

PRI RESPONSE TO THE ASX CORPORATE GOVERNANCE COUNCIL CONSULTATION ON THE FOURTH EDITION OF THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS

27 July 2018

INTRODUCTION

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 2000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US \$82 trillion in assets under management. Over 130 signatories, managing AUD \$2.6 trillion are based in Australia.¹

Responsible investment explicitly acknowledges the relevance to investors 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 to the ASX Corporate Governance Council consultation on the Fourth Edition of the Corporate Governance Code.

ABOUT THE CONSULTATION

In May 2018 the ASX Corporate Governance Council launched a public consultation including a draft revised Code that was opened for comment until 27 July 2018. The consultation sought to explore views on proposed amendments for a revised Australian Corporate Governance Code.

The Code is applicable to ASX listed entities. ASX listed entities are required to provide a corporate governance statement that meets the requirements of Listing Rule 4.10.3. The Rule acts to encourage listed entities to adopt the Council's recommendations, but does not force them to do so. ASX listed entities are required to compare their corporate governance practices with the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why.

The revised code focuses on: company culture, social license to operate, anti-bribery and corruption, cybersecurity, diversity, climate change, reporting quality, and risk management.

¹See <https://www.unpri.org/signatory-directory/>

SUMMARY OF THE PRI'S POSITION

The PRI welcomes the proposed amendments to Recommendations: 1.5, 1.6, 3.3, 3.4, 4.4 and 7.4. of the Fourth Edition of the Corporate Governance Code from the ASX Corporate Governance Council.

The PRI strongly supports the revision of Principle 3 including; the focus on corporate culture, and recognition that social license to operate is one of the most valuable assets of any listed entity.

In addition we recommend extending some parts of the Code's the proposed commentary to recommendations 1.5, 1.6, 4.4. and 7.4 for:

- listed entities to consider disclosing insights from annual review of diversity objectives;
- listed entities disclose how insights from board performance evaluations have been used to improve board effectiveness;
- the Code commentary to clarify non-prescriptive examples of how entities should adopt a fit for purpose validation process of corporate reports;
- the ASX to endorse the Task Force on Climate-related Financial Disclosures framework,² and encourage its use through the Corporate Governance Code.

PRI RESPONSE TO SELECTED NEW AND AMENDED PRINCIPLES AND RECOMMENDATIONS

Recommendation 1.5: Diversity policies, measurable objectives, management responsibilities and disclosure

The PRI strongly supports the amendments to Recommendation 1.5, including that listed entities should:

- set a measurable objective to have a minimum of 30 per cent of directors of men and women on their 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 gender objectives

84 companies in the ASX200 now have boards with 30% or more women, there are close to 60 ASX200 companies with just one woman on their board, and three companies that have no women on their boards. We believe that measurable objectives with monitoring and review will drive necessary focus on board gender diversity.³

In 2017, the Sustainable Stock Exchanges initiative conducted a focused analysis of actions that stock exchanges in 13 markets have taken to address gender inequality.⁴ ASX contributed to the report, which recommended that to ensure progress on gender equality, stock exchanges should

² <https://www.fsb-tcfd.org/>

³ The [Australian Institute of Company Directors, 30% by 2018: Gender diversity progress report \(March - May 2018\)](#) lists five companies that had no women on their boards as at 31 May 2018. Since that time, Ausdrill Limited and Ardent Leisure Group have appointed female board members.

⁴ Including Australia, Brazil, Egypt, Germany, Hong Kong, India, Italy, Jordan, Kazakhstan, Kenya, South Africa, the United Kingdom and the US.

require or encourage listed entities to report on diversity objectives and how they are achieved as well as supporting policies and metrics and implementation programmes.⁵

We welcome guidance provided in the commentary that boards of listed entities should consider board diversity beyond gender, to also encourage diversity of skills, qualifications, age and ethnicity. We believe that representation of diverse skills, experience and qualifications will make well-rounded and better informed decision-making.

We recommend that the Code encourages listed entities to consider disclosing insights from the annual review and any changes it has made as a result, to demonstrate the effectiveness of the review and initiatives it undertakes to achieve the entity's diversity objective. In addition, we recommend that the Code encourages listed entities to consider disclosing their gender pay gap to progress equal pay.⁶

Recommendation 1.6: Board, committee and director evaluations⁷

The PRI welcomes this recommendation.

We recommend that the commentary is extended to encourage boards to disclose how insights from board performance evaluations have been used to improve board effectiveness. Examples can be seen in both the UK and France's recently revised Corporate Governance Codes.

Provision 23 of [UK Corporate Governance Code \(July 2018\)](#) states that the annual report should describe the work of the nomination committee including "how the board evaluation has been conducted, the nature and extent of an external evaluator's contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence board composition."

Similarly, 9.3 in the [French Corporate Governance Code of Listed Companies \(June 2018\)](#) states that "shareholders should be informed each year in the report on corporate governance of the evaluations carried out and, if applicable, of any steps taken as a result."

