New Zealand Shareholders Association Inc.
NZSA®
Many Investors, One Voice

January 28th 2022

NZSA response to NZX Consultation
NZX Code of Corporate Governance

The NZ Shareholders' Association (NZSA) would like to thank NZX for the opportunity to comment on the review of the NZX Code of Corporate Governance (referred to as "the Code" in this submission document). We look forward to the release of the next consultation paper and upcoming workshops in March-April 2022.

Context for the Review and Consultation Process

1. **Do you agree with the objectives of the review?**
   NZSA supports the objectives of this review, as expressed within the 'objectives' sub-heading within the consultation document.

   We do note that the Page 5 of the document notes that the NZX "*intends to retain the Code's regulatory settings as recommendations that issuers may adopt and adhere to on a voluntary basis*". NZSA believes that the core principles within the Code should be considered as mandatory compliance activities.

2. **Do you have any comments on the timeline for the review?**
   NZSA is comfortable with the timelines and process of the review, particularly the workshop process planned for March-April 2022.

3. **Are there any review areas where NZX should undertake a 'deep-dive' to review the adequacy of the current Code settings?**
   NZSA believes that some elements of the Code should form part of the core compliance requirements for issuers within the Listing Rules. In particular:

   a. A statement that directors who have served greater than 12 years cannot be considered as independent (similar to Singapore Stock Exchange rules). NZSA believes this should apply to all issuers.

   b. The inclusion of mandatory climate change reporting as per the Taskforce on Climate-related Financial Disclosures (TCFD) standards. NZSA notes that the upcoming NZ climate-related disclosure (CRD) regime will be based on the TCFD standards.

c. Other areas as discussed in our submission response in Review Area One, para. 4.

Costs: We are also mindful of the relative compliance costs of disclosure for small or mid-cap companies and intend to perform further analysis on these costs during 2022. Our hypothesis is that compliance costs indirectly affect investors and the pool of companies available for investment.

a. NZSA believes that further standardisation of disclosure will ultimately *reduce* costs as expectations and requirements are clear from the outset.

b. We would also encourage NZX to review the appropriateness of a 'compliance continuum' approach, both within the Listing Rules and as part of the Code, linked to market capitalisation. This may allow an effective balance between upholding (and improving) minimum governance standards and improving compliance costs for smaller issuers.

4. **Do you have any other feedback on the proposed engagement framework for the review?**
Principle 1: NZSA questions why the NZX is not including a review of *Principle #1: Code of Ethical Behaviour* as part of this review process.

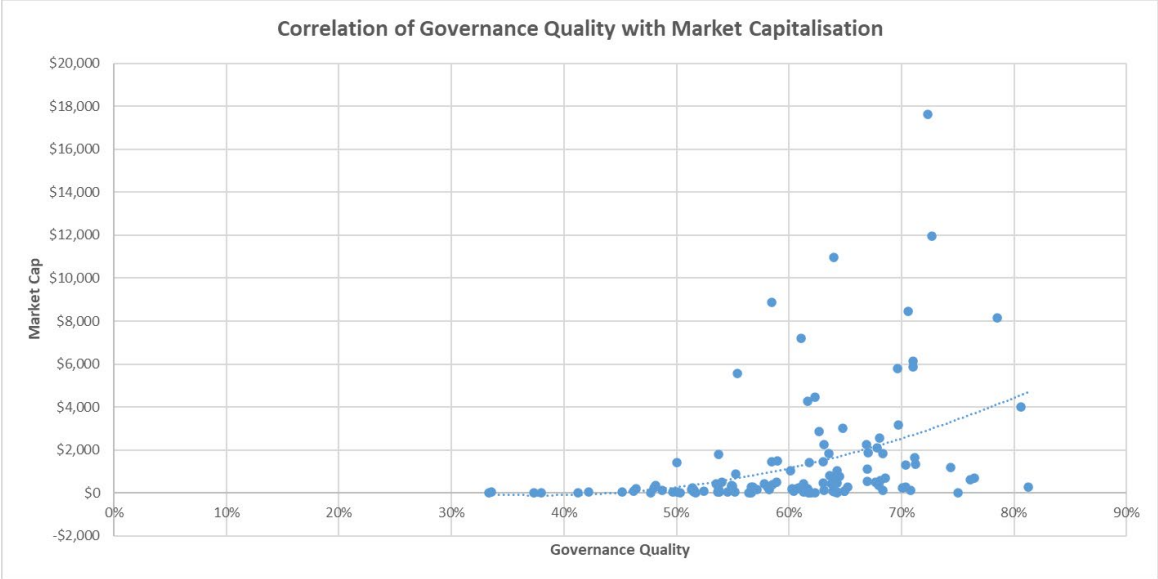
Internal Review: NZSA would be interested in further detail associated with how NZX measures compliance with the Code and would welcome the opportunity to work more closely with NZX to share its own assessments and monitor compliance with the Code.

