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Dear Hamish

NZX Review of Corporate Governance Reporting Requirements

The Institute of Directors (IoD) appreciates the opportunity to comment on the NZX *Review of Corporate Governance Reporting Requirements within NZX Main Board Listing Rules*.

We endorse NZX's review and the updating of the Corporate Governance Best Practice Code (the Code). It is important to develop a reporting regime that is current, effective for good corporate governance reporting, and aligned with best practice. It is also important that we reduce fragmentation, duplication and inconsistencies as much as possible in the various corporate governance reporting regimes in New Zealand.

About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to raising governance standards in New Zealand. We represent a diverse membership of over 7,000 members drawn from NZX-listed corporations, unlisted companies, private companies, small to medium enterprises, public sector organisations, not-for-profits and charities. Our chartered membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

General comment

Good corporate reporting supports good corporate governance and the underlying principles of accountability, transparency, probity, and long-term business sustainability. Thoughtful reporting focused on performance also promotes shareholder and stakeholder confidence and trust.

We agree that the fragmentation of corporate governance guidelines in New Zealand is problematic, in particular for NZX listed companies, and needs to be addressed. We also agree with NZX that a revised reporting regime needs to be flexible, appropriate for New Zealand, take a holistic approach, deliver value to shareholders and stakeholders and be balanced between effective disclosure and cost to issuers.

We support a 'comply or explain' approach and the proposed tiered framework.

A revised reporting regime also needs to avoid overloading the annual report as this won't serve corporate governance well. For example this can be achieved through disclosing that there is a policy in the annual report but publishing the policy online.

The IoD has found variable quality in corporate reporting and we support initiatives that will help improve reporting.

We recently assessed 20 top NZX listed companies and their 2015 annual reporting on selected matters, such as director remuneration, CEO remuneration, and health and safety performance. We found variability in the clarity of information presented and cases where additional explanation was needed to make the information meaningful and support transparent accountability.

There is no benefit in regulations for regulation's sake. Ultimately, the IoD takes a view that each change to reporting must pass an implicit test that it serves the end user (whether investor, analyst or regulator) and contributes meaningfully to better corporate governance in New Zealand.

There is a risk that poorly drafted or overly complex Rules and supporting guidance:

- materially increases the length and complexity of disclosures without meaningful benefit
- encourages a "conformance" mentality, where the focus is on technical compliance
- stifles innovation and alternative practices which could support better corporate governance
- imposes increased costs for businesses to implement.

We consider consultation on the Code and thoughtful revision of the Code will ultimately be a benefit to New Zealand business.

In considering the NZX's review we have sought feedback from IoD members. Our feedback focuses on the proposed framework and approach and four matters that are particularly important:

- board composition and independence
- reporting on diversity
- additional reporting on ESG matters
- additional reporting on health and safety performance.

We also comment in brief on specific review questions in the table below.

We understand that feedback on the discussion document is the first stage in revising the Code and we welcome the opportunity for continued involvement as NZX progresses the review.

Corporate governance guidance

As the premier membership organisation for people involved in governance in New Zealand, the IoD has a key role in raising standards of governance across all areas of New Zealand business and society.

The *Four Pillars of Governance Best Practice for New Zealand Directors* is the IoD's comprehensive reference guide for directors in New Zealand. It blends high level principles with practical guidance on day-to-day directorship, and provides commentary on legislative requirements.

The IoD *Code of Practice for Directors* provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members must sign up to the Code.

NZX issuers are also subject to several corporate governance regimes. These include legislative requirements (e.g. under the Companies Act 1993), NZX requirements (Listing Rules and the Corporate Governance Best Practice Code), the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (for dual listed companies) and the Financial Markets Authority (FMA) principles and guidance. In addition, in 2015 a group of institutional investors formed the New Zealand Corporate Governance Forum and released additional guidelines for listed companies.

