

23 September 2022

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Submission on NZX Corporate Governance Code – Second Consultation Paper - August 2022

The Institute of Directors (IoD) appreciates the opportunity to comment on the NZX Corporate Governance Code (the “Code”) **Second Consultation Paper** and **ESG Guidance Note Consultation Paper**, both dated 3 August 2022. (The IoD has previously submitted on the NZX Corporate Governance Code Review 2021 (the **Initial Discussion Document**) in [2022](#), and has also submitted on earlier reviews of the Code in [2016](#) and [2018](#)).

Key points:

The IoD:

- welcomes the NZX’s initiative to revise the NZX Corporate Governance Code to ensure it is fit for purpose, and up-to-date with developments and trends in corporate governance. Good governance focuses on adherence to relevant codes and principles, with a clear understanding of roles, relationships and accountabilities of the key stakeholders of an organisation.
- generally supports the review and NZX proposed changes, and continues to support the “comply or explain” approach to implementing the Code, and encourages reporting requirements that provide for meaningful disclosure to owners and stakeholders, while avoiding creating a culture of ‘tick-box compliance.’
- supports the proposal that issuers disclose their Code of Ethics training practices, and frequency, for their employees.
- submits that in addition to current and proposed requirements, Audit Committees should have at least one member with internal audit experience.
- submits that chapterzero.nz be added to the “Further

About the Institute of Directors

The IoD has over 10,000 members, is New Zealand’s pre-eminent organisation for directors and is at the heart of the governance community. We believe in the power of governance to create a strong, fair and sustainable future for New Zealand. Our role is to drive excellence and high standards in governance. We support and equip our members who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities. Given that many of our members are directors & chairs of NZX listed companies, many of our members and the organisations they govern will be directly affected by the proposed amendments to the Code. Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good governance.

Resources” section of the ESG Guidance Note.

- submits that the Code references the IoD’s [Guide to Disclosing Director Remuneration in Annual Reports](#), to aid consistent and transparent disclosure of director remuneration.
- supports the establishment of the NZX Corporate Governance Institute and recently announced appointments to it.
- recognises the important role the NZX Corporate Governance Code has in improving corporate governance in New Zealand, and assisting directors to carry out their roles and responsibilities in a continually evolving corporate governance landscape.

General comments on NZX’s proposals

Consistent with comments made in our first submission in January, we continue to support the approach the NZX is taking to review the Code, including in particular the proposed areas of reform. We are encouraged to see that this Second Consultation Paper on the Code review and the Exposure Draft of the Code, has been informed by:

- the NZX’s sample testing of issuers’ disclosure practices
- the views of first stage submitters (including the IoD)
- consideration of the impact on issuers of other regulatory codes and practices and legislative requirements
- a review of international trends and standards
- recognition of the growing awareness internationally of an entity’s social licence to operate and expectations that more attention will need to be given to the needs of stakeholders and society at large

Specific Comments

The proposed amendments to the Code contained in the exposure draft, relate to a number of Code Principles, set out below. These are broadly consistent with the first review, with the addition of amendments to Principle 1 “Ethics” (which was out of scope and had no changes proposed in the Initial Discussion Document) as well as proposed changes to the way in which the Environmental Social & Governance reporting is undertaken (by amendments to Principle 4 of the Code and the ESG Guidance Note, and changes to the commentary which supports the recommendation in Principle 4 of the Code).

1. Operation of the Code

NZX propose retaining the ‘comply or explain’ framework for the Code and providing further guidance as to how disclosures against the Code should be made. The IoD supports continuation of the current “comply or explain” approach to implementing the Code, and the proposed further guidance as to how disclosures against the Code should be made, as set out by NZX in the consultation papers.

The Listing Rules require issuers to report against the Code, and to publicly report the extent to which the issuer has followed the Code recommendations. This allows the flexibility to adopt other

corporate governance practices, and explain why it hasn't followed a Code recommendation. The IoD agrees that the 'comply or explain' regime is appropriate. It allows an issuer's board flexibility to adopt corporate governance practices it considers to be more suitable than those recommended in the Code. It also ensures that investors and other stakeholders are provided with good information about the governance practices adopted, enabling them to make informed decisions and have meaningful dialogue with the boards of listed companies.