Review Area One: 'Comply or Explain'

1. **What are your experiences of reporting under a 'comply or explain' model?**
NZSA reviews the Annual Reports of all NZX issuers, and rates issuer disclosures against our policies. We follow up with issuers where there is a discrepancy or issue that requires clarification or discussion. In general, we note the relatively high level of engagement by corporates with this approach – supporting the 'comply or explain' model.

2. **What is the overall quality of issuers' 'comply or explain' reporting practices?**
In general, NZSA notes that issuer compliance with our policies is correlated to the size of the issuer; the larger the issuer the better the compliance. Mid-cap and small issuers appear to have difficulty in explaining their reporting in relation to the Code; in some cases it is clear there is little reference or understanding.

The chart below shows the relationship for issuer compliance with NZSA policies during 2021, correlated to market capitalisation. It is important to not take this chart out of context – NZSA recognises exceptions to its policies and situations that supports different approaches. At a general level, however, the relationship is clear. While NZSA policies include our own factors, they are based on the Code – the chart serves as a useful proxy for Code compliance.



3. **Are there any specific recommendations where additional guidance should be given as to how to explain non-adoption of a Code recommendation?**
   We recommend guidance be given that the Annual Report of issuers should include a "Governance" section that directly reflects the eight Principles (in order) with the issuers required to report their own practise against the Code in clear terms.

4. **Are there any recommendations that should be compulsory that should be addressed by way of an amendment to the Listing Rules?**
   NZSA believes that many of the recommendations expressed in the Code should form a part of the Listing Rules (i.e., mandatory disclosure and compliance), as a way of improving governance standards and practices. Specifically:
   a. All recommendations in Principle 2 (Board Composition & Performance)
   b. All recommendations in Principle 3 (Board Committees)
   c. All recommendations in Principle 4 (Reporting & Disclosure)[1]
   d. All recommendations related to disclosure in Principle 5 (Remuneration)
   e. All recommendations in Principle 8 (Shareholder Rights & Relations), although this may require clarification on exceptions applicable to 8.4.

   NZSA believes that development of an appropriate 'continuum'-based approach (as discussed in para.3 of the "Context" submission above) will help alleviate any concerns expressed by issuers in relation to compliance costs.

[1] NZSA notes that it has found examples where the CEO (who is on the Board) also serves on the audit or remuneration committee (or both). We do not believe this arrangement serves the interests of shareholders.

Review Area Two: Director Independence

1. **What difficulties do issuers have in applying the current principles-based assessment of a director's independence?**
   NZSA continues to query many issuers in relation to director independence. This is often on the basis of observing significant tenure or cross-relationships between directors across different

public companies. For smaller issuers, there is sometimes confusion as to who can be considered independent, with some taking the more 'prudent' approach in their descriptions.

We note the NZX website pages for issuers often contains incomplete descriptors. NZSA believes every issuer should be required to standardise their director descriptions as:

- Independent Non-Executive
- Non-Independent Non-Executive.
- Non-Independent Executive
- CEO / Managing Director

2. **What is the overall quality of issuers' 'comply or explain' reporting practices in relation to the director independence recommendations in the Code?**
   We note some Annual Reports, particularly mid and small caps do not include a full descriptor of the Directors designation in the Director Profile section.

3. **Are there any factors which are currently included in the Code that are irrelevant to an issuer's assessment of a director's independence?**
   NZSA believes al the factors expressed in the Code related to Director's independence are relevant.

4. **Are there any additional factors that should be included in the Code that issuers should consider in relation to director independence?**
   NZSA would like to see a mandatory requirement (i.e., Listing Rule) that where a director's tenure exceeds 12 years, they cannot be described as independent. NZSA's position is that a director should serve a maximum 9 year term, unless they are a founder, significant shareholder, would cause a significant loss of institutional knowledge or hold unique skills that cannot be replaced.

   NZSA utilises public records associated with director appointment dates as part of an evidence base to assess a company's focus on succession planning. This approach is less than perfect but is driven by a lack of publicly available information produced by directors relating to board succession plans. NZSA believes the addition of a factor recommending that issuers disclose succession plans would add value to an assessment of director independence.