Disclosing results of board performance evaluations gives assurance that the skills and effectiveness of the board are monitored.⁸ We encourage the ASX code commentary to adopt similar provisions for companies to disclose results of board evaluations as found in the corporate governance codes of the UK and France.

⁵ The report makes 12 recommendations on how to advance gender equality both for driving change across issuers and for exchanges to lead by example. See further in '[How stock exchanges can advance gender inequality](#).'

⁶ In the UK it is now a regulated requirement for organisations with over 250 employees to publish annually on their website: gender pay gap (mean and median averages); gender bonus gap (mean and median averages); proportion of men and women receiving bonuses; and the proportion of men and women in each quartile of the organisation's pay structure.

⁷ In full, recommendation 1.6 reads: "A listed entity should: (a) have and disclose a process for evaluating the performance of the board, its committees and individual directors for each reporting period; and (b) disclose, for each reporting period, whether a performance evaluation was undertaken in accordance with that process."

⁸ Between 2014 and 2016 the PRI led a collaborative engagement between 17 investors with a collective US\$2.3bn in AUM, in dialogue with 24 companies in the US and France about practices they adopt when nominating directors to the board. Whilst market analysis in the report shows that that 95 companies in the S&P100 did not publicly offer the results of periodic board performance evaluations in annual reports or proxy statements, it was one of the most commonly asked questions by investors and that more companies began to disclose this information after dialogue with investors. See PRI's publication, '[Engaging on director nominations](#).'

Principle 3: Instil the desired culture

The PRI strongly supports the revision of Principle 3 to include that “(a) listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner.”

We welcome the acknowledgement in Principle 3 that social licence to operate is a highly valuable asset of a listed entity. We welcome the examples of ESG issues provided in the commentary, that must be managed for companies to be considered “good corporate citizens.” Investors pay close attention to ESG issues and social license to operate, as evidenced by PRI’s work.

- Tax: the PRI has worked with global investors on corporate tax responsibility since 2015 to provide [guidance for investors to engage on corporate tax responsibility](#), [recommendations on tax practices investors should look for](#) to determine companies’ approach to tax responsibility and [research findings](#) about companies’ existing practices. This workstream has been driven by investors’ recognition that how companies’ manage tax can create earnings risk and lead to governance problems, but that it is also core to their social license to operate, with implications for company reputation and boarder macroeconomic and societal distortions.
- Anti-bribery and corruption: the PRI has worked with global investors on anti-bribery and corruption since 2010, to provide [guidance for investors to engage on anti-bribery and corruption](#), recognising that cases of corruption have financial and regulatory repercussions for business and impacts companies’ social license to operate.
- Living wage: the PRI produced an [investor briefing](#) on what investors should look for to determine the quality of human rights and standards of living wage within the apparel industry, recognising license to operate and reputational risks potential impact on revenue and business continuity.
- Environmental responsibility: the PRI has several areas of work which demonstrate investor recognition of, and engagement on, environmental issues and their impact on companies’ social license to operate including our guide to [engaging with oil and gas companies on fracking](#), and [engaging with oil and gas companies on methane](#).

We strongly agree with the focus on corporate culture in Principle 3, as core to business value. We agree with the Council’s timing of the incorporation of this principle, in light of the need for the ongoing [Royal Commission’s review](#) into misconduct in the financial sector.

Recommendation 3.3: A listed entity should have and disclose a whistle-blower policy⁹

The PRI supports the recommendation for listed entities to have and disclose a whistle-blower policy, and we support that the whistle-blower policy should serve all of the functions outlined in the commentary. Disclosure of a whistle-blowing policy provides assurance to investors that companies have mechanisms to manage anti-bribery and corruption and misconduct risks.

Between 2013-2015, the PRI co-ordinated a collaborative engagement convened 34 investors with collective assets under management of USD 2.7 trillion, engaging with 32 companies on their

⁹ In full, recommendation 3.3 reads: “A listed entity should: (a) have and disclose a whistle blower policy that encourages employees to come forward with concerns that the entity is not acting lawfully, ethically or in a socially responsible manner and provides suitable protections if they do; and (b) ensure that the board is informed of any material concerns raised under that policy that call into question the culture of the organisation”

anti-corruption measures. 88% of global and cross sector companies in the sample disclosed that they have a whistle-blower policy (64% prior to the engagement dialogue).¹⁰

The engagement demonstrated that companies recognised the importance of this disclosure to investors, and began issuing policies in response. We believe that this recommendation is aligned with a drive by both responsible investors and companies to demonstrate companies' risk management of corporate misconduct.

We support the commentary which outlines that the whistle-blower policy should incorporate a periodic audit or review to check if whistle-blower reports are appropriately recorded, investigated and responded to.

