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Governance Guidelines

A guide to investor expectations of listed Australian companies

December 2021

About ACSI

Established in 2001, ACSI exists to provide a strong voice on financially material environmental, social and governance (ESG) issues.

Our members include 34 Australian and international asset owners and institutional investors with over $1trillion in funds under management. Our members believe that ESG risks and opportunities have a material impact on investment outcomes.

Through research, engagement, advocacy and voting recommendations, ACSI supports members in exercising active ownership to strengthen investment outcomes. Active ownership allows institutional investors to enhance the long-term value of retirement savings entrusted to them to manage.

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.

Voting advice

We provide our members with voting recommendations that are consistent with the principles set out in these Guidelines. In determining our voting recommendations we take into account our engagement work, and consider the issues as they apply to each company on a case-by-case basis. Our advice is developed independently from our members.

Policy and 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 independently exercise their ownership rights.

Further details about us, our publications, policy positions and membership are available on our website at www.acsi.org.au.

Acknowledgement of Country

We acknowledge and respect the traditional lands and cultures of First Nations people in Australia and globally. We pay our respects to Elders past and present, and recognise First Nations peoples' longstanding and ongoing spiritual connections to land, sea, community and Country. Appreciation and respect for the rights and cultural heritage of First Nations peoples is essential to the advancement of our societies and our common humanity.

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Introduction

The purpose of ACSI's Governance Guidelines ('Guidelines') is to articulate the issues that we focus on in our engagement with companies, and the factors we take into consideration when determining our voting recommendations.

Constructively engaging with business is one way our members work to maximise investment outcomes for their beneficiaries.

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.

While the Guidelines are divided into sections, many areas of risk and opportunity are interconnected. We therefore encourage companies to consider their environmental, social and governance practices holistically. 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.[1]"

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.

> 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 how to independently 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 license 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. ACSI has over 300 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 recommendations, 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. Depending on circumstances, there may also be other factors that we take into account when exercising our judgement on how the Guidelines are applied, when determining specific recommendations. These factors are set out in our research and recommendations, so that subscribers can take them into account when determining their voting position.

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.
- We provide a copy of our voting advice free of charge to companies at the same time as we distribute 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:

- Principles for Responsible Investment (PRI)
- 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?

The updates in this tenth edition of the Guidelines are in response to issues we see across the market or observations made through company engagements.

As generally accepted principles of good governance have progressed since the early editions of the Guidelines, in this version we have removed some of the detail about principles that are now well accepted and adhered to. We continue to support foundational principles of good governance, widely accepted principles of good governance can be found elsewhere including in the ASX Listing Rules and the ASX Corporate Governance Council's Principles and Recommendations.

The themes underpinning the key updates to the Guidelines are outlined below:

Climate change

We have reflected ACSI's Climate Change Policy, adopted in 2021, as well as information on how the Policy will guide our voting recommendations.

Engagement with First Nations people

We have included information on how companies can engage with First Nations people to respect rights and protect cultural heritage. Our focus is on the development of long-term constructive relationships between companies and First Nations people.

Modern slavery

Now that the first round of reporting under the Modern Slavery Act is complete, there is a clearer understanding of better practices and disclosure on modern slavery risk management. We have therefore included guidance on meaningful action and disclosure in relation to modern slavery.

Human rights

We have clarified expectations related to human rights due diligence and noted the importance of companies appropriately managing human rights risks.

Labour rights and precarious workforces

We have outlined the risks related to casual and precarious workforces and updated our guidance on disclosure and risk management processes.

Safety

ACSI continues to see wide variations in safety reporting among relevant companies, so we have provided more specific information on the indicators upon which companies should report. We have also noted the importance of companies considering mental health as part of workforce safety.

Sexual harassment and racial discrimination

We have included expectations that companies proactively prevent and respond effectively to sexual harassment, racism and other forms of discrimination.

Gender diversity at management level

We have included expectations that companies are advancing gender diversity at management level.

1. Director responsibilities

The role 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. We expect directors to explain why their company's approach to governance is the most suitable in the circumstances.

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 renewal of non-executive directors must, therefore, be aligned and relevant to company strategy.

Directors must be adequately informed about key business issues and properly equipped to oversee management's delivery of the company strategy. Boards should have sufficient training and adequate expertise on a given subject area, or access to the necessary expertise, commensurate to the level of risk for the company.

A board should be able to demonstrate how it is guiding innovation and considering emerging material risks and opportunities. These could relate to, for example, digital technologies and cyber security, biodiversity, and the circular economy.

Directors are elected by shareholders to act in the best interests of the company and should be responsive to the interests of diverse stakeholders. 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.[2]"

We therefore believe that the best interests of a company are served by directors making decisions that emphasise long-term financial sustainability. Proper management of ESG risks and opportunities is key to achieving this.

In addition to the guidance set out in this section, we also expect companies to follow the ASX Corporate Governance Principles and Recommendations.

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.

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.

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.