   We note the difference in approach between the NZX's 'factor-based' approach and the ASX 'comply and explain' approach. NZSA remains comfortable with the NZX approach.

5. **How relevant is a director's tenure to the consideration of his or her independence, and is more guidance required in the commentary to the Code to clarify the relevance of tenure to a director's independence?**
   As stated above, NZSA believes tenure is an important factor in determining independence. There is also the matter of capture and influence by a strong CEO, especially if that person is also a director. We note the Malaysian Stock Exchange Rules requires a shareholder vote on Director independence after they have served 9 years.

Please note that NZSA has three policies relevant for this discussion, available on our website.

- Director Tenure (currently in consultation)
- Director Independence
- Board Composition (to be reviewed in 2022)

Note that amendments to the NZSA "**Director Tenure"** policy are currently in consultation. A copy of the proposed policy has been provided to the NZX and is also contained in Appendix 1 of this submission document. We are also in the process of reviewing NZSA requirements under the "Board Composition" policy.

Review Area Three: Remuneration

1. **Do you consider that any amendments are required to the Code in relation to the setting and/or reporting of director and/or executive remuneration? If so, please provide evidence to support your submission.**

   NZSA considers the setting of Directors Fees and Executive Remuneration as separate processes. We would prefer the NZX Code to separate the two areas to reflect this, rather than containing recommendations under a single principle.

   Executive Remuneration: NZSA believes New Zealand issuers should be required to disclose executive remuneration, especially for the CEO, more in line with other jurisdictions. Currently, our assessments have shown that most NZX issuers offer scant information that do not comply with the Code. There is a wide range of reporting quality adopted across NZX issuers on executive remuneration.

   At worst, the CEO's remuneration is not identified, and it is left to the readers of the Annual Report to assume it is the highest level in the scale of those paid over $100,000.

   Even large issuers have difficulty explaining their CEO's remuneration, particularly in relation to the methodology (metrics/measure groups, targets, level of achievement) associated with short and long-term incentive payments. NZSA has been told by some issuers that the CEO's remuneration is commercially sensitive therefore they are reluctant to make full disclosure.

   NZSA is happy to provide further details / examples in direct dialogue with NZX.

   We believe the disclosure implied by our own publication referenced in the consultation paper should be required by all issuers, so there is a consistent standard of reporting.

   Director Remuneration: We have also been advised that some Remuneration Consultants will not allow issuers to publish their Reports supporting Director Fee increases as they remain the consultants' Intellectual Property. We do not consider this approach appropriate and have discussed the matter with key providers of Director Remuneration reports in New Zealand.

   NZSA policy expects a full report to be published so that shareholders can make an informed decision. In general, NZSA will vote undirected proxies against any resolution for increased directors fees not supported by a transparent report.

2. **Should the commentary to the Code include any additional or different matters that should be considered as a relevant factor for setting executive and/or director remuneration?**
   We believe the focus should first be on improving executive remuneration reporting quality based on the current standards.

Please note that NZSA has policies relevant for this discussion, available on our website.

- Executive Remuneration (to be reviewed during 2022)
- Director Fees (currently in consultation)

Note that amendments to the "**Director Fees"** policy are currently in consultation. A copy of the proposed policy has been provided to the NZX and is also contained in Appendix 2 of this submission document.

Review Area Four: Shareholder Meetings

1. **Should the Code commentary to recommendation 8.2 be amended to encourage issuers to enable shareholders better access to an issuer where virtual meetings are held?**
   NZSA policy is that issuers should hold hybrid meetings to ensure shareholders have the opportunity to participate. We further believe this should be mandated as an NZX Listing Rule.

   We also believe that unless the likes of Covid restrictions apply issuers should be required to hold a physical meeting (as part of their hybrid meeting). This allows shareholders to engage face to face with Boards CEOs and senior executives in a manner not possible in a virtual meeting. It is a Shareholders Meeting - so shareholders should have the opportunity to attend in person.

   Note that NZSA does **NOT** support the recent amendments to the Australian Companies Act allowing issuers to substitute their physical meetings with a virtual-only meeting.

   NZSA has a policy that sets out its requirements for shareholder meetings:

   - Shareholder Meetings Policy

2. **Do you have any objections to NZX's proposal to prefer hybrid meetings over physical meetings?**
   Hybrid meetings are NZSA preferred option. We believe NZX should consider this as a mandator requirement for all issuers.