We are also encouraged the NZX sample testing indicates that over the last 3 years there has been greater adoption of the Code recommendations, under the 'comply or explain' regime, and that there was widespread support by submitters for the retention of the 'comply or explain' regime. We support the NZX proposed changes made in response to submitters concerns about the quality of 'explain' disclosures, and in particular the details provided for non-adoption or partial adoption of a recommendation. The proposed changes provide greater guidance, as to how the non-adoption of a recommendation should be reported, as well as amending the commentary in relation to particular recommendations to enhance disclosure.

We agree with the proposal to encourage the use of an index or explanatory subheadings when issuers report against the Code recommendations. This will assist readers of the issuer's corporate governance statement to more easily navigate disclosures in relation to the recommendations, including those an issuer has not adopted. Providing this level of clarity and transparency is good corporate governance practice and helps build trust with investors and stakeholders.

As we noted in our earlier submission, to work effectively, there needs to be genuine commitment to good governance. While the NZX feedback sample testing indicates that issuers have increasingly been adopting the Code recommendations over the past three years, further clarification and guidance as to how disclosures against the Code should be made will be beneficial to issuers, and ultimately all stakeholders.

2. Ethics

NZX is proposing to include Principle 1 within the review, and to amend the relevant Code commentary to provide guidance as to the frequency at which issuers should undertake training in relation to Codes of Ethics. The NZX is also recommending changes to encourage larger issuers to consider adopting formal whistle blowing arrangements, including access to third-party agencies.

As noted above, the NZX Initial Discussion Document did not propose any changes to current Principle 1 – Code of Ethical Behaviour. However, a number of submitters suggested the inclusion of Principle 1 in the review, given that ethical considerations are fundamental to good governance.

The IoD supports the NZX's proposal to include Principle 1 in the Code review. Further, by renaming it as suggested to 'Ethical Standards' it will better reflect that Recommendation 1.1 (i.e. the Board to document a Code of Ethics applying to all directors and employees) relates to ethical standards more broadly than a Code of Ethics.

Mandatory Code of Ethics?

We support the NZX's view that it is appropriate to retain its current expectations through recommendation 1.1 on a 'comply and explain' basis, not a mandatory requirement as favoured by some submitters. This is on the basis of consistency with international standards (i.e. not mandated through listing rule settings).

Training

The IoD agrees with the proposed amendment to the Code Recommendation 1.1 clarifying that it expects issuers to provide training to staff at least every three years, instead of the current "regularly". This reinforces NZX's expectations around disclosure relating to the frequency of training. Providing further clarity of NZX's expectations, while still on a 'comply and explain' basis, should assist issuers' organizational governance development.

To that end, the IOD does consider it would be appropriate for issuers to disclose their practices in relation to providing employees with training in relation to their Code of Ethics, including the frequency of that training.

Whistleblowing

Recommendation 1.1 currently notes that the code of ethics should outline internal reporting procedures for any breach of ethics, and that the code of ethics should require that an issuer's employees and directors adhere to any procedures about whistleblowing.

We support the NZX's decision to reject further enhancement of this recommendation to include external reporting procedures for any breach of ethics, in consideration of the provisions of the Protected Disclosures Act which came into effect on 1 July 2022. The IoD also supports the proposed updated Code commentary to recommend issuers consider whether it is appropriate to provide access to an external agency for whistleblowing purposes, and ensuring that issuers understand their legislative responsibilities in relation to protected disclosures.

3. Director Independence

NZX is proposing a number of changes to the recommendations underpinning Principle 2 that relates to board composition and performance. A number of these changes relate to NZX's requirements for independence and include technical changes to the Rules and Code. This includes amendments to recommendation 2.4, that the board of an issuer should provide disclosure of its reasons for a determination of director independence when one of the factors contained in the Code commentary is present. Also proposing that issuers carefully consider the independence status of a director whose tenure on the board is twelve years or more.

The IoD notes that NZX Policy plans to undertake a 'deep-dive' in relation to the Rule settings for independent directors in 2023. This submission responds to the proposed material amendments arising from the current review.

Matters to be considered when determining director independence

The definition of "Disqualifying Relationship" contained in the Listing Rules. The Rules currently

require that this definition is interpreted having regard to the factors described in the Code that may affect director independence, if applicable.