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.[3]"

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.[4]"

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 regular 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 and other disclosure obligations; and
- involvement and participation in board subcommittees.

Box 1.1: Assessing director election or re-election proposals

When we formulate recommendations on director election or re-election proposals, we consider factors relating to the performance and accountability of the individual candidate and the performance of the company.

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 and responsiveness to material 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 and company performance
- progress on the board's diversity
- progress on the company's management of material climate-related risk; and
- 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, including management of material risks
- 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; and
- 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 based on an assessment of the likely best outcome for the company.

1.2 Promoting good governance

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

- develop and maintain a publicly-disclosed charter, or code, on governance and ethics
- ensure that risks are properly and regularly identified and managed 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 does not include any features or proposed changes that may diminish or impinge upon the rights of shareholders; and
- provide opportunities for shareholder engagement at regular intervals throughout the year, not only at Annual General Meetings (AGMs), and adequately address shareholder questions.

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 will 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 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; and
- 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.

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.

The chair should be selected from the pool of independent non-executive directors on the board. The roles of chair, CEO and executive director should be separated to avoid a concentration of power. 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.

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:

- limit the number of other board and chair positions held by the chair
- consider any other commitments that may compromise the chair's capacity to fully engage in periods of high workload (such as significant corporate action); and
- we will consider, on a case-by-case basis, the capacity of a chair to fulfill their role, taking into account competing commitments.

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 management of all material risks. Our focus is ensuring that the board has effective oversight of ESG risks and opportunities. Companies should demonstrate alignment across risk appetite, risk monitoring, and risk and other outcomes. 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.

In interpreting 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.

2.1 Independence

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. A person who is regarded as an independent non-executive director is expected to be able to make decisions in a manner that is independent of management and free of any business (or other) relationships that could materially interfere with their judgement.

Assessment of independence

ACSI recognises 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 automatically be considered 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.

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.

As a guide, the following table outlines some circumstances where directors could be considered to be affiliated and non-independent. The table is not exhaustive. We evaluate each factor on a case-by-case basis.

Box 2.1: Assessing independence

Relevant relationships and activities	Factors that may compromise independence
Relationship to executives and advisers	Employment within the company in the past three years
	Senior employment by a significant professional adviser in the past three years
	Concurrent service between a non-executive director and executive or adviser.
Relationship to substantial shareholders	Ownership of more than five per cent of the voting rights in the company's shares.
	Being, or having been, an officer, director, representative or employee of such a shareholder
Relationship to customers, suppliers and other service providers	Being a major supplier or customer to the company (or their representative or executive).
	Having a material contractual relationship with the company
	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.
Relationships which may impact decision-making	Relationships (including other directorships past or present).
	Benefiting from a related-party transaction.
Incentive pay	Participation in performance incentive schemes, including options that are also granted to executives.
Relationship with a related-party	Being a spouse, de facto spouse, parent or child of affiliated directors, executive directors, senior executives or advisers.
Participation in a takeover bid	Participating in the bid for the counterparty (either as buyer or seller).
Length of tenure	Where the director has served for a significant period on the board, independence may be affected, although not necessarily in all cases. Many boards consider the impact on independence where a director has served a period of 10 years or more (also reflected in the ASX Corporate Governance Council's Principles and Recommendations). We will consider individual tenure in light of broader board renewal.

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 significant contributions.

To provide evidence that all shareholder interests are considered, we expect that boards clearly articulate the checks and balances in place.

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:

- Gender
- Age
- Education & professional experience
- Ethnicity
- Overall board tenure

We encourage companies to disclose how they take all facets of diversity into account, along with information on the diversity of the board (across all areas).

Gender Diversity

We strongly support efforts to improve gender diversity on boards and in management teams.

We expect that no gender occupies more than 70 per cent of board positions in an ASX-listed company. In addition, companies should set a timeframe within which they will achieve gender balance (40:40:20)[5] on their boards.

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

ACSI encourages companies to advance gender diversity at executive level and to disclose the actions that they are taking to achieve this, by:

- Pledging to achieve gender balance (40:40:20) in executive leadership by 2030.
- Declaring measurable medium and long-term gender targets for 2023 and 2027.
- Making the plan public.
- Reporting annually on performance against targets.

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

2.3 Board process

Board Evaluation

A process for evaluating the board should be established, as per recommendation 1.6 in the ASX Corporate Governance Principles and Recommendations. In addition to the elements in this recommendation, the evaluation should also assess the board's performance in managing corporate culture, as well as shareholder and stakeholder expectations.

Director skills and performance assessment

The assessment of director skills and performance should:

- 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; and
- be communicated to shareholders.

Board succession

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.

Boards should 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
- 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.
- There should be sufficient overlap in director succession so that gaps in skills, experience, subject matter expertise or corporate memory do not occur.

Length of service as a director

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

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.

In general, the following expectations apply:

- A committee should be a reasonable size taking into account the size 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 board should be sensitive to the votes and interests of the non-controlling shareholders, particularly where there is significant misalignment between the controlling shareholder and other shareholders.

