September 30th 2022

NZSA response to NZX Consultation
NZX Corporate Governance Code Consultation

The NZ Shareholders' Association (NZSA) appreciates the opportunity to comment on the Exposure Draft of the proposed Corporate Governance Code ('Code').

NZSA notes that much of the feedback offered through our submission of January 2022 have been considered and addressed (to a greater or lesser extent) within the Exposure Draft.

This NZSA submission should be read in the context of recent submissions related to NZX Capital Raise settings and the exposure draft of the ESG Guidance Note.

General Commentary on NZX Consultation Document

1. In its January 2022 submission, NZSA questioned whether a 'compliance continuum approach' should form part of the NZX review process, to "*allow an effective balance between upholding (and improving) minimum governance standards and improving compliance costs for smaller issuers.*"

   NZSA has discussed this with NZX subsequent to our submission. We accept that this has been attempted in various forms in the past and is not currently seen to offer any benefit.

2. We note that issuer disclosures on the NZX website contain non-standard descriptors of directors, some of which offer no clarity as to director independence. While not strictly within the Code, we believe that the proposed changes to Principle 2 of the Code form an opportune time to introduce a standardised descriptor.

3. NZSA does **not** support the acceptance of equity-based remuneration for directors as outlined in the commentary associated with recommendation 5.1, except in specific circumstances such as early-stage or startup companies. NZSA considered this as part of its own policy review in early 2022 (Director Fees Policy).

   Where equity-based remuneration is paid, we believe the Code should provide more specific guidance as to the circumstances where it is acceptable and also as to disclosure requirements.

   a. Equity-based remuneration should be included **within** the fee pool, with clear disclosure as to the actual equity amount awarded.

b. There should also be further disclosure to investors as to any methodology associated with their award and the potential dilutive effect on shareholders.

4. NZSA is currently reviewing its framework for Executive Remuneration, including clearer formats/guidelines associated with the disclosure of short-term and long-term incentives.

    a. Our own policy encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure 'groups' to preserve confidentiality), weightings, and the level of achievement versus target for each component associated with any inventive award.

    b. We are supportive of the changes proposed in Recommendation 5.2 and are happy to work with issuers and NZX to provide an optimised disclosure format.

5. NZSA encourages an addition to the wording of Recommendation 6.1 within the Code to encourage the disclosure of **mitigations** associated with risks, as well as disclosure of the issuer's risk management framework.

6. NZSA maintains its position that virtual-only meetings should be removed as an option for NZX-listed companies unless exceptional circumstances apply and that 'hybrid meetings' become the default standard for all (not just NZX50) companies.

7. Unless highlighted in specific consultation questions below, NZSA is **supportive** of changes highlighted in the Code exposure draft and the changes to the Listing Rules highlighted in the Appendix. This includes provisions related to:

    a. Additional commentary related to information disclosure in the "Reporting against the NZX Code" section. We especially note the exposure draft Code encouragement to issuers to "*avoid boilerplate or templated disclosures*" thereby improving the quality of the explanation provided under the comply or explain framework.

    b. The broadening of Principle 1 to cover "Ethical Standards" and the requirements for training (and disclosure thereof. However, we contend that the requirement for the disclosure of a whistleblowing process including access to a third party should be a 'comply or explain' requirement in the Code (see our commentary in relation to Consultation questions below).

    c. Broadening of factors for issuers to consider in assessing director independence and improving disclosure – with some further amendments by NZSA as proposed in our response to the Consultation questions below.

    d. The requirement for a 'comply or explain' target (not a quota) for gender diversity on an NZX20 Board, an encouragement to issuers to provide gender pay gap information and the encouragement for issuers to consider ALL forms of diversity within their diversity policies.

    e. The strengthening of Recommendation 2.9 to support an independent Board Chair and the separation of the CEO role from Board Chair.

    f. The addition of recommendation 4.4 to support 'non-financial reporting', separate and distinct from 'financial reporting' (section 4.3). We also support the contents of recommendation 4.4 and its relationship to the ESG Guidance Note exposure draft.

g. The clear distinction proposed in the Code exposure draft related to the components of director remuneration and the requirement for disclosure of independent benchmarking (but please note our commentary on Principle 5 in paragraph 3 above).

Consultation Questions – Principle 1 - Ethics

1. **Do you consider it 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?**

   Yes.

2. **Are the costs involved for issuers providing access to their employees to third-party whistleblowing services proportionate to the benefits of those services?**

   NZSA's existing assessment policies look for evidence & disclosure of a whistleblowing process, including access to a third party. We also note the relationship of this requirement to the Protected Disclosures Act 2022.

