

Via Email

July 26, 2018

Mavis Tan
ASX Corporate Governance Council
c/o ASX Limited
P.O. Box H224
Australia Square NSW 1215

Dear Ms. Tan:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding \$3.5 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$25 trillion in assets under management.¹

The purpose of this letter is to respond to your consultation entitled “Review of the ASX Corporate Governance Council’s Principles and Recommendations.”² We generally support the proposed revisions to ASX’s Corporate Governance Principles and Recommendations and offer the following comments for your consideration.

Proposed new recommendations

Recommendation 4.4: *A listed entity should have and disclose its process to validate that its annual directors’ report and any other corporate reports it releases to the market are accurate, balanced and understandable and provide investors with appropriate information to make informed investment decisions.*³

We generally support proposed Recommendation 4.4. This proposal is consistent with our long-standing policies on corporate governance. CII believes that every company should have written, disclosed governance procedures and policies.⁴ These corporate governance structures

¹ For more information about the Council of Institutional Investors (“CII”), including its members, please visit CII’s website at <http://www.cii.org/members>.

² See ASX Corporate Governance Council, “Public Consultation: Review of the ASX Corporate Governance Principles and Recommendations” (May 2, 2018) (hereinafter, “Consultation Document”), <https://www.asx.com.au/documents/asx-compliance/consultation-paper-cgc-4th-edition.pdf>.

³ See *id.* at 7-8.

⁴ Council of Institutional Investors, Corporate Governance Policies § 1.3 Disclosed Governance Policies and Ethics Code (updated September 15, 2017) (hereinafter “Corporate Governance Policies”), https://www.cii.org/files/policies/09_15_17_corp_gov_policies.pdf.

and practices should protect and enhance accountability to shareholders.⁵ CII has long held that good corporate governance—defined to include general issues affecting market transparency, integrity, and accountability of management to boards and shareholders—is in the best long-term interests of shareholders and capital markets.⁶

We believe that shareholders, other investors, and other stakeholders benefit when rules and regulations provide adequate protections to owners and ensure that important information is promptly and transparently provided to the marketplace.⁷ The adoption and disclosure of companies' processes to verify that the information contained in any publicly-available corporate reports is accurate and understandable will facilitate adherence to these principles of good corporate governance.

Recommendation 6.4: *A listed entity should ensure that all resolutions at a meeting of security holders are decided by a poll rather than a show of hands.*⁸

CII strongly supports eliminating the “show of hands” method of voting at shareholder meetings. A shareholder’s right to vote is inviolate and should not be abridged.⁹ Each share of common stock should have one vote.¹⁰

Voting by show of hands runs directly contrary to these principles. Because it grants every shareholder one vote regardless of whether they own one share or one million, this method is fundamentally flawed and unfair.¹¹ Moreover, this method may entirely ignore proxy votes cast prior to meetings, thereby disenfranchising shareholders who do not attend.¹² As the Australian Council of Superannuation Investors has observed, this system is “fundamentally undemocratic and problematic.”¹³

This system also hinders effective and efficient proxy voting. CII believes that public equity markets and stakeholders are best served by a system characterized by timeliness, accessibility, accuracy, certainty, and cost-effectiveness.¹⁴ Voting by show of hands undermines most of these characteristics. As mentioned above, proxy votes may be entirely disregarded under this system, limiting accessibility to shareholders. The show of hands method also produces uncertainty because proxy votes cast before the meeting may either be excluded or the chairman or qualifying members may call for voting by poll so that proxy votes are counted.¹⁵ Shareholders voting prior to the meeting cannot be certain which method will ultimately be employed. Additionally, this method reduces cost-effectiveness because shareholders may risk having their

⁵ See *id.* § 1.4 Accountability to Shareowners.

⁶ See Council of Institutional Investors, Policies on Other Issues, Value of Corporate Governance, http://www.cii.org/policies_other_issues#value_corp_gov.

⁷ *Id.*

⁸ Consultation Document at 8.

⁹ Corporate Governance Policies § 3.1 Right to Vote is Inviolable.

¹⁰ *Id.* § 3.3 Voting Rights.

¹¹ Omar Dannawi, Glass Lewis, Blog, “Thumbs Down for a Show of Hands” (July 29, 2013).

¹² *Id.*

¹³ See *id.*

¹⁴ Policies on Other Issues, Effective and Efficient Proxy Voting, https://www.cii.org/policies_other_issues#effective_proxy_voting.

¹⁵ Dannawi, “Thumbs Down for a Show of Hands.”

proxy votes ignored (and thus wasting any accompanying expenses) or expend substantial resources to attend the meeting in person just to cast one vote.

For these reasons, we strongly favor voting by poll and urge the adoption of Recommendation 6.4.