Through the PRI co-ordinated engagement, we found that while an increasing number of companies disclosed the provision of a whistleblowing hotline, reporting on the operation of the hotline remained relatively low and improved only for a few companies¹¹ (14% of the sample, rising to 27% of the sample after engagement).

In March 2018, a research report from ACSI¹² found that of all ASX200 companies:

- 91 do not disclose if they offer anonymity-hour availability (45%)
- 97 do offer 24-hour availability (48%)
- 71 do not provide a commitment that retaliation is not acceptable (36%)

Companies' disclosure of a whistle-blowing hotline is only meaningful if it is implemented effectively. Investors see audit and reporting on the use of whistle-blowing hotlines as evidence that the line is being used and monitored, and an indication of a healthy "speak-up" culture.

Recommendation 3.4: A listed entity should have and disclose an anti-bribery and corruption policy¹³

The PRI welcomes the recommendation that listed entities should be required to disclose an anti-bribery and corruption policy, and we support that the anti-bribery and corruption policy should serve all of the functions outlined in the commentary.

Recommendation 4.4: A listed entity should have and disclose its process to validate that its annual directors' report and any other corporate reports

We welcome the acknowledgement of 'integrated reporting' as a useful framework for providing information about a listed entity's future prospects, risks and opportunities, strategy and business model in the commentary to recommendation 4.4.

The PRI supports the introduction of this new recommendation for the annual director's report and other corporate reports which are not subject to external assurance, are subject to appropriate

¹⁰ See [guidance for investors to engage on anti-bribery and corruption](#)

¹¹ For example, the number and type of complaints made, whether the report was internal or external and resulting dismissals.

¹² ACSI's research report, '[Codes of Conduct, Whistleblowing and Corporate Culture](#)' compares codes of conduct and whistleblowing systems of ASX200 companies against a set of leading practice indicators and identifies key gaps in their coverage and content. The report also states that ACSI will be actively advocating to improve weaknesses identified in the report through the ASX review of the Corporate Governance Code.

¹³ In full the recommendation reads: "A listed entity should: (a) have and disclose⁴⁵ an anti-bribery and corruption policy; and (b) ensure that the board is informed of any material breaches of that policy."

process to validate that the report is accurate, balanced and understandable in order to facilitate informed investment decision making.

We recommend the commentary clarifies non-prescriptive examples of how entities should adopt a fit for purpose validation process, borrowing from existing frameworks and standards. In addition, we recommend the Council clarifies what if any difference is implied by the proposed change in wording in the Principle from “independently verify and safeguard” to “validate”.

Recommendation 7.4: A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks.

The PRI welcomes this recommendation.

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 superannuation members. 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.

We strongly support reference to climate related risks in the commentary of recommendation 7.4. Based on research by ACSI, [‘2017 Corporate Sustainability Reporting in Australia’](#), the level of climate-related disclosures lags that of sustainability reporting more generally. Specifically we welcome:

- 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 ASX endorse the TCFD framework, and encourage its use through the Corporate Governance Code. The TCFD framework outlines information that is required for disclosure, and will help directors at ASX listed companies to reduce the likelihood of future exposure to legal liability for failing to assess and manage climate risk. In addition, 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 exchanges¹⁴ with a combined market capitalisation of over US\$6.3 trillion, including 150 financial institutions responsible for assets of over US\$81 trillion.¹⁵

¹⁴ Including: Bangladesh’s Chittagong Stock Exchange; Brazil’s B3; Chile’s Bolsa de Comercio de Santiago; Egypt’s EGX; Europe’s Euronext; India’s National Stock Exchange of India Ltd.; Italy’s Borsa Italiana; Norway’s Oslo Børs; UK’s London Stock Exchange Group and London Stock Exchange plc; Singapore’s Singapore Exchange Ltd.; and Vietnam’s Hochiminh City Stock Exchange. See <https://www.fsb-tcfid.org/tcfid-supporters-july-2018/>.

¹⁵ [TCFD Secretariat press release 12th December 2017](#)

APPENDIX A

An excerpt from the public consultation document, outlining key issues for feedback.

“The primary purpose of this consultation is to seek feedback from listed entities, their advisers, security holders and other stakeholders on the consultation draft of the fourth edition of the Principles and Recommendations accompanying this consultation paper. The Council wishes to ensure that the fourth edition of the Principles and Recommendations strikes the right balance between the needs and interests of all stakeholders. The Council is especially interested to receive comments on:

- whether stakeholders agree with the nine proposed new recommendations and, if not, why not; whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;
- specifically, whether stakeholders agree with the Council’s proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date;
- whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7;
- whether stakeholders agree with Council’s proposed changes to box 2.3, setting out the factors relevant to assessing director independence;
- whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity’s values, culture and social licence to operate;
- whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities;
- whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations; and
- whether there are any other gaps or deficiencies in the Principles and Recommendations that have not been addressed by the proposed changes in the consultation draft of the fourth edition”