As a result of submission feedback NZX is proposing a technical amendment to the definition of a “Disqualifying Relationship” contained in the Listing Rules. The aim is to clarify that the factors contained in the Code are not the only factors that a board should consider when making an assessment of a director’s independence.

The IoD supports this change, and agrees with concerns expressed by a number of other submitters that the current factors identified in the Code are likely to be applied on a ‘tick-box’ basis by issuers when determining independence, rather than being included as part of a more holistic assessment.

Proposed amendments to the Code commentary emphasise that the factors contained in the Code are examples of interests and relationships that may preclude a director from being regarded as independent.

The IoD agrees with and supports the NZX’s assessment to introduce a change that better aligns with the approach taken under the ASX Code.

Disclosures relating to an independence determination

General submission feedback indicated that issuers only provide a disclosure in relation to a director’s independence when that director had been determined not to be independent. Furthermore, NZX’s sample testing identified that a large proportion of issuers did not explain the basis for a determination of independence.

As a result, and after considering the various factors that may be considered as part of an independence determination, including legislative requirements, the NZX is proposing a new Code recommendation as part of recommendation 2.4. This will encourage issuers to provide disclosure when a director is determined to be independent despite the presence of one of the factors identified in the Code.

The IoD agrees with the NZX’s determination that this will enhance the information available to investors regarding director independence determinations (noting that the Code operates on a ‘comply or explain’ basis, which would allow an issuer to explain why it is appropriate not to provide the recommended disclosure). The IoD supports the NZX view that this proposal strikes a balance in enabling an appropriate level of detail regarding the independence determination to be provided to the users of the corporate governance statement provided under Listing Rule 3.8.1. The IoD also notes that this aligns with the approach taken in Australia.

Consequences of a determination that a director is not independent

NZX notes the importance security holders place on the board’s assessment that a director is independent, and the feedback from submitters that there is often a stigma attached to the determination that a director is not independent. We agree with other submitters and the NZX that nonetheless, non-independent directors may be high-performing stewards. In the event of a determination a director is not, or is no longer independent, what is most important is that the issuer has appropriate conflict management arrangements to manage the conflict that has given rise to the director’s lack of independence.

The IoD supports the proposed clarification to Recommendation 2.4 that the Listing Rules set the board composition requirements, and that an issuer may have a certain number of non-independent directors in accordance with those requirements, while ensuring that there are appropriate conflict management arrangements in place to manage the relationship or circumstance that has given rise to the director being considered to be not independent.

Changes to the independence assessment factors

The IoD generally supports the NZX proposed technical amendments to the drafting of some of the factors listed in the Code as inclusive considerations that should be used to determine a director's independence, including changes to the length of time within which previous relationships with an external audit firm are relevant, for consistency with recommendation 3.1 relating to the audit committee chair's independence.

The IoD also supports the proposed expansion of the term "close family ties", to include close personal relationships. This would include personal, business or social connections, reflecting that these relationships can also affect a director's independence. This aligns with the approach taken in Australia.

Tenure

The IoD supports the proposed clarification in the Code that where a director's tenure exceeds twelve years, the director's tenure may be a factor that precludes the director from being regarded as independent. The inclusion of this change (along with the recommendation noted above) is not intended to prevent a board from making a determination that a long tenured director is independent, but if so, will encourage greater disclosure of the issuer's reasons for such a determination.

Succession planning

The IoD notes the NZX is proposing a change to the Code commentary to Recommendation 2.4 (dealing with the disclosure of information about each director in the annual report or on its website). This is in response to submission feedback, that issuers also publish information about the board's succession planning arrangements. The IoD agrees with other submitters that this information would be useful for stakeholders to know, and would be good governance practice, reinforcing transparency and building trust.

- Requirements relating to the independence of the chair
- The IoD supports the proposed amendments to clarify what existing recommendation 2.9 says about having an independent chair of the board, and requiring the chair and CEO to be different people if the chair is not independent. This includes:
 - splitting current Recommendation 2.9 (Chair and CEO independence requirements) into two separate recommendations, ensuring that appropriate disclosures are provided in relation to both limbs of the current recommendation.
 - New recommendation 2.10, providing that the chair of the board should be independent of the board's CEO, whether or not the chair is independent.