   We believe that issuers should provide access to an independent third party as part of their whistleblowing process. Furthermore, we believe that the issuer's whistleblowing process should be disclosed as part of the issuer's governance documentation. NZSA contends that the proposed wording of the Code should be strengthened from "*An issuer may wish to consider whether it is appropriate to adopt formal whistleblowing procedures…*" to be directly included as a 'comply or explain' requirement within the Code.

Consultation Questions – Principle 2 – Director Independence

3. **Do issuers have any concerns with the revised recommendation that the issuer discloses its reasons for determining a director to be independent in the presence of a Code factor?**

   NZSA absolutely supports issuer's disclosing their reasons for deeming a director to be independent. Given the factor-based approach of the existing Code, we feel this should not be an onerous requirement, as issuer's should already be considering those factors.

   NZSA's own assessment of issuer disclosures supports the outcomes of sampling undertaken by NZX, in relation to issuer's disclosing their basis for determination of director independence

4. **Do you have any comments in relation to the amendment to the factors described in the Code?**

   Review: NZSA is supportive of the planned 'deep-dive' review of director independence Listing Rule settings in 2023, although we are also supportive of the factor-based approach set out with the Code. We support the 'broadening' of this approach to include any other factors self-identified by the issuer to avoid a compliance or' tick-box' mentality, as set out in the consultation paper and in Table 2.4 of the Code exposure draft.

We note and support the current factors being used as '*examples*' in the Code exposure draft.

Ability vs Independence: We note the consultation paper commentary that "*NZX agrees with the feedback of submitters that non-independent directors may be high-performing stewards*". However, we do not believe that the functional ability of a non-independent director is the substantive issue – ultimately, the extent of independence affects the shareholder agency relationship, regardless of stewardship ability. We also note that **independent** directors may also be 'high-performing stewards' while maintaining effective shareholder agency.

As evidenced by our regular commentary, we do **not** share the view that there is a 'stigma' attached to individual non-independent directors, particularly where they are in a minority on the Board.

Non-independent majority: A common comment made by issuers in relation to Boards containing a majority of non-independent directors aligned with a majority shareholder is that the board composition "reflects the shareholding base". While fulfilling the 'comply or explain' approach, we do not consider this an appropriate explanation in the context of maintaining shareholder agency for minority investors. As directors are bound to act in the best interests of the company, we believe thee is no loss of value for a majority shareholder in maintaining a majority of independent directors.

a. While NZSA supports the 'comply or explain' approach, this situation may form part of the review of the settings associated with the planned review. NZSA would support explicit direction in the Code for this situation, perhaps through clarification that section 2.8 (relating to majority of independent directors) applies "*regardless of ownership structure*".

b. We note that the proposed last paragraph within 2.4 states that "*An issuer is permitted to have non-independent directors on its board so long as its board has two independent directors in accordance with the requirements of Listing Rule 2.1.1(c).*".

c. NZSA believes that this statement should more explicitly refer to section 2.2 and 2.8 of the Code, which clearly states that "*a majority of the board should be independent directors*".

Tenure: NZSA is mindful of the need to balance innovation and the retention of institutional knowledge when it comes to board composition. In this context, we are supportive of the Code's proposed approach by including a 12-year 'brightline' tenure as one of the example factors for a Board to consider in determining independence.

5. What is the utility of information relating to an issuer's succession planning arrangements for its board, are there any difficulties that issuers face in providing this information?

NZSA reviews the appointment dates for directors on a company's board, with the aim of identifying potential risks associated with a sudden loss of institutional knowledge or a potential loss of innovation. We look for evidence of 'staggered' appointment dates that support the regular rotation of Board members.

In this context, we value disclosures related to the future of individuals on a Board, as we believe this fulfils a key risk management function for investors. We also believe that succession planning is a key function of any Board Chair.

For issuers, we recognise the privacy/confidentiality aspects, relating to individuals, as a potential barrier to providing thorough disclosure. This is particularly relevant for issuers who have listed more recently, with common director appointment dates. This situation requires a degree of finesse by the Chair to implement succession planning for individuals prior to the completion of a full term.

6. **Should executive directors be able to sit on an issuer's Remuneration Committee?**

   NZSA does not consider it appropriate for a director who is also a CEO or Managing Director of the issuer to be a member of the Remuneration Committee, as we believe this is a conflict of interest that cannot be effectively mitigated.

Consultation Questions – Principle 2 – Diversity

7. **What difficulties will issuers in the S&P/NZX 20 Index face in reporting against a target over a specified period for its board to be comprised of persons 30% of whom are male and 30% of whom are female, noting the comply or explain nature of this recommendation?**

   NZSA does not believe issuers will have any issues in reporting the gender mix of its Board, and note that many already do.

   In terms of providing explanations for lack of compliance, NZSA does not believe there any substantive difficulty for issuers to provide disclosure. NZSA (and many retail investors) will be very interested in these disclosures.

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