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.

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 pay parity, monitor for discriminatory pay practices and meaningfully disclose findings and action taken.

We support disclosure of the CEO's pay ratio to that of their Australian workforce's median, 25th and 75th 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. We 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.

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. 'Non-financial' targets should be appropriately weighted to reflect the range of matters that are important to an entity's long-term success, including the entity's strategy, risks, opportunities and priorities.

Weaknesses in the management of ESG factors have clear financial impacts and present financially material risks. We are therefore not convinced by the term 'non-financial measures' to describe ESG factors. Nonetheless, we use the term because it is the generally understood terminology.

As ASIC has stated:

> "Boards cannot afford to ignore the oversight of non-financial risks. As we have seen, all risk can have financial consequences. If not well managed, non-financial risks carry very real financial implications for companies, their investors and customers.[6]"

Binding vote on pay

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.

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.

Fixed remuneration

Once the amount is set, fixed remuneration is paid without a direct link to individual or company performance. 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, deferred equity or a combination of both) 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; and
- how the variable pay component(s) align with the company's strategy and values and the interests of long-term investors.

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.

Box 3.1A: 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: Persistently high variable remuneration outcomes imply either performance hurdles are not sufficiently demanding or the board is reluctant to use its discretion. We encourage the board to apply discretion in pay outcomes 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, performance against 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: 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. 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. Longer performance periods are encouraged.
- Use of financials 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.
- Minimum shareholding requirements: We support minimum shareholding requirements for executives that are meaningful and proportionate to remuneration received.
- 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(including what was foregone at their previous employer), the weighting of the grant to long-term performance-based components, and the quantum of the grant.
- 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. We will consider recommending against the election of relevant directors where a company circumvents the views of the majority of its shareholders in this way.
- 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.
- Consequence management: In addition to potential termination, executives' pay outcomes should be subject to forfeiture or reduction if there are material failures in the executive's areas of responsibility. This should include the management of risks related to culture, conduct and reputation, among others

Box 3.1B: 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; and
- measures such as relative TSR where vesting commences when performance is below the median percentile of the company's peers.

Box 3.1C: Assessing termination pay resolutions

Termination payments are a cost to the company. The board should therefore seek to limit 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.

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.

ACSI will generally oppose termination payment resolutions where approval is not sought for a specific period of time (typically 3-4 years).

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 circumstance.

Two strikes

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 in holding 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.

Box 3.1D: 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, noting that holdings may vary based on individual circumstances. 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.

The board should justify why remuneration is fair and commercially reasonable having regard to company performance, and be able to explain, in plain language, why particular remuneration metrics were considered suitable.

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.

We support the use of technology to improve shareholders' access to AGMs. ACSI supports a hybrid model for AGMs, whereby participants have the option to attend in-person or virtually. The use of technology should not compromise shareholders' ability to actively participate in AGMs.

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.

We are guided by the core principle that shareholders should not have to meet unduly difficult thresholds to call general meetings, propose resolutions or otherwise exercise their shareholder rights.

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 award of securities to a director, unless it is under a bona fide salary sacrifice arrangement from a director's fixed remuneration
- all substantive items of business being decided by poll
- procedures to ensure votes are properly counted and recorded; and
- ASX-listed companies domiciled outside of Australia voluntarily submitting resolutions for a shareholder vote in alignment with the requirements for Australian domiciled companies.

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 having reasonable access to minutes of general meetings
- detailed announcements of results within 24 hours of the closure of the meeting; and
- 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 will consider recommending against the re-election of the chair or any non-executive directors as appropriate.

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 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.

Box 4.3: 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.

Resolutions should be linked to improved governance or transparency within the company and promote effective management of risk over the long-term. We will consider 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 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.

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.

When assessing resolutions, we will take into account any communication and commitments made by the company through engagement.

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 communities, consumers, employees, governments, investors, regulators, and suppliers, and that acting in the best interests of the company over the long-term requires considering a range of interests
- 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. For example, whether the board receives regular briefings or advice from internal and external topic experts and whether 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; and
- ensure the company has effective oversight and management systems in place for environmental, social and governance issues. For example, audit and performance assessment systems, as well as appropriate remuneration incentives.

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.

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.[7] 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.[8]

Effective ESG disclosure should:

- identify the environmental, social and governance 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 company's impact on stakeholders and articulate how the company takes into account the views and interests of its stakeholders
- describe policies and procedures for managing environmental or social impact over the short and long term and demonstrate how policies and procedures are implemented
- include information about how the company evaluates whether its ESG management systems are effective, including performance against metrics and targets.

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
- The Value Reporting Foundation's International Integrated Reporting Framework
- 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

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

Unmitigated climate change would have catastrophic impacts across the globe, including impacts on human health, biodiversity, water availability, and disruption of ecosystems. Climate change therefore presents significant financial risk to the global economy. In order to mitigate the impacts of climate change on investment portfolios, and the financial system as a whole, ACSI supports the Paris Agreement aim of limiting global warming to 1.5 °C which will require a shift to net zero emissions by 2050.