- The IoD agrees with and supports the NZX proposed changes, on the basis the amendments are consistent with the corporate governance expectations of the ASX, SGX and the UK Financial Reporting Council. These changes recognize and reinforce the importance of the separation between the management of an issuer and the chair’s governance role, in enabling a board to effectively challenge management.
- The IoD generally supports proposed changes under the following headings audit committees, remuneration committees and takeover committees.

We agree with the proposed amendments to the Code commentary, similar to the approach taken in Australia, that issuers should disclose the qualifications and experience of audit committee members. We agree that it is important that internal audit and management have a co-operative working relationship. In addition to the audit committee having an independent chair, a majority of members that are independent directors, and at least one member with an accounting or financial background, **we submit that** at least one committee member should have experience with internal audit. We refer to chapter 3.5 of the IoD’s **Four Pillars “Internal Audit”** and chapter 4.9.3 **Four Pillars “Features of an effective audit committee”**.

4. Remuneration – Principle 5 of the Code

Clarification of separate recommendations applying to directors and executives

The IoD supports NZX proposed drafting changes to recommendations 5.1 and 5.2 and the associated commentary to clarify the recommendations and commentary, so that they more clearly relate to director remuneration and executive remuneration, respectively.

Non-financial goals when setting executive performance-based remuneration

The IoD also supports the proposed amendments to the commentary to recommendation 5.2 that expand the matters issuers should take into account when setting performance-based remuneration for executives. These should include non-financial goals identified by an issuer as integral to its strategy, and the values of the issuer.

As we noted in our earlier submission, consistent and open reporting on director and officer remuneration helps build trust and confidence in corporate governance. Director and officer pay is increasingly in the spotlight. Boards can continue to expect greater scrutiny and heightened debate about levels of remuneration and corporate income disparities.

The IoD supports the proposed change to the commentary to recommendation 5.2, in line with our earlier submission this year, to encourage issuers to disclose how its executive remuneration arrangements align with its strategy and performance objectives. This includes disclosing any generic eligibility and vesting hurdles for any long-term incentive scheme that forms part of those arrangements.

Independent advice

We support clear and transparent reporting of organisations’ remuneration policies and procedures, including the reasoning behind the approach to remuneration paid to directors and senior executives.

We support the proposed changes to the recommendation 5.2 Code commentary, in line with submitter feedback, that where an issuer relies on an independent remuneration report in formulating its director remuneration arrangements, the issuer should disclose a summary of the report (in line with the recommendations for executive remuneration arrangements). We agree that this is important information to make available in the interests of clear and transparent reporting, to enable shareholders to make informed decisions about director remuneration proposals.

Expectations of institutional investors and the public are continuing to increase and it is important that companies look to meet these expectations by considering other opportunities for transparency such as reporting on diversity or pay gap matters.

Reporting director remuneration

In our earlier submission, we referred to the IoD's 2017 [Guide to Disclosing Director Remuneration in Annual Reports](#) developed in conjunction with experienced company director members. The guide aims to support transparent and consistent disclosure of director remuneration. The framework includes disclosing details on all board and committee fees received, plus any other benefits or payments received and associated explanations.

As we noted in our earlier submission, the Financial Markets Authority references the IoD guide in their Corporate Governance Handbook. We continue to encourage the NZX to reference the [Guide to Disclosing Director Remuneration in Annual Reports](#) in its own Code to aid consistent and transparent disclosure of director remuneration.

Gender pay-gap reporting

NZX is proposing that issuers within the S&P/NZX 50 Index and with more than 50 employees consider providing gender pay gap reporting information. These proposed changes are discussed in more detail in relation to the proposed amendments to the Code for issuers' diversity practices

5. Shareholder meetings

Sound corporate governance holds shareholder participation as a key factor in successful shareholder meetings. Shareholders must be able to engage with the board and attend and vote at shareholder meetings on an equal basis to maintain the integrity of corporate governance in New Zealand. Traditionally this has been through being physically present at meetings. This has now extended to virtual meetings, particularly over the last three years following Covid related restrictions.