3. **What do you consider to be the benefits of a hybrid meeting model? In particular, do you consider that there would be time and cost savings for issuers who facilitate hybrid rather than physical meetings?**
   Hybrid meetings maximise shareholder engagement by allowing shareholders to participate if they can't get to the physical meeting. We note the increase of younger investors who can't always get to a physical meeting during working hours and also investors living in non-main centres across New Zealand and internationally.

   We believe the cost of the technology to hold a virtual meeting is not excessive and that, as a Shareholders Meeting, issuers should be prepared to facilitate the meeting for the benefit of the shareholders.

4. **Are there any other matters in relation to shareholder access to issuers that should be addressed by way of an amendment to the Code?**
   On a practical note, shareholders report difficulty asking questions at a virtual meeting. NZSA believes issuers should encourage technology that mirrors the physical meeting – including the ability for attendees to ask verbal questions (rather than in writing) and also have the opportunity for a supplementary or clarification question.

We believe issuers should be facilitating interaction with their shareholders. An Annual Shareholder Meeting is one part of a wider shareholder engagement and communications plan.

Review Area Five: Shareholder Participation in Capital Raising

1. **Is the quality of issuers' disclosures as to why they have not followed recommendation 8.4 sufficient to provide meaningful information for investors and other stakeholders?**
   In general, NZSA feels that disclosures made by issuers raising capital as to why they have not followed recommendation 8.4 are **insufficient**.

   In discussions between issuers and NZSA, the major reasons given for non pro-rata shareholder offers relate to:

   - Timing: for example, a capital raise made to fund acquisition where settlement timing constraints do not allow for an accelerated rights entitlement offer (AREO).
   - Issuers are targeting shareholder diversity, with the aim of reducing their cost of capital. Somewhat ironically, rather than a diverse base of retail shareholders, this can result in a single international institutional placement.
   - Underwriting costs – created by uncertainty in markets, such as that caused by Covid-19.

   NZSA recognises the need to have multiple forms of capital raise methodologies. However, we also believe that existing shareholders should have the opportunity to participate on a pro-rata basis, regardless of methodology.

   In some instances, we have seen some evidence that issuers are mindful of this when not using a pro-rata methodology – for example, undertaking analysis of their shareholder base and introducing mechanisms (such as broker stamp duties) to ensure that all shareholders are able to maintain their holdings.

   NZSA would like to see additional disclosures included in 8.4 that show:

   a) the percentage of individual shareholders that had the ***opportunity*** to maintain their pro-rata holding in the company following a non pro-rata capital raise
   b) the process/logic used by the Board to determine the (non pro-rata) capital raise structure

2. **Is there particular information that issuers have difficulty in disclosing when explaining an approach that differs from recommendation 8.4**
   We do not feel there are any barriers to disclosure.

3. **Should the commentary to recommendation 8.4 encourage issuers to make specific disclosure of any particular matter when a non pro-rata offer has been made?**
   See our comments above. NZSA would like to see additional disclosures included in 8.4 that show:
   a) the percentage of individual shareholders that had the ***opportunity*** to maintain their pro-rata holding in the company following a non pro-rata capital raise.

b) the process/logic used by the Board to determine the (non pro-rata) capital raise structure and what options were considered.

c) Explicit reporting on shareholder dilution (i.e., shareholdings pre and post cap raise)

4. **Should the commentary to recommendation 8.4 include specific factors that issuers should consider when structuring a capital raise, if so what factors should be included?**
NZSA is apprehensive at specifying particular factors, as these could be utilised by issuers looking to avoid a non pro-rata offer.

We note the commentary provided to NZSA by issuer stakeholders as shown above.

Review Area Six: Environmental, Social and Governance Reporting

1. **What is your purpose for reviewing an issuer's ESG reporting information?**
NZSA is in the midst of introducing a Sustainability Policy to be applied as part of its Company Assessment Reporting for members, which also inform our proxy voting intentions.

Investors have multiple reasons for investing in a specific entity, with sustainability now of increasing importance to a broad range of retail investors. Sustainability information is required to determine a company's risks and opportunities from externalities – including climate change, other environmental or social factors.

2. **How frequently do you review and issuer's ESG report?**
NZSA looks at ESG reports of each NZX listed entity (where they exist) at least annually.

3. **What is your primary source of an issuer's ESG disclosures?**
While NZSA recognises that an issuer's website may contain relevant ESG information, we would prefer to utilise a company's annual report or associated documents as the primary source of ESG information, with relevant links to external information sources as required.