Sources of investment risk and opportunity

Climate change presents financial risks and opportunities for business and investors.[9] There are physical risks 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.

Financial system participants and regulators around the world have acknowledged the significant and systemic financial risks associated with climate change.[10] The risks are deeply embedded across the financial system and therefore will influence the value of our members' investments. The economic transition is underway and is accelerating.

Our expectations on climate change

Integrating climate-related risk into investment decisions requires materially exposed companies to set their strategy to adapt to a low-carbon future. This includes a company identifying climate risks and opportunities, assessing the materiality of these risks for the company, and demonstrating how they are integrated into its governance, strategy and risk management processes.

Diverse companies and sectors will need to take differentiated approaches to managing climate risk, and ACSI does not specify pathways for company responses. Instead we focus on how a company communicates to investors that its pathway is credible and Paris-aligned. We expect companies' responses to be informed by a science-based assessment of the carbon constraints required to avoid dangerous climate change.

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.

Where companies face material climate-related risks, we expect companies to adopt the risk assessment and reporting framework in the Financial Stability Board's Taskforce on Climate-related Financial Disclosure (TCFD) and make substantive climate-related disclosures according to this framework.

ACSI expects companies to demonstrate how they are integrating these risks and opportunities into their governance, strategy and risk management processes.

For more detail on ACSI's approach to climate risk and expectations of companies, please see ACSI's Climate Change Policy.

The table below outlines the standards that we expect relevant companies to be meeting or demonstrating concrete progress towards meeting.

Box 5.1: Assessing climate risk management

ACSI analyses companies' disclosure and management of climate change across the following seven core principles, which are drawn from ACSI's Climate Change Policy:

- **TCFD disclosure**: whether the company has adopted the Task Force on Climate-related Financial Disclosures (TCFD) risk assessment and reporting framework. In line with TCFD, this includes whether the company has effective board oversight and governance structures to manage climate risk, and whether it discloses its trends in Scope 1, 2 and 3 emissions.
- **Alignment of corporate strategy**: whether the company's corporate strategy is aligned with the Paris Agreement and net zero emissions by 2050. These standards should be integrated into capital-allocation decisions, financial reporting and, where appropriate, remuneration practices. A company should disclose its roadmap and long-term strategy, including key levers and annual disclosure of progress.
- **Scenario analysis:** whether the company stress-tests its portfolio and strategy resilience against a range of plausible but divergent climate futures, including a Paris-aligned 1.5°C scenario and physical-risk scenarios based on current warming trajectories. A company should disclose the key assumptions and signposts used, as well as both qualitative and quantitative disclosure of impacts.
- **Paris-aligned targets**: whether the company has set short, medium and long-term emissions-reduction targets aligned to Paris Agreement. This may include investing in partnerships, research and development, or other areas to address material risks.
- **Physical risk management**: whether the company undertakes analysis of physical risks to portfolio assets. Assessment should be detailed and include asset-level and/or industry-level exposures and resilience plans, including estimated costs.
- **Policy and advocacy activity**: whether the policy and advocacy activity of both the company and the industry associations to which it belongs are consistent with Paris Agreement goals. We expect disclosure of any material policy differences (on an issue-by-issue basis) between a company and its industry associations, and how the company intends to respond to these differences.
- **Planning for equitable transitions**: whether the company incorporates impacts on employees, communities and other stakeholders into transition strategy and planning. This includes whether the company engages effectively with stakeholders and how it discloses the key risks and measures being taken into account to minimise negative impacts.

The list above should not be considered prescriptive or exhaustive, but rather a guide on the types of information that ACSI will take into account. The ways that companies manage climate risks and opportunities will necessarily vary, so the materiality of individual factors will be considered in the context of a specific company, depending on their particular risk and opportunity profile. In assessing companies' approaches, ACSI will consider all elements holistically, exercise informed judgment, and avoid a one-size-fits all or 'tick the box' evaluation.

Our voting recommendations on climate-related risk will take into account qualitative and quantitative factors. ACSI will also integrate the progress a company has made, and compare a company's performance against peers, the sector and best in class examples.

In line with ACSI's Climate Change Policy, where companies consistently fall short of our expectations, ACSI may recommend that our members vote against directors on a case-by-case basis. Our recommendations will focus on the individual directors most accountable for oversight of climate-change related risks, for example company Chairs, and the Chairs of the Risk and Sustainability committees or similar.

ACSI supports the provision of a 'Say on Climate' whereby companies that are materially exposed to climate risk provide investors with an advisory vote on the company's management of climate-related risks and opportunities. A 'Say on Climate' vote facilitates greater transparency, accountability and focus on material risks and opportunities. Providing a vote annually allows investors to express their opinions on a company's ongoing progress against its strategy.