NZX Corporate Governance Council

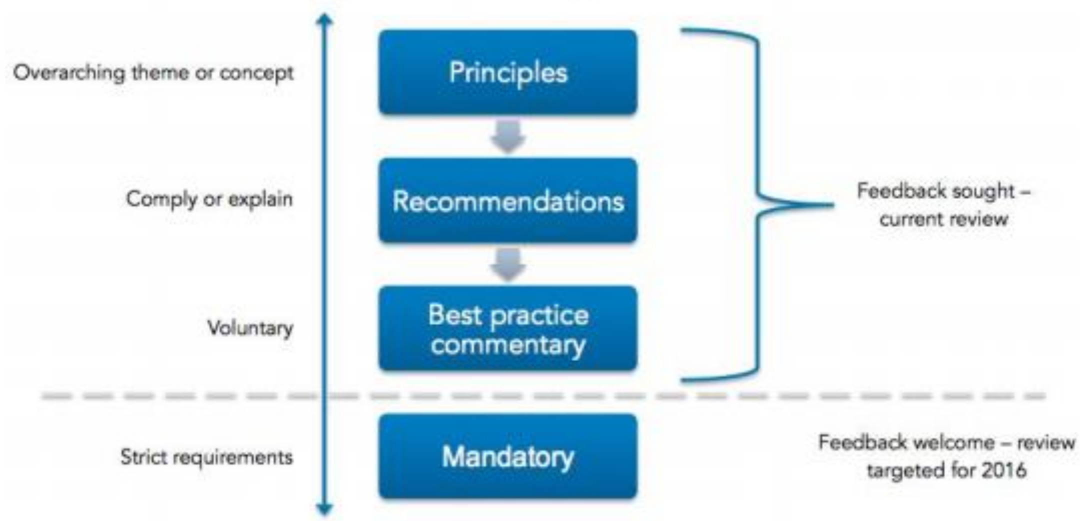
We strongly support Chapman Tripp's recommendation to establish a New Zealand equivalent to the ASX Corporate Governance Council to help achieve agreement on one code which could then evolve over time as needed. The IoD welcomes the opportunity to participate in such an initiative.

Proposed framework

We agree with NZX that updating of the Code in line with one of the existing frameworks will help alleviate fragmentation and support updating the Code in line with the FMA's 9 principles. Where possible, dual listed companies will be well served by bringing the frameworks in line with the ASX Corporate Governance Principles and Recommendations. The principles, recommendations and commentary in the ASX guide are well presented and easy to follow and could be a useful format for the new NZX Code.

An effective reporting framework that underpins good governance needs to be clear and encompass relevant legislative, regulatory requirements and good practice guidance.
NZX has proposed the tiered framework below. It refers to mandatory requirements which NZX plans to review and update in its broader review of the Listing Rules later in 2016.

An illustration of how the regime is intended to operate is as follows:



We agree with a tiered approach to the reporting regime. It is critical that the requirements and expectations for each tier are clear, including when explanations are and are not required.

Consolidating requirements

It would aid clarity, and further minimise fragmentation, to cover all corporate governance reporting requirements in one place, including mandatory requirements:

- currently covered in section 10.4.5 of the Listing Rules
- specified in legislation or Listing Rules, e.g. reporting director remuneration is covered by Listing Rule 3.5.1 with reference to the disclosure requirement under s 211(1)f of the Companies Act 1993.

'Comply or explain'

We support introducing a 'comply or explain' approach to corporate governance reporting on Code Recommendations. However it needs to be clear that this only applies to Recommendations and not to voluntary reporting covered by Best Practice Commentary.

'Comply or explain' can support good governance and is preferable to straightforward compliance, which can tend to 'tick-box' reporting. It provides flexibility and proportionality for boards to report in a way that is appropriate and meaningful to the circumstances, size and nature of the entity. For 'comply or explain' to work effectively there needs to be genuine commitment to good governance and meaningful, open explanations. A constructive culture needs to be fostered where explanations are assessed on their merit rather than assuming non-compliance is inherently negative. Explaining why the board has not complied and outlining how practices are consistent with the relevant principle and contribute to good governance and the achievement of business objectives, is good reporting.

Best Practice Commentary

We consider there is value in introducing best practice commentary as supporting material to the recommendations. It should be appropriately disclaimed that the commentary is not a 'one size fits all' and is designed to assist the listed entities involved, not to be utilised as a compliance tool. We are conscious that the judiciary and regulators may find the commentary attractive to reference as persuasive commentary during regulatory processes. It is therefore critical that the purpose of the commentary is clear.

We would be pleased to be involved with development of appropriate commentary.
We note that there is some reservation about the term 'best practice.' Should the review take a final view this is an issue it may be useful to use the term 'Supporting commentary' (or similar) for each recommendation.

Board composition and independence

The IoD encourages openness, challenge and independent thinking in board composition and decision-making. Independent directors and shareholding directors can both bring significant value to a board.

In our view issuers should have an independent chairperson and a majority of non-executive directors on their boards. This should be a Recommendation in the Code and not mandatory.
We agree that the separation of the roles of Chair and CEO promotes independent leadership of the boards and facilitates more effective monitoring and oversight of management. We support maintaining this Recommendation.