4. **Do you consider that an ESG report must be included in an annual report, or should it primarily be housed on an issuer's website? Do you consider that an issuer's annual report needs to refer to the location of ESG reporting information and that some level of integration is necessary?**
See comments in (3) above. NZSA fully appreciates that there may be some requirement for integration between various information sources; this is no different to existing governance aspects (such as a Board Charter on a company's website).

Nonetheless, we would prefer to see core ESG ***summary*** reporting contained withing a company's annual report or equivalent, with links to supporting data.

5. **Does the Code contain appropriate guidance for issuers in relation to ESG reporting, if not what amendments should be made?**
NZSA would prefer to see the existing ESG guidance note contained directly within the Code, as a separate principle covering **non-financial reporting** (i.e., not as part of principle 4.3).

In terms of guidance provided, NZSA feels it may be appropriate to work in collaboration with the XRB Climate-Related Disclosures process to avoid rework or duplication of effort. We note that the existing guidance note refers to the identification of risks and opportunities driven by

environmental and social factors (similar to TCFD); such disclosure is supported by NZSA and we would welcome NZX efforts to improve these requirements.

For non-climate change ESG reporting, NZSA would like to see a greater focus on other forms on non-financial reporting, including H&S, diversity and staff turnover measures.

6. **Should the ESG Guidance Note or Code be updated to reflect the New Zealand legislative requirements for TCFD reporting?**
   Yes – recognising that this may again be subject to further review.

7. **There is no legislative requirement for modern slavery reporting for New Zealand companies, to what extent should this type of reporting be brought within the non-financial reporting recommendations contained in the Code?**
   As part of a new principle within the Code focused on non-financial disclosures, NZSA would prefer to see a greater range of disclosure associated with 'social' risks, metrics and measures included within the Code, similar to the Singapore Exchange approach.

   This may cover some issues within *Principle #1: Code of Ethical Behaviour* – NZSA feels that this principle should be included within the scope of the Code review in the context of a broader discussion around non-financial disclosures.

   Examples may include:

   - Modern Slavery
   - H&S disclosures
   - Corruption
   - 'Whistleblower' reporting
   - Diversity metrics (age, gender, ethnicity)
   - Staff turnover
   - Gender pay gap

8. **Should there be greater alignment between the Code and the ASX Code in relation to ESG reporting?**
   NZSA would prefer a more global alignment to non-financial / ESG reporting.

Review Area Seven: Diversity Practices

1. **Are the Code's settings appropriate in relation to diversity practices? If not, what amendments should be made?**
   NZSA believes that a board culture encouraging diversity of thought, the willingness of board members to constructively challenge each other and board members maintaining an open mind contributes significantly to long-term organisational performance.

   In an objective sense, we acknowledge that such a broad-based measure of cultural-based diversity is difficult to measure.

   NZSA believes the NZX could utilise Code recommendations as part of an active approach to encourage both diversity within issuers and disclosure of key social diversity measures, as this provides an objective approach towards understanding diversity around the board table.

Regardless, NZSA believes that (collectively) the Board must maintain its ability to challenge itself and bring the appropriate skills required to govern the company to the Board table.

2. **Are the Code's settings appropriate in relation to diversity reporting? If not, what amendments should be made?**
   NZSA notes that a level of base reporting is included as mandatory within the Listing Rules. While this is appropriate, NZSA believes that the inclusion of both pay equity (equal pay for equal work) and gender pay-gap reporting should also be included directly within the Code.

3. **What are your views in relation to a recommendation to report against a target determined by NZX that would specify thresholds for gender diversity on boards, which is similar to the approach taken by ASX?**
   As per our response in para. 1 above, NZSA believes that diversity is a broader measure than gender, but 'board culture' measurement is problematic.

   In this context, NZSA supports the adoption of a 'target' for gender diversity to be established as a recommendation within the Code, with a 'comply or explain' approach for issuers that do not achieve the target.

4. **Does the Code's guidance in relation to ESG reporting appropriately take account of diversity considerations?**
   The current ESG reporting guidance note does not adequately take into account diversity considerations. However, as stated in 6.7 above, NZSA would support an outcome where diversity, environmental and social reporting was considered as a new 'Non-Financial Reporting' Principle within the Code.

Review Area Eight: NZX Corporate Governance Institute

1. **Do you support the introduction of the NZX Corporate Governance Institute?**
   NZSA supports the introduction of the NZX Corporate Governance Institute, and appreciates the intention expressed by NZX to include NZSA as a representative of retail investors.