ACSI will apply the principles set out above in determining its recommendations on companies' climate reports, analysing a company's strategic plans and outcomes holistically. Where a company has adopted a 'Say on Climate', this will be the primary focus for ACSI's engagement and analysis. ACSI will assess other shareholder resolutions on a case-by-case basis, taking into account whether they relate to issues that are not already adequately covered by a 'Say on Climate' resolution.

5.4 Workforce and human rights

Human rights

Safeguarding human rights is vital for businesses to build long-term sustainability, as poor practice can expose companies to significant reputational and financial risk. It is widely accepted that companies have a responsibility to respect the human rights of any people they impact, including their workforce, communities, customers and end-users.[11] We expect companies to ensure that their human rights risks are mitigated, whether in the company's direct operations or in their value chains.

Ensuring the protection of human rights also creates opportunities for companies, for example to improve relationships with key stakeholders, reduce the potential for conflict, and create a company culture that attracts talent.

We encourage companies to recognise all relevant human rights impacts that can arise in their operations or value chains. Human rights risks may impact workforces as well as other people, for example through community harm, displacement or undermining the right to personal safety and security. Management of human rights risks should extend to digital risks, including data privacy. Companies should work to ensure that digital tools are not used to suppress, limit or violate rights (e.g. through online harassment, discrimination, censorship or surveillance).

Companies should be particularly sensitive to human rights risks to particularly vulnerable groups (including, for example, Indigenous Peoples, women, children, ethnic and religious minorities). in locations where the domestic legal frameworks inadequately protect human rights. If there is misalignment between local human rights laws or practices and international standards, companies should adhere to international standards at a minimum.

A company's board should oversee and have ultimate accountability for the company's human rights practices. To do so, the board should ensure that it receives sufficient information to be able to assess and manage the risks.

We refer companies to the internationally recognised International Bill of Human Rights, the ILO's Declaration on Fundamental Principles and Rights at Work and the UN Guiding Principles on Business and Human Rights, which clarify how companies should carry out their responsibility to respect human rights.

Modern slavery

Modern slavery occurs all around the world and has a devastating human impact. It also represents a material investment risk because of its potential to undermine shareholder value.

Australia's Modern Slavery Act ('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.

We expect companies to identify modern slavery risk, proactively address the risks identified, and report on their actions and risks across their supply chains.

Effective risk management requires companies to genuinely engage with the issue, and work with suppliers, contractors and partners along the supply chain to identify and respond to modern slavery risk. Public reporting is important because it allows investors to assess their level of investment risk, and also supports investors' compliance with their own obligations under the Modern Slavery Act.

We encourage companies to improve their capacity to identify and respond to modern slavery risk and will be assessing the extent to which modern slavery statements show improvement in companies' year-on-year performance. If there is a gap between reporting and implementation, this can present a significant investment risk.

Sources of investment risk and opportunity

Examples of investment risks related to labour and human rights	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 companies are implicated in forced labour through increasingly global supply chains; increased cost of capital as investment markets continue to understand the risks and integrate them into investment decision-making.

▶ Our expectations on human rights and modern slavery

Each company will face a different set of risks and opportunities, which is why it is important for companies to have robust processes to **identify, prevent, respond, assess and disclose** adverse human rights impacts and modern slavery risk. This should apply in relation to all permanent and casual workforces and throughout the supply chain, regardless of the sector, operational context or structure of the company.

We expect companies to:

- **Avoid causing or contributing** to adverse human rights impacts and modern slavery in their own operations
- **Understand and mitigate the risks** of adverse human rights impacts and modern slavery in their supply chains.

Modern slavery is one specific area of human rights risk. Our expectations apply to modern slavery and all other forms of human rights risk.

In order to effectively manage human rights and modern slavery risks, companies should undertake the actions outlined in the table below.

Effective management of human rights and modern slavery risks	
Identify risks	• **Identify the risks in the company's operations and supply chains** through effective risk assessments, conducted by credible professionals and involving relevant stakeholders and rights-holders. Risk assessments should be reviewed on a regular basis and should be incorporated into decision-making. • Companies should be particularly sensitive to procurement and labour practices that increase the risk of modern slavery, such as complex and long supply chains (e.g. use of several intermediaries or agents) and extreme timeline and price pressures. See also the section below on poor labour standards and precarious workers.
Establish policies and standards	• **Set clear standards through policies** that express commitment to respect rights in a company's operations and supply chain and adhere to international standards.
Take action	• **Implement practices that aim to prevent** adverse human rights and modern slavery impacts. This should include: – an effective human rights due diligence process, – independent third-party audits of the supply chain, – active education and engagement with employees, contractors, customers, suppliers and other relevant stakeholders to ensure understanding of human rights risks and to mitigate the risk of adverse impacts, – ensuring that information and complaints are considered and acted upon at the appropriate level of the company, including escalation of serious risks and complaints to the board where necessary, – engagement with peers and industry associations to improve practices on human rights and modern slavery risk.
Respond to adverse impacts	• **Respond to adverse human rights and modern slavery impacts** by: – ensuring that effective grievance mechanisms are in place to uncover and address complaints. Grievance mechanisms should adhere to the standards set out in the UN Guiding Principles on Business and Human Rights, and must be trusted and accessible for all relevant stakeholders. Companies must carefully ensure that workforce and human rights incidents are dealt with in a way that does not put survivors or other relevant people at risk. – establishing clear accountability mechanisms for employees or contractors if they fail to meet company standards.
Remediate	• **Provide for, or cooperate in, remediation for individuals and communities** that are adversely impacted, where the company has caused or contributed to these impacts.
Evaluate	• **Assess the effectiveness** of the company's actions on a regular basis.