We are supportive of NZX's proposed changes to the Code commentary that would encourage issuers, particularly those in the S&P/NZX 50 Index, or those with geographically diverse registers, to facilitate hybrid meetings. Offering virtual meetings allows for greater attendance and by promoting hybrid meetings, which by definition include a physical meeting, shareholder participation is encouraged by whatever form of engagement suits them best.

We support the proposed amendments to recommendation 8.2 of the Code, and the associated commentary to promote shareholder meeting arrangements being designed in a manner that encourages shareholder participation, including through the use of hybrid meetings, and to provide additional guidance in relation to the virtual aspects of a shareholder meeting.

6. Non-financial reporting - also headed 'Environmental, Social and Governance reporting in the consultation documents.'

NZX is proposing amendments to clarify the operation of the Code's recommendations in relation to non-financial reporting, and to reflect the new legislative climate related disclosures framework.

NZX is not proposing changes to reflect modern slavery reporting requirements in recognition of the Government's current consultation regarding legislative change in this area.

Extensive feedback received by the NZX reflected the increasing importance to investors and other stakeholder in understanding an issuer's ESG practices. Changes have been proposed to the Code and the ESG Guidance note as a result.

The NZX originally published the guidance note relating to environmental, social and governance (ESG) reporting to accompany the Code. The ESG Guidance Note provides a resource to NZX issuers to understand the benefits of ESG reporting, provide information about global frameworks, and support the effective communication of ESG opportunities and risks to investors and other stakeholders. The exposure draft contains changes resulting from the review of the Code, submitter feedback, and international best practice.

Split recommendation 4.3 – financial and non-financial reporting

We support the proposal to split recommendation 4.3, so that the Code contains be-spoke recommendations relating to financial and non-financial reporting, to increase the prominence of the Code's endorsement of non-financial reporting

Website as the primary location for ESG reporting

We agree with the proposed amendments to the Code commentary relating to the location of ESG disclosures, to note that where an issuer provides ESG reporting on its website, that its annual report should include a clear statement as to where that information is available.

We also support the reported general view of submitters that an issuer should have the discretion to provide reporting on its website so long as the reporting was referenced in the annual report. This is reinforced by NZX sample testing which showed that more detailed ESG reporting was commonly available on an issuer's website.

Process for non-financial disclosures

We agree with the reported feedback that submitters were supportive of NZX expanding the Code commentary to encourage issuers to report the process by which their non-financial reporting disclosures had been prepared where it has not been subject to formal review of audit by an external auditor. This reflects amendments made by ASX to the ASX Code in 2019. We support the proposed changes to reflect this feedback in the exposure draft of the Code.

Description of risk management framework

The NZX has agreed with a submission made that it would be helpful for the commentary to recommendation 6.1 (which relates to an issuer's risk management framework) of the Code to clarify that an issuer should report its risk management framework. The IoD agrees with the NZX

view that this could be a useful disclosure, in order to provide investors with more clarity as to how an issuer has identified the material risks to its business.

We support the proposed additional commentary to recommendation 6.1 to address this consideration.

Climate-related disclosures

As we submitted earlier, transparent and clear reporting on financial and non-financial information, including on environmental, social and governance (ESG) matters is critical to building and maintaining trust and confidence in corporate governance and financial markets.

It is vital that reporting is useful and meaningful, and goes beyond compliance, to help drive strategic thinking and performance. One of the challenges for listed companies is the myriad of reporting expectations and frameworks. It's essential that there is as much alignment as possible, in particular with any mandatory requirements such as the incoming climate disclosure standards.

The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 was enacted in October 2021. The legislation will require climate reporting entities, which will include all NZX issuers (other than small listed issuers) to mandatorily report using the framework to be implemented by climate standards that are being developed by XRB.

We agree with the NZX's proposed consequential changes to the Code commentary to alert issuers of the new legislative obligations, and to update the ESG Guidance Note to provide additional material to support issuers in becoming familiar with the new reporting requirements.

Modern Slavery

We support the NZX's position that given the Government's recent consultation on modern slavery reporting, it is inappropriate to amend the Code at this time, while the obligations are being designed through a legislative review process.

Further Resources (for ESG Guidance Note)

We recommend the inclusion of [chapterzero.nz](https://www.chapterzero.nz) in the **Further Resources** section of the ESG Guidance Note.