2. **Which stakeholder groups do you consider should comprise the NZX Corporate Governance Institute?**
   NZSA agrees with the recommendations made in the consultation paper. NZX may also wish to consider Governance NZ within its stakeholder group.

3. **Do you agree that the mandate of the NZX Corporate Governance Institute should act as an advisory body to NZX?**
   NZSA supports this initiative and feels the status of an advisory body to NZX is appropriate.

Appendix One: NZSA Director Tenure Policy (In Consultation)

Application: This policy applies to all NZX listed companies.

Purpose: NZSA maintains a range of policies to positively influence the behaviour of all participants in the NZX listed company sector. These policies should be read in the context of the NZSA Policy Framework Statement.

Statement No 14:

This policy document replaces the previous NZSA policy document dated July 2018. Key changes in this update include greater granularity in the factors used by NZSA in assessing director tenure.

1.0 Policy: Director Tenure

1.1 When a Director has served a total of 9 years, we would expect that Director and the Board to have a discussion around their continued tenure.

a) This should reflect on the skills the Director brings to the Board table in relation to the skills the Board has determined to be appropriate for the business.

b) It should also reflect on the institutional knowledge of the Director and the need to retain this knowledge.

1.2 If the Director and the Board believe the Director should seek a further term we would expect to see the discussions reflected in the Notice of Meeting – including any justification for re-election past 9 years

1.3 Our decision whether to support a further term will be based on the information provided and predicated on the principle of ensuring optimum Board performance. This may include (but is not limited to):

a) Ensuring an appropriate level of institutional knowledge is retained by the Board.

b) The degree of historic sustained company performance improvement;

c) Board appointment dates, taking into account the timing of director appointment dates to minimise succession risks for shareholders.

1.4 Where succession is not explicitly indicated by the company, NZSA will also look at appointment dates for evidence of managed succession across a Board.

1.5 While the scope of this policy applies to all directors, regardless of independence or level of share ownership, NZSA recognises the unique energy and innovation a founder-shareholder or major individual shareholder can bring to a Board.

2.0 Commentary

2.1 The mix of people on a Board and their skills sets are a significant determinant of the success or failure of a company. As a company's strategy changes and evolves over time, the members and skill sets around the board table need to match these changes.

2.2 NZSA believes there is a strong case to balance the development of capability with institutional knowledge of the company.

2.3 The Board should be continually reviewing its membership through its Board Performance Evaluation process. Regular changes at Board level encourage diversity of thought and ensure ongoing sustainability of the Board.

2.4 Regular changes of individual directors reduce risk for investors in the long-term, by reducing the risk associated with the transfer of institutional knowledge.

2.5 Whilst the NZX Listing Rules require a Director to stand for re-election at least every 3 years, and do not place any restriction on the number of terms a member can serve, Board membership should not be considered to be open ended.

a) We note 2013 Australian research carried out on behalf of the Australian Financial Review that "there is no strong correlation between tenure and performance". The same study highlighted a much stronger correlation of CEO tenure to performance, with an optimal tenure of 6-7 years.

b) In the US, a 2017 study carried out by Harvard noted that 24% of directors of Russell 3000 companies had served more than 15 years. However, we also note that attitudes in the US have changed during 2020-21, with more research papers broadly supporting tenure limits as a response to investor-led concerns around succession risk.

c) We note tenure guidelines are explicitly stated in the UK (9 years) and France (12 years). Singapore considered introducing a mandatory limit of 9 years in 2018, although this has now been reduced to a requirement for shareholder approval for terms greater than 9 years.

2.6 There is a strong research base for different criteria to be applied to 'founder-led' companies, recognising both the influence of the founder on the Board and the performance outcomes of those organisations.

3.0 Key Regulatory Requirements

none

References

Board Tenure: How Long is Too Long? – Egan Associates

Is there a case for limiting director length of service? | BoardPro | Board Management and Productivity Software (boardprohub.com)

Term Limits for Directors – Hansell McLaughlin Advisory Group (hanselladvisory.com)

On Long-Tenured Independent Directors (harvard.edu)

The Harvard Law School Forum on Corporate Governance | Board tenure

Board Refreshment and Succession Planning in the New Normal (harvard.edu)

Are long-tenured directors detrimental to effective corporate governance? | Nanyang Business School | NTU Singapore

Definitions

The definition of Independence is given in the NZX Listing rules under 2.13.3 (f).

Related Policies

17 – Board Composition

18 – Director Share Ownership

6 – Independent Directors

15 – Future Directors

Appendix Two: NZSA Director Fees Policy (In Consultation)

Application: This policy applies to all NZX listed companies.