Recommendation 8.4: *A listed entity should only enter into an agreement for the provision of consultancy or similar services by a director or senior executive or by a related party of a director or senior executive:*

- *if it has independent board advice that:*
 - *the services being provided are outside the ordinary scope of their duties as a director or senior executive (as applicable);*
 - *the agreement is on arm's length terms; and*
 - *the remuneration payable under it is reasonable; and*
- *with full disclosure of the material terms to security holders.*¹⁶

We applaud ASX's focus on director independence and disclosure of potential conflicts to shareholders. CII believes that director independence is critical for good corporate governance and shareholder value.¹⁷ We understand that directors can be appealing candidates to provide certain additional services due to their familiarity with the company, their existing relationships with the board and management, and the same competence that qualifies them for their board positions.¹⁸ When determining whether to enter into and how to structure director consulting arrangements, however, boards should consider the implications for director independence and disclosure.¹⁹ Accordingly, while we support the conditions in the current proposal, we would advise that ASX expand Recommendation 8.4 and the accompanying commentary to better address director independence concerns and ensure that these arrangements serve the best interests of shareholders.

A narrowly construed definition of an independent director coupled with the policies referenced in footnote 17 is in the shareholders' and corporation's financial interest.²⁰ Independence is critical to a properly functioning board, and while an across-the-board application of any definition to a large number of people will inevitably mis-categorize a few of them, the risk is sufficiently small and is far outweighed by the significant benefits.²¹ Although no clear rule can perfectly describe and distinguish independent directors, independence depends on all the

¹⁶ Consultation Document at 8.

¹⁷ See Corporate Governance Policies §§ 2.3 Independent Board (at least two-thirds of directors [on a company's board] should be independent..[and] [t]he company should disclose information necessary for the shareowners to determine whether directors qualify as independent"), 2.4 Independent Chair/Lead Director ("The board should be chaired by an independent director...[When the CEO and chair roles are combined], the board...should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules..."), 2.5 All-independent Board Committees (stating that all members of the audit, nominating, and compensation committees should be independent).

¹⁸ See Scott D. McKinney, "Corporate Governance: Director Consulting Arrangements," *Insights: The Corporate Securities Law Advisor* 1 (August 2015).

¹⁹ See *id.*

²⁰ See Corporate Governance Policies § 7.1 Introduction.

²¹ *Id.*

relationships directors have, including relationships between directors, that may compromise objectivity and loyalty to shareholders.²² Boards have an obligation to consider all relevant factors when determining a director's independence.²³ These include a director's past and current relationships with the company itself.

An independent director is someone whose only nontrivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is their directorship.²⁴ We note that CII's definition of independent director is likely consistent with ASX's current definition.²⁵ We further note that the ASX's examples for assessing director independence are largely similar to CII's.²⁶ Under both definitions a director consulting arrangement would likely create a material business relationship and/or material contractual relationship²⁷ that would comprise the director's independence. Accordingly, we would advise that Recommendation 8.4 and the accompanying commentary explicitly indicate the effects of such arrangements on director independence.

Additionally, we agree with other commentators that approval for a director or executive consulting arrangement should follow a process similar to that used for approving director and executive compensation generally.²⁸ This process should include approval by an all-independent compensation committee,²⁹ annual approval and review by the compensation committee (if the arrangement lasts longer than one year),³⁰ committee responsiveness and accountability to shareholders,³¹ retention and termination of outside advisor when the committee deems necessary,³² and comprehensive and prompt disclosure (in plain English) of all aspects of executive and director compensation.³³ Companies should provide for annual advisory shareholder votes on these arrangements to the extent that they provide such votes on executive compensation generally.³⁴ We respectfully submit that Recommendation 8.4 and the accompanying commentary should include language consistent with these policies.

²² *Id.*

²³ *Id.*

²⁴ *See id.* § 7.2 Basic Definition of Independent Director.

²⁵ *See* ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, Commentary on Recommendation 2.3 (3d ed. 2014) (stating that a director should only be considered independent "if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, *in a material respect* his or her capacity to bring an independent judgment to bear on issues before the board and to act in the best interests of the entity and its security holders generally") (emphasis added).

²⁶ *Compare id.* at Box 2.3: Factors relevant to assessing the independence of a director *with* Corporate Governance Policies § 7.3 Guidelines for Assessing Director Independence (differing primarily in the time period relevant to director independence—three vs. five years).

²⁷ *See Corporate Governance Principles and Recommendations* at Box 2.3; Corporate Governance Policies §§ 7.3a, 7.3d.

²⁸ *See* McKinney, "Director Consulting Arrangements" at 1; *see generally* Corporate Governance Policies §§ 5 Executive Compensation, 6 Director Compensation.

²⁹ Corporate Governance Policies §§ 5.5a Committee Composition.

³⁰ *See id.* § 5.5e Annual Approval and Review.

