEO, sufficient weight should be given to the CEO's capacity to deliver a strong culture.
- Companies should make meaningful disclosures in relation to corporate culture, for example in relation to culture assessments, action taken to promote compliance with corporate values and codes of conduct, and any material breaches and accompanying action.
- Companies should explain and disclose relevant metrics that demonstrate how they perform in managing the company's culture. These will naturally differ from company to company but may include measures of employee and customer satisfaction levels, turnover, absenteeism and regulatory and compliance measures. External and objective measures should be included.



## Codes of Conduct

Companies should have a code of conduct that is tailored to the risks faced by the business. Companies should invest adequate resources into training staff and communicating about the code of conduct, to ensure that material risks are effectively managed and performance is measured.

As the business evolves, the risks included in the code and training should be revised.

Codes of conduct should be regularly reviewed, use examples, 'question and answers' or case studies and cover key topics including equal opportunity/non-discrimination, safety, gifts, environment, bribery, fraud/corruption; conflict of interest, bullying, human rights, anti-competition/anti-trust/ anti money laundering/ counter-terrorism finance; data protection/cybercrime and fair dealing/product responsibility.

## Bribery and corruption

Companies should have and disclose an anti-bribery and corruption policy that ensures that the board or a committee of the board is informed of breaches of the policy.

Disclosure should include action taken to promote compliance and whether there have been material breaches of the policy, and how they have been addressed.

For guidance and suggestions for the content of a policy, we refer to the ICGN's [Guidance on Anti-Corruption Practices](#) and the ASX Corporate Governance Principles and Recommendations (Recommendation 3.4).

## Whistleblower processes

Companies should have and disclose a whistleblower policy incorporating an independent, confidential mechanism whereby an employee, supplier or other stakeholder can raise (without fear of retribution) instances of potential or suspected breaches of the company's code of ethics or relevant law, including on an anonymous basis.

Companies should design processes to investigate concerns raised by whistleblowers and take disciplinary action where appropriate. The focus should be to encourage a pro-disclosure culture with robust internal reporting.

## 5.6. TAX PRACTICES

In a global economic landscape, the issue of adopting aggressive tax planning strategies has become a key focus area for governments, international regulators and civil society.

### Sources of investment risk

An aggressive corporate approach to tax planning is a concern for long-term investors as it has the potential to:

- create earnings risks and lead to governance problems
- damage reputation and brand value
- cause macroeconomic and societal distortions.

### Our expectations

Investors benefit from an enhanced level of corporate income tax-related disclosure addressing tax policy, governance and risk management, and performance. We encourage companies to adopt the Board of Taxation's Voluntary Tax Transparency Code.

Comprehensive disclosure about tax practices include:

- disclosure of a tax policy signed by board-level representatives outlining the company's approach to taxation and how this approach is aligned with its business and sustainability strategy
- evidence of tax governance as part of the risk oversight mandate of the board and management of the tax policy and related risks
- details of tax strategies, tax-related risks, inter-company debt balances, material tax incentives, detail on any gap between the effective tax rate and the statutory tax rate, country-by-country activities and current disputes with tax authorities.

### References

We refer companies to the PRI's *Investors' recommendations on corporate income tax disclosures* for elaboration on the above points.

# 6. FINANCIAL INTEGRITY

Companies must provide an accurate and true representation of their financial management, performance and reporting in line with relevant legal and accounting standards.

As Justice Middleton held in the *Centro Case*:

*All directors must carefully read and understand financial statements before they form the opinions which are to be expressed in the declaration required... Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director.*<sup>10</sup>

The audit committee and auditors execute many of the responsibilities regarding financial integrity. However, the full board remains ultimately responsible for the oversight of a company's financial integrity. Where there is a material failure in oversight of financial integrity, we will consider recommending a vote against the re-election of relevant directors.

## 6.1. AUDIT COMMITTEE

### Role

The audit committee's role is to assist the board to discharge its responsibilities in connection with the financial management, performance and financial reporting of the company.

### Composition

Our composition requirements include:

- ensuring adequate technical expertise to maintain diligent independent oversight and scrutiny
- all audit committee members be independent directors, notwithstanding that the ASX Corporate Governance Principles require only a majority of the audit committee members be independent directors

- ensuring discussions with external and internal auditors can occur without executives and executive directors present.

## 6.2. AUDITOR RESPONSIBILITIES

Auditors play a key role in assisting the audit committee to discharge its responsibilities and so must meet appropriate, ongoing competency requirements established by the audit committee.

Auditors must provide reports of their activities to the audit committee and must be present at AGMs to answer shareholders' questions.

## 6.3. AUDITOR INDEPENDENCE

### General requirement

External auditors (including the firm and individual members of the audit team) must be, and be perceived to be, independent of the company (including its directors and executives as individuals).