Purpose: NZSA maintains a range of policies to positively influence the behaviour of all participants in the NZX listed company sector. These policies should be read in the context of the NZSA Policy Framework Statement.

Statement No 1:

This policy document replaces the previous NZSA policy document dated July 2018. It aims to set out best-practice conduct in terms of director fee disclosure and the process associated with changes in directors fees. Key changes in this update include recognition of the maturity of listed entities and their impact on director fee payments.

The scope of the policy applies to non-executive directors, unless otherwise stated. Non-executive directors can be either non-independent or independent, depending on factors contained within the NZX Code of Corporate Governance. Non-executive directors do not hold a usual executive role within the organisation.

1.0 Policy: Director Fees

Director Fee Payments

1.0 Director fee pools or the amount approved for each individual non-executive director role must be clearly and comprehensively disclosed in companies' remuneration reports.

1.2 Shareholders expect non-executive director fee pools to include all amounts paid to directors including any superannuation contribution and the value of share-based payments

1.3 Companies should not accrue retirement benefits for non-executive directors.

1.4 Companies should not award options or other share-based payments for non-executive directors.

1.5 A policy exception relating to the award of options or other share-based payments will be considered by NZSA for companies at an early stage of their life-cycle and for US-based directors. Any such award should require shareholder approval.

1.6 Any options, share-based or non-cash payments to Directors should be included in both the limits set by the fee pool and the disclosure of actual fees paid to directors.

1.7 For any options or share-based payments for Directors, NZSA expects disclosure of the methodology used to support the incentive – including metrics, weightings, targets and the level of achievement.

1.8 We expect any company paying share options to directors to disclose an assessment of the dilutionary impact on shareholders as part of the explanatory notes for any resolution proposed for approval.

1.9 Share options are expected to be long-term in nature, with an assessment period over at least 3 years. We also expect that the holder is subject to an escrow period of one year post-vesting.

1.10 Special exertion benefits, additional to director fees, may be acceptable in limited circumstances, but should not be paid without shareholder approval. Companies should conform to NZX guidelines.

1.11 Special exertion benefits for non-executive directors should fall within the cap of any explicit 'headroom' approved by shareholders within the Director Fee Pool.

1.12 In considering circumstances where special exertion payments may be acceptable, NZSA will consider:

a) the extent of disruption facing the organisation

b) step-change internal development

c) additional effort associated with Schemes of Arrangement and/or Takeovers as a 'target'

1.13 We expect both the amount and the reason for any special exertion benefits paid to individual directors to be disclosed

1.14 Shareholders expect that companies with an executive Chair (a dual role we do not favour) should have a significantly lower total fee pool than their peers.

Director Fee Increases

1.15 In seeking an increase for the director fee pool, companies should state the percentage increase sought as well as the amount in dollars and should outline the distribution of pool funds, including the level of proposed fees for each director (or position in the case of committee chairs yet to be appointed) for the next financial year. NZSA continues to support individual Board judgements as to individual fee allocations.

1.16 In addition, companies should assess whether they have an optimal board size. On occasion it may be more appropriate to reduce the number of directors rather than seek an increase in fees.

1.17 The proposed fee pool, and the fees paid to individual directors and the Chair, must be reasonable and supported by some form of independent benchmarking.

1.18 Where consultant reports are used to justify fee increases, the NZSA believes at least the executive summary from the full report should be made available to shareholders as part of normal disclosure. This should include:

a) a summary of the methodology used;

b) the actual company comparators or market parameters used to develop the proposed remuneration;

c) where a 'peer group' comparator set of companies is used, those companies should be of a similar market capitalisation;

d) A transparent appraisal around the complexity of the organisation compared with benchmarks.

1.19 Where the company constitution allows a pro-rata to increase in the director's fee pool for any appointment made between Annual General Meetings, companies should refrain from seeking fee increases in advance based on the possibility of an increase in board numbers during the year.

1.20 The directors must consider the overall performance of the company prior to approaching shareholders for a fee increase.

2.0 Commentary

2.1 In general, unless otherwise specified, our policy statements apply to non-executive directors.

2.2 Companies listed on the NZX are required to obtain shareholder approval by ordinary resolution for increases in their total non-executive director fee pools.

2.3 Due to an inherent and unavoidable conflict of interest, directors most often refrain from making a recommendation to shareholders on how to vote on these resolutions.