Reporting on diversity

The IoD has long held that the ultimate goal of board diversity is diversity of thought and capability. Board diversity brings a broader range of perspectives to the boardroom and increases the potential for success, effective risk oversight and long-term business sustainability. Diversity encompasses ethnicity, age, disability, culture, qualifications, experience and other dimensions as well as gender. Since NZX introduced guidance on gender, reporting the percentage of women on boards has increased from 12% in 2013 to 17% in 2015. Although there is still a long way to go to achieve parity, the introduction of metrics and reporting has made a difference.

We support including a Recommendation in the Code that issuers adopt a diversity policy, establish measurable objectives for achieving appropriate diversity in its senior management and board and report on progress made in achieving those objectives. This would be consistent with the ASX position (Recommendation 1.5).

Reporting on ESG matters

NZX has asked if it should introduce any additional Recommendations or Best Practice Commentary in relation to non-financial reporting matters, including ESG (environment, social and governance) disclosures (Q19) and ESG risks (Q27).

Increasing consumer and stakeholder demands for clear communication about organisational performance and intentions are driving changes in corporate reporting on the global stage. We are seeing more corporate reporting on sustainability, ESG matters, corporate social responsibility (CSR) and Integrated Reporting.

In November 2015 the IoD issued a *directors***brief** (attached) to members on the future of corporate reporting, which looked at global trends and non-financial frameworks including Integrated Reporting.

We think more holistic reporting supports good corporate governance and can help demonstrate how an entity manages opportunities and risk, and creates value over the long-term. It is widely accepted that financial information alone doesn't tell the whole story - corporate reporting needs to reflect this.

The World Federation of Exchanges (WFE) issued guidance, in November 2015, for exchanges to adopt metrics and indicators for ESG reporting, as appropriate to their markets.

Increasingly we are seeing sustainability or ESG reporting mandated in other countries, such as Financial Reporting Council (FRC) requirements for strategic reports by UK listed companies and Securities Exchange Commission (SEC) requirements for USA-listed companies on material environmental risks. The Singapore exchange is mandating sustainability reporting in 2016/2017, the

Hong Kong exchange is reviewing ESG reporting as it updates its Corporate Governance Code and the NZX has raised ESG reporting in its review of corporate governance reporting.
Integrated Reporting is formally mandated in South Africa and Brazil through their listing rules. In other jurisdictions, such as the UK and Europe, Japan, India, and Malaysia, governments and regulators are endorsing Integrated Reporting as a model of good governance congruent with requirements in those jurisdictions.

ASX Recommendation 7.4 requires reporting on any material exposure to economic, environmental and social sustainability risks, and how an entity manages or intends to manage those risks.

When we looked at reporting by top 20 NZX companies we found that 65% of the companies were reporting in some form on environmental, social, and corporate responsibility matters. The information was highly variable, which was not surprising given reporting this information is voluntary and there are a range of frameworks that companies have adopted.
The IoD supports the introduction of a Recommendation requiring additional reporting on ESG matters and risks. This should be supported by Commentary that provides guidance on what high quality ESG reporting looks, in particular given the range of frameworks and approaches being taken globally.

It is critical, in our view, that any guidance should not be prescriptive but should provide flexibility to allow reporting on matters that are most relevant to the business. This is particularly relevant, given this is a new and evolving aspect of corporate governance reporting in New Zealand.

Health and safety performance

Significant reforms have been introduced to try and improve New Zealand's appalling health and safety record, including to improve health and safety governance and leadership. The new Health and Safety at Work Act 2015 comes into effect on 4 April 2016 and introduces new responsibilities and liabilities for directors.

Reporting on health and safety performance is evolving in New Zealand and currently sporadic and variable in nature. When we looked at reporting by top 20 NZX companies we found that health and safety performance was reported by 8 companies.

The IoD has been actively working to improve director and board awareness and capability in relation to health and safety governance for several years.

We support including a Code Recommendation which requires reporting on health and safety performance, accompanied by Commentary on what this should look like – again allowing flexibility for what is appropriate and meaningful for different entities. Companies are already focusing on preparing and boards on reviewing this information, so reporting it would be a logical next step for many entities looking to provide open disclosure to shareholders and other stakeholders.

Comments on specific review questions:

We have commented on some questions in the sections above. The following tables provides brief answers to other questions.

