

PRI'S RESPONSE TO THE JSE CONSULTATION PAPER ON POSSIBLE REGULATORY RESPONSES TO RECENT EVENTS SURROUNDING LISTED ISSUERS AND TRADING IN THEIR SHARES

INTRODUCTION

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 2100 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US \$83 trillion in assets under management. 55 of these signatories are based in South Africa.

Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets. The PRI welcomes the opportunity to contribute evidence on possible regulatory responses to recent events surrounding listed issuers and trading in their shares, and more specifically to the topics within this consultation relevant to corporate governance regulatory best practice.

ABOUT THE CONSULTATION

The Johannesburg Stock Exchange (JSE) seeks public input on possible improvements to its regulatory approach to new and existing listings on the JSE.

Under current listing requirements, listed companies must disclose on an apply and explain basis the extent to which they comply with the King Code.

King IV sets out the framework for sustainability reporting, as well as integrated reporting. JSE has also introduced mandatory governance disclosure requirements beyond the principles of the King Code.

The current JSE consultation seeks input on possible revisions to its listing requirements. The proposals relevant to corporate governance disclosure requirements are:

- Mandatory training for members of the audit committee (Part I, 3.4)
- Non-binding advisory vote on corporate governance (Part I, 3.5)
- Composition of the board of directors – diversity (Part I, 5.1)

PRI'S RESPONSE TO THE CONSULTATION

Summary:

- The PRI supports the introduction of mandatory training for members of the audit committee on their responsibilities prior to listing and as a continuing obligation post listing, including training on systemic issues, such as the urgent need to tackle climate change. (Part I, 3.4)
- The PRI supports the increased focus on the corporate governance report and recommends that if a non-binding vote for the corporate governance report were to be introduced, it should aim to improve the effectiveness of engagement between the issuer and shareholders in alignment with Principle 2 of the PRI¹. (Part I, 3.5)
- The PRI supports the additional emphasis placed on overall diversity in its broad sense at board level by introducing a requirement that boards have and publish a mandatory policy, with measurable objectives, and that they publish performance against that policy on an annual basis. (Part I, 5.1)
- In addition, the PRI recommends that JSE endorse the Task Force on Climate-related Financial Disclosures framework, and encourage its use through the corporate governance framework.

PRI comments:

Mandatory training for members of the audit committee (Part I, 3.4)

The PRI strongly believes that board members should have sufficient training to ensure they are effective and a regular assessment of members' skills and needs should be undertaken. Logically, it follows that this should be supported by a training plan designed to address weaknesses for all members, not just those undergoing inductions. This proactive training may also be supported by reactive training triggered by events such as, for example, entering new markets, mergers and acquisitions, or in response to systemic issues such as the urgent need to tackle climate change.

The PRI believes that the need for continued training and development of board members in order to ensure effectiveness applies to the board as a whole, sub-committees with specific mandates i.e. the audit or remuneration committee, or with regards to critical skills such as sustainability oversight.

From the PRI's perspective, we encourage further education on sustainability for financial services, investors and other professionals who need to understand how ESG issues are impacting company performance, shareholder value and investment decision making².

¹ Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices. For more information on the PRI principles see [here](#). To read PRI's guidance on active ownership, see [here](#).

² For example, the PRI Academy provides industry-leading training on how ESG issues are impacting business and investment decision making using financial modeling, case studies, interactive spreadsheets and implementation guides. More information [here](#).

We recognise the emphasis placed on the audit committee by the JSE listing rules, including the committee's responsibility to: (i) consider the expertise and experience of the financial director on an annual basis, (ii) ensure that the applicant issuer has established financial reporting procedures and that those procedures are operating and (ii) applying a detailed and robust approach when considering the appointment of the auditor. We are therefore supportive of a potential amendment to the JSE Listings Requirements, requiring all the members of the audit committee to undergo formal training on their responsibilities pursuant to the provisions of the Companies Act and the Listings Requirements, prior to listing and as a continuing obligation post listing; and we would encourage the JSE to consider additional training requirements to ensure effective oversight of board members.