To be independent, there should be no significant financial, business or employment relationship (defined below) between the company and the audit partner or the audit firm:

- financial relationships arise where the auditor:
  - directly invests in the company
  - has a material indirect investment in the company
  - is involved in loans to or from the company.
- business relationships arise where the auditor has a business relationship with the company that is not insignificant to the auditor
- employment relationships arise where the company employs:
  - current or former partners or employees of an auditor
  - an immediate family member of one of the auditors who can affect the audit.

The law requires auditors to provide an annual statement of independence detailing whether there were any circumstances that may affect independence. If there are such circumstances, an assurance should be provided that the audit has not been materially compromised.

<sup>10</sup>ASIC v Healey & Ors [2011] FCA 717.

## Non-audit services

An audit firm can provide a limited range of non-auditing services. The law requires listed companies to disclose fees paid to an audit firm for non-audit services and the level and nature of the non-audit services performed. Auditors must provide reports to the audit committee outlining the provision and quantum of non-audit services. The audit committee must approve these.

The ratio of audit to non-audit fees is a useful metric in assessing whether the provision of non-auditing services affects independence. Boards should ensure that this ratio always remains low to reduce potential, or perceived, conflicts of interest. Where the amount paid for non-audit services is persistently higher than 50 per cent of the total fees paid to the auditor, we expect the board to explain why this is the case. We will consider these issues when recommending on the re-election of audit committee members.

Some non-audit services should never be provided as they may compromise independence. These include:

- preparing accounting records and financial statements
- valuation services
- internal audit services
- strategic taxation advice
- services that may result in the situation where the auditor is required to audit its own work.

## Familiarity and rotation

Signing audit partners must be rotated every five years in accordance with the law. If boards decide to extend the audit partner's tenure, they should disclose their reasons for doing so.

Companies should rotate audit firms every 10 to 12 years. If the board decides not to rotate audit firms, they should disclose their reasons for not doing so.

# 7. CAPITAL STRUCTURE AND SHAREHOLDER RIGHTS

Major equity capital raisings, share buybacks and mergers and acquisitions have the potential to inequitably transfer or destroy shareholder value. They may also increase the potential for conflicts of interests between shareholders and company executives or their advisers.

It is the board's responsibility to exercise independent judgement to ensure that these major transactions are conducted in accordance with existing shareholders' interests.

## 7.1. CAPITAL RAISINGS

The board must maintain effective oversight of management and external advisers in equity capital raisings to ensure they are conducted in the best interests of shareholders.

The board should seek to minimise the costs of raising new equity, and to ensure that the fees paid to advisers, including investment banks and underwriters, reflect the actual value delivered and the risks incurred.<sup>11</sup>

We provide the following guidance to boards on oversight of capital raisings.

### Respecting existing shareholders' interests

Equity capital raisings have the potential to dilute shareholders' investments. As such, companies should respect the interests of existing shareholders by endeavouring to raise new equity capital in such a way that all existing shareholders have an opportunity to maintain their interest, or be compensated for the dilution of their interest. We consider that a renounceable rights issue (also known as an entitlement offer) best meets this requirement.

### Non pro-rata capital raisings

Where it is not practical to raise capital on a pro-rata basis, the participation of existing shareholders in any capital raising should be prioritised. Where equity capital is allocated without regard to existing shareholders' interests (or where no compensation has been offered for dilution, as in the case of a non-renounceable entitlement offer) companies should provide disclosure to the market of:

- how the board oversaw the capital-raising process
- how the capital raised was priced
- why it was necessary to disregard the interests of existing shareholders
- the identity of advisers and underwriters
- the fees paid to advisers and underwriters
- any differential in the fees paid to underwriters and those paid to sub-underwriters.

<sup>11</sup> ACSI's 2014 research report *Underwriting of Rights Issues* provides further guidance for boards on underwriting fees. Company directors "should understand the model used by the underwriter to determine its fee, the assumptions that go into this model and whether the premium (if any) is appropriate. Directors should also be aware that previous research has suggested that past relationships with underwriters are associated with higher premiums and, so, should consider offering others the opportunity to tender for underwriting" (p. 6).

## ASSESSING CAPITAL RAISING PROPOSALS

Companies should respect the interests of existing shareholders by raising new equity capital in such a way that all existing shareholders have an opportunity to maintain their interest, or be compensated for the dilution of their interest. Boards play a critical role in the governance of capital-raising processes.

Where companies seek approval for non pro-rata capital raisings, we will consider a range of issues including:

- the board's oversight of the capital-raising process to ensure existing shareholders' interests are considered
- the context and reason for the non pro-rata capital raising, particularly the need to raise capital quickly
- the ability for existing shareholders to participate in the raising process
- the price paid by subscribers and the dilution caused by the capital-raising process.