Principle 1: Ethical standards	
Q 8	We support a Recommendation that provides for a code of ethics for employees, but flexibility should be permitted so that employee ethics can be separate from a code for directors if appropriate. The recommendation should include a requirement to disclose the existence of a code of ethics and any material breaches of the code during the reporting period.
Q 9	We support including whistleblowing in the code of ethics. Reference to the Protected Disclosures Act 2000 should also be included.
Principle 2: Composition and Performance	
	See separate comments on board composition and on diversity.
Q 11	We support including a Recommendation that issuers disclose the respective roles and responsibilities of the board and management along the lines of ASX Recommendation 1.1. We support a Recommendation that issuers have a diversity policy with measurable objectives. This is consistent with ASX requirements and we do not consider such reporting obligations would be onerous. We support reporting information about each director, including experience, length of service, independence and ownership interests. The provision of a skills matrix would be consistent with the Australian regime, however the composition of the board should remain the prerogative of the board properly constituted through election by shareholders. We agree issuers should have written agreements with senior executives and directors establishing their terms of reference, but these don’t need to be published.
Principle 3: Board committees	
Q 15	We agree that the Code should include Recommendations that boards disclose all board committee charters, members of each board committee, number of meetings and individual attendance. This is relevant information for investors. It would be helpful to include Listing Rules requirements about audit committees in the Code so all requirements are in one place.
Q 16	We consider the ‘unless constrained by size’ exception for nomination and remuneration committees remains important for small issuers or where it is more appropriate for the board to undertake this work without establishing a separate committee.
Principle 4: Reporting and disclosure	
Q 18	We support a Recommendation about having and disclosing a written policy for complying with continuous disclosure.

	We also consider delegated financial authorities should remain internal matters for the board and entity.
Q 19	*See separate comments about ESG reporting*
Principle 5: Remuneration	
Q 21	We agree with a Recommendation that issuers publish a remuneration policy dealing with directors and senior executives (may be separate policies). We do not support a Recommendation requiring a blanket performance-dependent element in executive remuneration as this is not appropriate for all issuers. This should be included in supporting Commentary.
Q 22	We support clarity and openness in the reporting of chief executive remuneration, including the proportion that is performance based and the value of the total remuneration package. It is also important to include explanations so that it is clear which year remuneration payments (including performance components) relate to. Senior executive remuneration reporting by band of $10,000 or similar is also an appropriate recommendation. Best Practice Commentary would provide further guidance. Reporting on director remuneration should include, total fees approved for the board, all remuneration received by directors individually, including a break-down of committees fees. If directors receive any other payments e.g. for consultancy services these should be disclosed with explanation. We note the ASX Listing Rules were amended in 2014 to provide that "Directors' fees" now expressly include superannuation contributions for the benefit of a non-executive director, any fees which a non-executive director agrees to sacrifice for other benefits and all fees payable by the entity or any of its subsidiary entities to a non-executive director for acting as a director of the entity or any child entity, including attending and participating in any board committee meetings.
Q 23	We do not support including a Recommendation or Commentary about the use of recruitment consultants. The decision to take the advice of a remuneration consultant is the prerogative of the board and an input to a decision for which the board is responsible.
Principle 6: Risk Management	
Q 25	We agree with Recommendations that issuers: • have policies and procedures to identify and manage key risks facing their business • disclose details of internal audit functions or alternative measures (may differ as appropriate to size and nature of the business) • have and disclose a staff share dealing policy We note that the reporting data will depend very much on the nature of the entity.
Principle 7: Auditors	
Q 29	We support a recommendation that the external auditor should attend the AGM to answer questions from shareholders in relation to the audit. This is already expected

	under the Companies Act 1993. This is likely to be particularly relevant once the new audit report containing 'key audit matters' has been introduced (from December 2016).
Q 30	We support extending the maximum period for auditor rotation from 5 to 7 years, in line with current FMA and ASX requirements. We have previously submitted to regulators that New Zealand listed companies can have a challenge in finding firms of sufficient size and calibre to perform independent audit. It can also take auditors a long time to build specialist knowledge about companies and sectors, especially those operating in a multi-national context.
Principle 8: Shareholder Relations	
Q 32	The IoD encourages the fostering of constructive relationships with shareholders that enables engagement. However shareholder and stakeholder engagement varies depending on company strategy. We support including Best Practice or Supporting Commentary about this.
Principle 9: Stakeholder Relations	
Q 34	We also support including Best Practice or Supporting Commentary about fostering stakeholder relations.

Conclusion

Transparency and a level of consistency in corporate reporting is important to the market, stakeholders and shareholders. Good governance practice expects reporting that is open and meaningful – that goes beyond 'tick box compliance'. It is important the New Zealand corporate reporting evolves to keep up with corporate governance developments and international trends and best practice.

We welcome this review and encourage NZX to undertake regular future reviews to ensure the Code continues to be fit for future purpose.

The IoD thanks the NZX for the opportunity to make a submission on behalf of its members. We would be happy to discuss this submission and we look forward to continued engagement with NZX as it progresses the review.

Yours sincerely

Simon Arcus
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