Chapter Zero New Zealand is part of a global network of board directors committed to taking action on climate change. The mission of **Chapter Zero New Zealand** is to mobilise, connect, educate and equip directors and boards to make climate-smart governance decisions, thereby creating long term value for both shareholders and stakeholders.

Chapter Zero New Zealand is governed by a Steering Committee made up of high-profile corporate, social and scientific leaders; and administered by a Working Group made up of representatives from the IoD, corporate partners, climate-change advisory groups and other key stakeholders.

7. Diversity

NZX is proposing a number of changes to recommendations in the Code under **Principle 2** that relate to diversity. There was a general acceptance by submitters of the value of diverse boards and

leadership teams in driving long term business sustainability and success.

NZX considers that its proposals are validated by the academic research in relation to the benefits of a diverse board and leadership team, and the acceptance by proxy advisors in the benefits of reporting the effectiveness of an issuer's diversity practices.

As we submitted earlier, the IoD has long held that the real goal of board diversity is diversity of thought and capability. Board diversity brings a broader range of skills and experienced perspectives to the boardroom and increases the potential for success, effective risk oversight and long-term business sustainability. The IoD is committed to supporting diversity on boards including through our [Future Directors](#) and [Mentoring for Diversity](#) programmes. We also continue to support that boards set and report on diversity targets (e.g. a gender target of between 30 and 50 percent). Shifting the dial on board diversity can take a long time, especially for smaller boards. To help enable more diversity some boards may wish to consider adding an additional director or Future Director to their board.

Diversity is broader than gender

The Code currently recognizes (recommendation 2.5) that diversity is broader than gender. We support proposed changes to recommendation 2.5 recognising that diversity is increasingly acknowledged by stakeholders as delivering better long term outcomes for issuers.

We agree that it is appropriate for the board of an issuer to consider the issuer's diversity needs, based on the issuer's size, the nature of its product or service offering, its customer base and the jurisdictions in which it operates, to determine how it can bring broad perspectives in leadership and thought to its governance and management arrangements, and workforce. We agree with proposed changes to the recommendations to encourage issuers to consider factors beyond gender (to include factors such as ethnicity, social background, sexual orientation, skills, and age) when designing their diversity practices.

The proposed changes at recommendation 2.5 are supported as they are also consistent with the ASX Code's suggestions that a diversity policy should 'express the organisation's commitment to inclusion at all levels of the organisation regardless of gender, marital or family status, sexual orientation, gender identity, age, disabilities, ethnicity, religious beliefs, cultural background, socio economic background, perspective and experience'.

We strongly endorse the proposed commentary update to recommendation 2.5 that reinforces to issuers that fostering a culture of inclusion will best enable it to deliver on its diversity goals.

Gender diversity targets – S&P/NZX 20 Issuers

We agree with and support the NZX proposed changes to the Code recommendations to encourage issuers in the S&P/NZX 20 Index to set a measurable objective for gender diversity which is for their board to be comprised of at least 30% men and at least 30% women, within a specified period. We note that this would apply on a 'comply or explain' basis, and aligns with the approach taken in the ASX Corporate Governance Council's 8 'Corporate Governance Principles and Recommendations (4th Edition)' (ASX Code) for issuers in the S&P/ASX 300 Index.

Gender pay gap reporting

The IoD supports NZX encouraging gender pay gap reporting as an ESG disclosure. We support the proposed changes to highlight in the Code commentary to recommendation 2.5, that issuers (particularly issuers within the S&P/NZX 50 Index with more than 50 employees) may wish to provide gender pay gap information either on their website or in their annual report.

8. NZX Corporate Governance Institute

NZX received strong endorsement for the establishment of the Institute, and provide further details of the role and purpose of the Institute in the second consultation paper. NZX indicated in August 2022 that it expects to convene the Institute in early Q4 2022, for a one year initial establishment period.

The IoD has already congratulated the NZX on their recent announcement of the launch of the Corporate Governance Institute (CGI) to help raise governance standards across NZX listed entities and offer better investor protections. The NZX has now also announced the CGI establishment members, which includes a representative member from the IoD Council, Anne Urlwin.

We appreciate the opportunity to comment on behalf of our members.

Yours sincerely



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