We expect companies to disclose their material risks related to human rights and modern slavery and how the company effectively manages the risks (ie how it complies with the expectations outlined above). A company with better practice is one that transparently report cases of modern slavery discovered in its operations or supply chains (including both direct and indirect suppliers) and how it is addressing them. ACSI supports companies disclosing identified human rights and modern slavery incidents in a way that does not put survivors or other relevant people at risk.

Companies should provide information that goes beyond generic high-level risk factors, such as country and sector risks. It is useful for companies to describe how they may potentially be involved in modern slavery by using the 'cause', 'contribute', 'directly linked' continuum set out in the UN Guiding Principles on Business and Human Rights (or similar language).

Companies should be transparent in relation to their wider workforces, including casual and contracted workers, not only permanent workers.

Disclosure should also include how the company uses and expands its existing leverage with suppliers and other business partners to address modern slavery and human rights risks. Companies should provide meaningful information about consultation with owned or controlled entities and other reporting entities (where relevant).

Further references

We refer companies to the following sources for further information.

On human rights:

- the United Nations Guiding Principles on Business and Human Rights and the United Nations Guiding Principles Reporting Framework provide further detail on how to establish effective policies, due diligence processes, access to remedy, grievance mechanisms and other areas.
- for extractive sector companies, the Voluntary Principles on Security and Human Rights are also relevant.

On modern slavery:

- ACSI research undertaken in 2021, 'Moving from paper to practice: ASX200 reporting under Australia's Modern Slavery Act'

Poor labour standards and precarious workforces

There is growing evidence that poor labour standards can create financial risk to companies, and that a motivated, well-supported workforce can improve business performance.[12] Failure to uphold workforce rights can cause significant damage to a company's reputation, leading to material financial costs. With the rise of informal and increasingly globalised workforces, there are growing risks involved in precarious and casual employment. Certain workers may be more vulnerable and face heightened risks (such as migrant workers).

Insecure workers may face:

- low levels of rights protection
- unacceptably poor or dangerous working conditions
- impediments to collective bargaining
- unfair wages and underpayment; and
- unfair/unprotective contract terms (e.g. through 'sham' contracting).

▶ Our expectations on labour standards and precarious workforces

As with human rights and modern slavery, we expect that companies identify and mitigate risks related to labour rights and precarious workforces. We also expect companies to disclose:

- how the company ensures fair pay and contract terms, safe working conditions, and supports the health and wellbeing of its workers.
- any underpayments discovered, their remediation, and the systems the company has in place to avoid underpayments.

Further references

We refer companies to the following sources for further information.

- ILO Declaration on Fundamental Principles and Rights at Work

Engagement with First Nations people and the protection of cultural heritage

According to international standards, companies have a responsibility to respect the rights and cultural heritage of First Nations people. Failure to do so can carry a significant human and social cost. Companies can face financial costs, through reputational damage, production implications, project delays, litigation, poor retention and engagement of employees, and physical damage where conflict arises.

We expect companies to effectively assess and manage their risk. To do so, companies should engage in good faith and work to build constructive, fair and long-term relationships with First Nations people. For further information on our expectations, see ACSI's Policy on Company Engagement with First Nations people.

Further references

We refer companies to the following sources for further information:

- UN Declaration on the Rights of Indigenous Peoples
- ACSI policy on company engagement with First Nations people.

Safety

There are wide divergences in the safety information disclosed by companies, even among those where it is a more material risk factor. A lack of transparency may mask the extent of workplace harm and slow the identification of systemic risk. Comprehensive reporting by companies helps to demonstrate to investors that they are managing health and safety effectively.

▶ Our expectations on safety

ACSI recommends that:

- Companies immediately disclose any fatal incidents involving employees, contractors, or members of the public, preferably via the ASX Announcements platform. It is also important to provide information on consequence management and improvements that a company has made to its safety culture and framework following a fatal incident.
- Companies disclose leading safety indicators relating to the severity of incidents, illnesses and injuries (both actual and potential) in their annual reports, as this provides information on harm prevention and safety management.
- Companies disclose lost-time injury frequency rate (LTIFR) and total-recordable injury frequency rate (TRIFR).
- When a company uses a safety metric in its variable remuneration structure, it should disclose the safety performance data used for assessing that metric.
- Companies update investors on the status and ultimate outcomes of any investigations (both internal and external), as well as the provision of support to immediate families.