³¹ *Id.* § 5.5f Committee Accountability.

³² *Id.* §§ 5.5g Outside Advice, 6.2b Outside Advice.

³³ *See id.* §§ 5.5h Disclosure Practices, 6.2c Compensation Committee Report.

³⁴ *Cf. id.* § 5.2 Advisory Shareowner Votes on Executive Pay (recommending that companies provide for annual shareholder votes on executive compensation generally).

Proposed changes to existing recommendations

*Changes to **Recommendation 1.5** (Diversity)*

CII thanks ASX for its commitment to achieving better gender diversity outcomes.³⁵ We generally support the proposed changes to Recommendation 1.5³⁶ and believe that they promote shareholders' interests.

We support board diversity because we believe that a diverse board has benefits that can enhance corporate financial performance.³⁷ Nominating committee charters, or their equivalents, should reflect a commitment to board diversity and incorporate considerations of background, experience, age, race, gender, ethnicity, and culture.³⁸ We note that the proposed changes encompass several additional factors.³⁹

Board diversity yields economic benefits for shareholders.⁴⁰ Empirical evidence suggests that diversity leads to increased firm value, improved corporate governance, increased returns on equity, and higher returns on invested capital.⁴¹ Board diversity also leads to better problem-solving and enhanced quality of the board's performance of its monitoring functions.⁴² While we express no opinion regarding specific diversity thresholds,⁴³ we note that research suggests that some critical mass beyond one or two directors of any particular minority group or gender "is necessary to realize fully the benefits of diversity on corporate boards."⁴⁴

*Amendments to **Recommendation 2.3** (disclose independence and length of service of directors)*

As discussed above, CII believes that director independence is critical for good corporate governance and shareholder value. Consequently, we generally support the proposed changes to Recommendation 2.3.⁴⁵

³⁵ See Consultation Document at 13.

³⁶ See *id.*

³⁷ See Corporate Governance Policies § 2.8b Board Diversity.

³⁸ See *id.*

³⁹ Consultation Document at 13 (marital or family status, sexual orientation, physical abilities, religious beliefs, and perspective).

⁴⁰ See, e.g., Mike Fucci, Deloitte, 2017 Board Diversity Survey, *Harv. L. Sch. F. on Corp. Governance & Fin. Reg.* 3 (Dec. 19, 2017) (noting that more than 90% of respondents surveyed believe that greater board diversity will enable the organization to improve its overall business performance), <https://corpgov.law.harvard.edu/2017/12/19/2017-board-diversity-survey/>.

⁴¹ See, e.g., Fawn Lee, Note, "Show Me the Money: Using the Business Case Rationale to Justify Gender Targets in the EU," 36 *Fordham Int'l L. J.* 1471, 1481 (2013) (summarizing studies on the effects of board diversity in the EU), <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2635&context=ilj>.

⁴² See, e.g., Deborah L. Rhode & Amanda K. Packel, "Diversity on Corporate Boards: How Much Difference Does Difference Make?," 39 *Del. J. Corp. L.* 377, 396 (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1685615.

⁴³ See Consultation Document at 13 (recommending that certain companies should set an objective of having at least 30% of directors of each gender within a specified period).

⁴⁴ See Rhode & Packel, "Diversity on Corporate Boards," 39 *Del. J. Corp. L.* at 409.

⁴⁵ See Consultation Document at 14-15.

We agree with ASX's recognition that a director's independence can be compromised by close personal relationships outside of their family.⁴⁶ This broader conception of close personal ties is consistent with CII's stance that a board must consider all relevant factors in determining a director's independence.⁴⁷ A number of relationships may interfere with a director's objectivity and loyalty to shareholders. Only by conducting adequate inquiry into all relevant relationships can a board determine a director's independence.⁴⁸

CII also supports the proposal to add guidance to Recommendation 2.3 establishing a presumption that if a director falls within one of the examples in box 2.3, the director is not independent unless it is clear that the potential conflict is immaterial and will not interfere with the director's ability to exercise independent judgment and to act in the best interests of the company and shareholders.⁴⁹ The benefits of a narrow definition of director independence far outweigh the risks.⁵⁰ If an interest, position, affiliation, or relationship potentially threatens a director's ability to serve objectively, it is in the best interests of the company and its shareholders to presume, absent strong evidence otherwise, that the director's independence is compromised.

*Amendments to **Recommendation 7.4** (sustainability disclosures)*

CII places great importance on corporate risk oversight.⁵¹ In determining a company's risk profile, the board should consider the dynamics of the company and its industry, as well as any systematic risks.⁵² The board should, at least annually, disclose to shareholders sufficient information to enable assessment of whether the board is fulfilling its risk oversight duties effectively.⁵³ In its present form, Recommendation 7.4 aligns with these principles by asking companies to disclose whether they have "any material exposure" to certain risks and how they manage or intend to manage those risks.⁵⁴ For this reason, we are concerned about the proposal to remove the term "economic" from Recommendation 7.4's list.⁵⁵ It appears that as a result of this change companies would no longer be expected to disclose risks to their economic sustainability. Because these risks impact a company's ability to operate at a particular level of economic production over the long-term,⁵⁶ they are likely the risks about which investors most want information.