Where capital raisings, such as selective placements, do not adequately respect existing shareholders' interests, we will generally recommend voting against the capital raising in the post-facto approval process. Selective placements are unfair and dilutive to non-participating shareholders, and there is no regulatory limit on the discounts at which shares may be issued.

Where an unfair and dilutive capital raising is not put up for shareholder approval at a shareholder meeting, we will generally recommend voting against the directors present at the time the placement was agreed.

## 7.2. SHARE BUYBACKS

Similarly to capital raisings, the board must maintain effective oversight of management and external advisers to ensure any buyback is conducted in the best interests of shareholders.

Companies should generally conduct pro-rata buybacks where shareholders' ability to participate in the buyback is directly proportional to their shareholding. Where a selective buyback is proposed, the Corporations Act requires approval by special resolution of shareholders not involved in selling shares (or their associates).

## ASSESSING SELECTIVE BUYBACKS

We will evaluate whether the buyback is in the interests of shareholders not involved in selling shares. In doing so, we will consider:

- the board's oversight of the buyback to ensure all shareholders' interests are considered
- the purpose of the buyback, and whether there are valid reasons why a pro-rata buyback could not achieve that purpose
- the value of the benefit: the premium to the market price being offered to the buyback participant(s), including the potential value of franking credits.

## 7.3. MERGERS AND ACQUISITIONS

Mergers and acquisitions (M&A) have the potential to destroy shareholder value. During M&A activity, there is an increased potential for misalignment between the interests of shareholders and executives, and between shareholders and advisers.

The board is responsible for managing these possible conflicts and ensuring that executives and advisers always act in the interests of shareholders.

### Board oversight of mergers and acquisitions

The board plays a critical role during M&A activity. Accordingly, the board should establish appropriate protocols that set out the procedure to be followed if there is an offer for the company including any communication between insiders and the bidder. These protocols should

include the option of establishing an independent takeover committee, its likely composition and implementation.

The establishment of an independent takeovers committee, comprised of non-conflicted directors, is critical where the executive management or directors are involved with a bidding party in a takeover.

### Transaction structures which disenfranchise shareholders

A merger should not be structured in a way which unduly disenfranchises the shareholders of one of the entities. The starting presumption is that existing shareholders will be able to vote on any company-changing transactions, particularly in cases where they will become a minority holder of the merged entity.

## WHEN MAKING VOTING RECOMMENDATIONS RELATING TO M&A ACTIVITY

We will evaluate whether the transaction is in the interests of all shareholders. In assessing the governance issues related to the M&A activity (such as a takeover or scheme of arrangement), we will consider:

- the process followed by the board to arrive at the proposal including consideration of alternative transactions.
- the risks associated with the transaction
- the governance of the proposed merged entity, including board representation, the proposed executive team, management structures and any control implications

- the proposed benefits to shareholders under the transaction, assessed against the likely consequences of the transaction being rejected
- the management of related-party risks, including any benefit accruing to related parties.
- any other issue relevant to the particular transaction.

Where shareholders do not have the opportunity to vote on an acquisition (a reverse takeover), we will consider recommending a vote against the re-election of directors who decided to commence the reverse takeover.

## 7.4. DISCLOSURE OF TRADING AND VOTING RIGHTS IN COMPANY SHARES

A company should disclose its policy on trading and voting in company securities by directors, officers and employees. The policy should set out:

- the rules that apply to directors and senior executives who enter into margin loans over the company's shares
- the requirements that such loans be made known to the company
- the policy of the company towards the disclosure of such loans to the market where the holdings or exposures are material.

In addition to any applicable regulatory requirements, we consider that disclosure should extend to:

- where shares are purchased on market to fund employee share schemes, the cash costs of these transactions should be provided within the company's cash flow statement as an operating cost
- companies disclosing on their website information about beneficial holding details (when they are obtained) within two days of receiving the information. This complements the statutory requirement for companies to make the information publicly accessible

- the board disclosing directors' and senior executives' (including the CEO's) share trading within two days
- the policies which restrict the times directors may trade shares to specific 'trading windows'. We generally support an approach that would include:
  - a director not dealing in any securities of a listed company during a 'closed period', which is a period of:
    - two months immediately preceding the preliminary announcement of the company's annual results
    - two months prior to announcement of half yearly reports
    - one month prior to announcement of quarterly results
  - a director dealing outside the closed period following receipt of clearance by the board.
  - a director not directly, or indirectly, applying to buy or sell shares of another company about which they have price-sensitive information arising from their directorship of the company.



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