Safety reporting should include both contractors and employees, and distinguish between the two groups.

The safety of a workforce not only relates to workers' physical safety, but also their mental health, and companies should ensure that there is adequate support for employees' psychosocial wellbeing.

Sexual harassment

All organisations need to approach sexual harassment seriously, have measures in place to prevent it and to deal with it effectively when it arises. This is a fundamental part of providing a safe workplace for all employees. There is strong contemporary evidence of companies that fail to appropriately manage this issue suffering significant damage. Long-term investors have an interest in ensuring that the companies they invest in are well run, safe for their employees, and have cultures that prevent and address, workplace sexual harassment.

▶ Our expectations on sexual harassment

Boards have a responsibility to ensure that they are receiving the information needed to appropriately respond to, and prevent, sexual harassment. Stakeholders increasingly expect companies to manage this material risk. In order to do so, companies must proactively prevent sexual harassment. It is not sufficient to respond to sexual harassment on a reactive basis.

We expect companies to:

- Demonstrate **visible leadership from the board and senior management**, to create a culture of trust and respect. Directors must prioritise and embed good company culture within their organisations, and act immediately where there are instances of misconduct or unethical behaviour.
- Establish systems for **proactive risk identification and mitigation.** This should include:
  - robust reporting to the board, allowing directors to make informed decisions based on data. Internal reporting should also be used to improve learning and behaviours in the company.
  - ensuring that the organisation has the appropriate skills and experience to prevent and respond to sexual harassment
  - impactful training for staff
  - clear responsibilities and accountability.
- Establish **effective and accessible grievance mechanisms** and **respond to complaints.** Companies should adopt a victim-centred approach to the way investigations are conducted and ensure that employees are supported and feel comfortable to report sexual harassment.
- **Disclose** their policies and risk management practices, as well as their performance.

Racism and other forms of discrimination

Racism, other forms of discrimination, and harassment impact employee health, wellbeing and job satisfaction. It is crucial to establish a safe and inclusive working environment for all people.

Companies can perpetrate racial and other discrimination not only within their workforce culture, but also through their products, services, marketing, public policy activities and other actions. We expect companies to identify these risks, and be proactive in ensuring that their culture and operations promote and enhance respect, inclusion and equality.

It is good practice for companies to review current policies and practices, and establish clear values and expectations related to racism and other forms of discrimination. Companies should engage with employees and key stakeholders to identify discriminatory practices and areas of risk, as well as opportunities to enhance inclusion and equity.

Further references on sexual harassment, racism, and other forms of discrimination

- Research published by the Australian Human Rights Commission and ACSI in June 2021 on sexual harassment in the workplace.
- The Australian Human Rights Commission's Respect@Work: Sexual Harassment National Inquiry Report (2020).
- AICD, 'A director's guide to preventing and responding to sexual harassment at work', 2021.
- For further guidance on effective grievance mechanisms, see the United Nations Guiding Principles on Business and Human Rights.
- International law and standards, including the International Covenant on Civil and Political Rights; the Convention on the Elimination of All Forms of Discrimination against Women; International Labour Organisation Convention (No. 111) Concerning Discrimination in Respect of Employment and Occupation, and the International Convention on the Elimination of All Forms of Racial Discrimination.

High standards of workforce and human rights protection will also contribute to a healthy corporate culture (see section 5.5 below on corporate culture).

5.5 Corporate culture

Corporate culture plays a key role in driving performance and good outcomes for employees, customers and stakeholders. 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. Research has made the link between positive company cultures and better long-term company performance.[13]

In the same way that companies protect their financial capital, they should also protect, value and develop their workforce. The health, wellbeing and engagement of a company's workforce can strongly influence the success of a company. As companies increasingly move to more flexible ways of working, companies should be particularly careful that corporate culture is robust and well managed.

Boards are equally as responsible for oversight of culture as they are for financial performance, and directors play a critical role in governing culture. Understanding the company's actual culture and devising a roadmap to the desired culture is crucial. Directors have access to a breadth of different metrics and should take a sophisticated approach to interrogating and synthesising this data. We expect directors to be curious, persistent and willing to synthesise many formal and informal sources of information when overseeing the company's culture.

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. Unhealthy corporate cultures can develop within departments or operational 'silos'. If high risk behaviours go unchecked, this can lead to major financial losses.

Aspects of corporate culture that can create risks	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 behaviour may not occur and instead inappropriate behaviour persists.
Lack of diversity	Lack of diversity in a workforce can lead to stagnant ways of thinking and ingrained biases. Diversity (in all senses, including diversity of thought, culture, ethnicity, age, skills and other characteristics) can lead to more understanding and respectful corporate cultures that better mitigate the risk of misconduct and discrimination. Companies that promote diversity are also more likely to attract and retain a wider pool of talent, which can improve performance.