Non-binding advisory vote on corporate governance (Part I, 3.5)

The PRI is supportive of the increased focus on the corporate governance report. Currently, the JSE requires issuers to adopt and apply King IV on an apply and explain basis, and further imposes certain mandatory corporate governance provisions. The JSE is considering implementing a mandatory non-binding advisory vote on the issuer's corporate governance report, requiring engagement by the issuer if the report is voted down by shareholders exercising 25 per cent or more of the voting rights.

The PRI does not take a view on what constitutes an appropriate dissent threshold to trigger further consultation and engagement by the issuer, as different levels of dissent should be considered within market context³. We would instead recommend that the JSE regularly reviews voting patterns and levels of dissent, to establish appropriate thresholds and provide relevant guidance.

The PRI strongly believes that non-binding votes, including for the corporate governance report, should aim to alert companies to significant shareholder concerns that have not been addressed and, ultimately, improve the effectiveness of engagement between the issuer and shareholders. To that purpose, we would encourage JSE to consider requirements for companies to:

- provide an update with regards to progress made on any issue (including the rejection of the corporate governance report by a significant number of votes), including any actions taken or considered to address concerns;
- provide an update within a reasonable timeframe;
- ensure that an overview is included as part of annual reporting and/or via any other appropriate channels.

³ Examples of different approaches include the recent revision by the UK's Financial Reporting Council (FRC) to require further consultation, engagement and reporting by companies when 20 per cent or more of votes have been cast against the board recommendation for a resolution; and the two strike rule in Australia, triggering a vote to 'spill' the board if the remuneration report receives an against vote of 25 per cent or more for two consecutive years.

Composition of the board of directors – diversity (Part I, 5.1)

The PRI strongly supports an amendment to the listing rules to require that boards have and publish a mandatory policy regarding diversity in its broad sense at board level (including, as mentioned in the JSE paper, field of knowledge, skills and experience as well as age, culture, race and gender). Furthermore, we believe that the requirement for boards to publish performance against that policy on an annual basis will drive the necessary focus on diversity and demonstrate the effectiveness of actions the board has undertaken to achieve the entity's diversity objectives.

The PRI would encourage a recommendation for companies to reference measurable objectives being used by boards to improve performance and report on progress, as well as specific requirements for companies to:

- set a measurable objective on the diversity of boards by a specified date;
- charge management with designing, implementing and maintaining programs and initiatives to help achieve those measurable objectives;
- require an annual review of the company's progress towards its diversity objectives.

We would also welcome additional clarification on a separate, a non-binding advisory vote on Board diversity with regards to follow up actions when support is withheld as per our response to a non-binding advisory vote on corporate governance (Part I, 3.5).

Additional recommendations:

In addition, the PRI recommends that JSE endorse the Task Force on Climate-related Financial Disclosures framework, and encourage its use through the corporate governance framework.

Investors are required to take into account all financially material factors in their investment decision-making, consistent with time horizon of the investment liabilities of their beneficiaries. Financially material factors include environmental and social risks across a range of investment time frames. Improved company disclosure of environmental and social risks enables investors to make better informed decisions about risk exposure and opportunities in their investment portfolios, and therefore execute their fiduciary duty to act in the best interests of clients and beneficiaries.

Specifically the PRI recommends:

- the acknowledgement of physical, transition and liability risks and that many listed entities will be exposed to these types of risks, even where they are not directly involved in mining or consuming fossil fuels;
- encouragement for entities to consider the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

We recommend that JSE endorse the TCFD framework, and encourage its use through its corporate governance framework. The TCFD framework outlines information that is required for disclosure, and will help directors at JSE listed companies to reduce the likelihood of future exposure to legal liability for failing to assess and manage climate risk.⁴

Finally, the PRI has experience of public policy on ESG integration and responsible investment across multiple markets and is available to support the work of the JSE on promoting sustainable investment. Any further question or comments can be sent to policy@unpri.org.

⁴ The TCFD framework is explicitly referenced in commentary to the [UK Corporate Governance Code \(figure 5\)](#) and is supported by 300 companies including 12 stock exchanges with a combined market capitalisation of over US\$6.3 trillion, including 150 financial institutions responsible for assets of over US\$81 trillion.