This proposed amendment appears to stem from a desire to focus on the "social license to operate."⁵⁷ Because a company's reputation and impact on the communities it comes in contact with tend to affect its long-term performance and shareholder value, the Consultation Document

⁴⁶ See *id.* at 14 (proposing an extension of the example in box 2.3 to include "close personal ties" and adding commentary that these ties may be based on "family, friendship or other social or business connections").

⁴⁷ Corporate Governance Policies § 7.1.

⁴⁸ See *id.*

⁴⁹ See Consultation Document at 14.

⁵⁰ See Corporate Governance Policies § 7.1.

⁵¹ See *id.* § 2.7 Board's Role in Risk Oversight (stating that "[t]he board has ultimate responsibility for risk oversight" and referring to risk oversight as a "critical corporate governance matter[]").

⁵² See *id.*

⁵³ See *id.*

⁵⁴ *Corporate Governance Principles and Recommendations* at Recommendation 7.4.

⁵⁵ See Consultation Document at 18.

⁵⁶ See *Corporate Governance Principles and Recommendations* at 37 (defining "economic sustainability").

⁵⁷ Cf. Consulting Document at 18 (proposing amendments to Recommendation 7.4's commentary regarding the importance of a company's "social license to operate").

correctly acknowledges that the “social license to operate” is “valuable.”⁵⁸ The long-term sustainability of a company’s production levels, however, would seem to be at least as, if not more, valuable to shareholders and the market. To fully capitalize on a positive reputation and a commitment to social responsibility, a company must have marketable products to offer.

For these reasons, we respectfully advise that Recommendation 7.4 retain the language addressing economic sustainability risks. Information regarding these risks and how the board intends to manage them is particularly relevant to investors.

*Amendments to **Principle 8** (remunerate fairly and responsibly)*

CII believes that remuneration policies should be aligned with the creation of shareholder value⁵⁹ and thanks ASX for embracing the same principle.⁶⁰ We generally support the proposal to amend Principle 8’s accompanying commentary so as to assert that remuneration should align with “the creation of value for security holders over the short, medium and longer term.”⁶¹ We respectfully submit that the commentary should be further amended by clarifying that remuneration policies should predominately focus on long-term value creation.

In serving the interests of all shareholders, directors should prioritize long-term value creation.⁶² CII encourages companies to resist both internal and external short-term pressure and thinking.⁶³ Thus, we endorse reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term.⁶⁴ Companies should adopt remuneration policies driven predominately by performance.⁶⁵ Performance measures should incorporate a company’s short- and long-term strategic goals and focus predominately on the long term.⁶⁶ Relatedly, these policies should include sufficient and appropriate mechanisms to recover erroneous bonus and incentive awards when subsequent developments reveal that an executive’s or director’s performance was overstated.⁶⁷ We believe that ASX’s Corporate Governance Principles and Recommendations could provide even more effective guidance by including commentary consistent with these suggestions.

⁵⁸ *See id.*

⁵⁹ *See, e.g.,* Corporate Governance Policies § 5.5d Pay for Performance (stating that performance measures for executive compensation “should be aligned with the company’s short- and long-term strategic goals” and that they should be “based predominantly on measures that drive long-term value creation”).

⁶⁰ *See Corporate Governance Principles and Recommendations* at Commentary on Principle 8; Consultation Document at 19.

⁶¹ *See* Consultation Document at 19.

⁶² *See* Corporate Governance Policies § 1.10 Commitment to Long-Term Performance.

⁶³ *Id.*

⁶⁴ *Id.* § 5.1 Introduction.

⁶⁵ *Id.* 5.5d.

⁶⁶ *See id.*

⁶⁷ *See id.*

*Amendments to Box 8.2 under **Recommendation 8.2** (disclosure of executive and non-executive remuneration policies)*

For the reasons detailed in the previous section, CII respectfully submits that the proposed changes to Box 8.2 regarding “short, medium or longer-term value performance objectives”⁶⁸ should include commentary encouraging boards to prioritize maximizing shareholder value over the long term.

Conclusion

Thank you for the opportunity to comment on the proposed revisions. If you have any questions, please contact me at 202-822-0800 or Brendan@cii.org, or our General Counsel Jeff Mahoney at the same number or Jeff@cii.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Brendan Tyler". The signature is written in a cursive, slightly slanted style.

Brendan Tyler

⁶⁸ See Consultation Document at 19.