Our expectations on corporate culture

We expect companies to:

- articulate their values through the creation and enforcement of codes of conduct that are tailored to the risks faced by the business. Companies should also have a whistleblowing policy and a bribery and corruption policy. Policies should be regularly reviewed and adjusted as needed
- articulate and disclose their behavioural expectations of employees, contractors, suppliers and other partners
- invest adequate resources into training staff
- encourage a 'speak-up' culture where boards, executives, managers and employees can safely raise concerns (eg through a confidential mechanism) and ensure there is robust investigation, internal reporting and disciplinary action as necessary, where poor behaviours are detected
- encourage a culture supported by the board and the CEO, where the organisation is quick to learn from mistakes and change practices; and
- promote all forms of diversity across the workforce and work to ensure the workforce is reflective of the diverse demographic and society in which the company operates.

The role of the board and senior management:

- The board and senior management set the tone from the top and should monitor the drivers that shape culture (including breaches of relevant policies).
- 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 employee feedback and external inputs.
- Boards should always challenge actions and decisions by asking whether they are consistent with the desired corporate culture. There is often a risk that management may present an overly optimistic picture of corporate culture, so directors should not become overly reliant on management's perspective.
- When selecting a CEO, sufficient weight should be given to the CEO's capacity to deliver a strong culture.
- Consequence management processes should lead to reduced remuneration, warnings and/or termination for CEO and/or senior executives as appropriate.
- Directors should ensure that they have oversight of the non-disclosure agreements (NDAs) that are being signed by the company, the reasons NDAs are being signed, and which party is requesting the NDA. Directors should be particularly sensitive to the risks involved in establishing NDAs related to breaches of conduct, including the potential for NDAs to be used to silence victims.

Disclosure

- Companies should make meaningful disclosures in relation to their corporate culture, for example regarding assessments of culture, relevant policies, and action taken to promote compliance with corporate values and policies.
- Companies should consider reporting the number of breaches of the code of conduct and the related consequences, including terminations and remuneration consequences.
- Companies should disclose whether the board has an oversight process in place regarding NDAs.
- Companies should disclose relevant metrics to reflect their workforce. Like financial statements, workforce reporting should provide investors with information that is material to investment decisions. This includes the overall scope and composition of human resourcing available to management, as well as the opportunities and risks in attracting, developing, and retaining a productive workforce. Workforce indicators will naturally differ from company to company but may include measures related to employee and customer satisfaction levels, training and development, turnover, absenteeism, diversity and remuneration.

Further references

- Research published by ACSI and AICD in 2020 on 'Governing company culture'
- For further information on bribery and corruption policies, we refer to the ICGN's Guidance on Anti-Corruption Practices and the ASX Corporate Governance Principles and Recommendations (Recommendation 3.4).
- Principles for Responsible Investment (PRI) guidance on whistleblowing and guidance on anti-bribery and corruption.

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; and
- cause macroeconomic and societal distortions.

▶ Our expectations on tax practices

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; and
- 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.

Further 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.[14]"

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.

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; and
- 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 interest 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.[15]

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

Respecting 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 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 (within 5 business days) of:

- how the board oversaw the capital-raising process
- how the capital raised was priced
- whether best efforts were made to allocate pro-rata to existing shareholders, and, if not, why this was not possible
- the identity of advisers and underwriters
- the fees paid to advisers and underwriters; and
- any differential in the fees paid to underwriters and those paid to sub-underwriters.

Box 7.1: Assessing capital raising proposals

Boards play a critical role in the governance of capital-raising processes.

Where companies seek approval for capital raisings that are not pro rata, 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 type capital raising, such as the need to raise capital quickly
- the ability for existing shareholders to participate in the raising process; and
- the price paid by subscribers relative to market 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

As with 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. Directors should consider the potential control implications of any share buybacks.

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).

Box 7.2: 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; and
- 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.

Transactions 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.

Box 7.3: When making voting recommendations relating to M&A activity

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; and
- 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; and
- 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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Endnotes

1 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.

2 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.

3 ASIC v Healey & Ors [2011] FCA 717 at 20

4 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.

5 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.

6 *Keynote address by ASIC Chair James Shipton, 'Launch of ASIC's report on director and officer oversight of non-financial risk'*, 2 October 2019.

7 ASX Corporate Governance Council, Corporate Governance Principles and Recommendations, 4th Edition, Recommendation 7.4.

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

9 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

10 For example, modelling conducted by the Network for Greening the Financial System (NGFS) found runaway global warming would result in a cumulative loss of global GDP of 25 per cent by the end of the century from physical risks (worsening extreme weather) alone: NGFS, 'NGFS Climate Scenarios for central banks and supervisors', June 2020.

11 UN Guiding Principles on Business and Human Rights.

12 See, for example: UN Global Compact, 'Realization of Decent Work for All'.

13 See, ACSI and the Australian Institute of Company Directors, 'Governing Corporate Culture', 2020, p9.

14 ASIC v Healey & Ors [2011] FCA 717.

15 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).