2.4 Directors often seek reports from independent consultants regarding appropriate fee levels.

a) NZSA notes the inherent conflict caused by the board being the very group that appoints and pays the consultant and the potential difference in recommendations when two consultants have reported on the same company.

b) We also note the different methodologies used by different consultants. Approaches may include a selected comparator group ('sampling') or a comparison with a full 'population' based off defined parameters.

c) NZSA notes that a pure comparative approach may result in a reflexive, 'increasing spiral' of director fee levels.

d) Companies sometimes claim that they are prevented from releasing a report due to the intellectual property rights (IP) asserted by the consultant. NZSA does not believe that a summary disclosure creates any issue with proprietary knowledge of the consultant, and that companies seeking an independent report should ensure that they retain the ability to release a summary excerpt disclosing NZSA requirements outlined in (1.18) when engaging the consultant.

2.5 Given that there is no formal independent oversight of proposed increases in fee pools, it is important that shareholders exercise their judgement on these resolutions.

2.6 The Companies Act 2003 requires directors to act in the "best interests of a company and its shareholders" (regardless of remuneration methodology).

2.7 In the UK, a recent case (see 'References') highlighted this by overturning the payment of excessive fees to Directors (representing majority shareholders) during a period where the company chose not to pay dividends to minority shareholders. That formed a series of useful guidelines that NZSA considers applicable within NZ:

a) Companies should provide clarity on the value if the services they are providing;

b) Director remuneration should be considered alongside the trading conditions of the company;

c) There should be transparency (i.e., clear disclosure) of fees and payments;

d) Fees should be supported by documentation, review and appropriate approvals;

e) Objective commercial criteria should be used to support the payment of Directors Fees.

2.8 NZSA recognises that retirement benefits for directors are not a common feature of the listed company landscape in New Zealand, with such benefits requiring approval from shareholders.

a) Nonetheless, we note that many company constitutions continue to explicitly allow for retirement benefits.

b) It can also be difficult for shareholders to re-visit prior disclosures and approved resolutions from previous years.

c) We consider it a simple matter for listed entities to include a short statement within their remuneration reports.

2.9 The payment of share-options to independent directors is not generally acceptable in a New Zealand context.

a) We note, however, that this is relatively commonplace in the United

States. NZSA does not consider this best practice as it potentially impacts a director's independence and creates a potential for misalignment between director incentives and shareholder interest

b) However, we also recognise that it may be advantageous for certain companies to retain a US-based director and that this may not be possible without offering appropriate terms.

c) We also recognise some examples of NZ-listed 'startup' companies paying options to directors as a method of saving all-important cash in the short-term. This represents a valid trade-off for shareholders, balancing short-term cash preservation with long-term dilution.

d) Where share options are paid to directors, we expect alignment with the long-term interests of shareholders.

2.10 NZSA notes the differing global approaches to the inclusion of share-based payments within independent director remuneration.

2.11 For example, while there is some acceptance of option payments within a UK context in support of incentivising long-term performance, the UK's Financial Reporting Council does not support such payments for non-executive directors. Similarly, share-based payments for non-executive directors are not supported by ASIC guidelines in Australia or by other bodies/exchanges in Asia-Pacific.

2.12 We also note that there is some risk, with a majority-owned company, of executive remuneration incentives being aligned with those of the majority shareholder, with a potential detrimental impact on minority holders. NZSA will consider this within its executive remuneration policy, although we will retain awareness of this situation in examining director remuneration practices.

2.13 We note the recent emergence of Australian company benchmarks used in reports to assess the validity of directors fees for New Zealand-listed entities. In general, NZSA is unlikely to support this as a comparable benchmark for most NZX-listed entities.

2.14 We may consider this an appropriate benchmark in situations where the company's production or administrative base is heavily concentrated within Australia,

3.0 Key Regulatory Requirements

3.1 NZX Listing Rules and Code of Corporate Governance specify disclosure requirements and guidelines for NZX-listed entities.

References

Companies Act 2003

UK Corporate Governance Code 2018 (Financial Reporting Council)

NZ FMA Guidelines

Australian Institute of Company Directors

OECD – Corporate Governance Board Practices (2011)

Chapman Tripp – Code Comparison, Oct 2019

Summary of the Booth Case (UK) 2016

Malaysia Stock Exchange Corporate Governance Guide

Definitions

none

Related Policies

Policy 5 – Executive Remuneration

Policy 6 – Director Independence

Policy 7 – Non-executive Directors

Policy 13 – Remuneration Report

Policy 17 – Board Composition