

June 30th 2023

NZSA response to NZX Consultation *NZX Director Independence Policy Settings*

The NZ Shareholders' Association (NZSA) appreciates the opportunity to comment on the Consultation paper related to the Director Independence settings contained within the NZX Corporate Governance Code and the NZX Listing Rules.

NZSA Context

Recent commentary by NZSA has focused on four key statements related to Director Independence, as summarised below. Note that NZSA has existing policy statements related to both **Non-Executive Directors** and **Independent Directors**, both of which will be reviewed and updated following this submission.

We also reviewed our own policy settings related to [Director Tenure](#) in March 2022. This is not impacted by the NZX consultation nor associated NZSA submission.

General Commentary on NZX Consultation Document and recent NZSA statements

1. **Director Tenure:** NZSA maintains a dataset that tracks director tenure, shortly to be available on our website. We do **not** consider tenure itself a barrier to independence – but is a risk factor that impacts effective succession planning and heightens transition risk for shareholders.
2. **Impact of Controlling or major shareholdings:** NZSA is currently gathering further data on the extent to which NZX listed entities have controlling shareholders and the effect this has on independence. Unsurprisingly, major shareholders are a feature of many NZX-listed companies.
 - a. In this situation, independent directors rely on the patronage (goodwill) of the major or controlling shareholder. When faced with a situation where they believe they are pressured to make decisions that are in the interests of a major or controlling shareholder (rather than the interest of the company), the only current sanction available to an independent director is to resign.

- b. Conversely, this may also unnecessarily impact investor perceptions where a director resigns for other reasons.
- c. Recent shareholder resolutions brought to the [November 2022](#) NZ Oil and Gas (NZX: NZO) shareholder meeting are of interest to NZSA. This proposed the introduction of a minority shareholder regime as a means of governing potential disagreements between the majority and minority shareholders.
- d. Specifically, Resolution 5 would have prevented the majority shareholder from electing independent directors, with only minority shareholders able to vote on the election of independent directors. Resolution 4 aimed to improve consultation between NZO's majority shareholder and minority shareholders, with disclosure of rationale required when a majority of minority shareholders did not vote in favour of any resolution passed.
- e. Similar to Resolution 5, NZSA is proposing the introduction of a **minority shareholder regime** into the NZX (see our response to [Minority Shareholder Interests](#) below) for the election of independent directors.
- f. We appreciate that the introduction of such a regime is likely to require further consultation by NZX to determine both an appropriate shareholding 'brightline' and to fully consider the risk of unintended consequences. In this consultation response, we have proposed a 30% shareholding by a single shareholder – in line with the definition of a 'controlling shareholder' used by the UK's Financial Conduct Authority (FCA).
- g. To the best of our knowledge, we are unaware of a similar regime operating elsewhere, although the concept of "controlling shareholder" is defined in other jurisdictions.

A lack of adoption is not in itself a reason to reject the proposal – we believe that this may have advantages given the smaller scale of our markets and a relatively small director population.

The approach may support NZX's aims of operating a 'fit-for-purpose' regional exchange and is likely to offer greater fairness to minority shareholders and an enhanced reputation to independent and non-independent directors.

- h. This is not entirely without precedent on the NZX. We note that the Constitution of Synlait (NZX: SML) has a clause that prevents the major shareholder, Bright Dairy, to vote for independent directors. Bright Dairy would be defined as a 'controlling shareholder' under the NZSA proposal. While this clause is linked to the waiver granted to Synlait at the time of its listing, this is a similar minority shareholder regime to that proposed by NZSA.

(Note, however, that we do not endorse other elements of the waiver offered to Synlait that allow a 50% representation on the Board despite a lower level of shareholding.)

3. **Board Culture:** A key focus of independence is on maintaining an 'open mind' and ensure that directors have not been 'captured' by management, nor by other non-independent directors.
 - a. These elements are difficult to assess for external parties.
 - b. Directors often point to programmes that allow board culture to be measured and assessed – however, this requires the co-operation of the Board. Minority shareholders

are unlikely to have the ability to compel the Board to co-operate in any assessment nor the disclosure of resulting information.

- c. This concept of culture as part of any definition of independence is separate and additional to independence derived from any ‘interest’ (and inherent conflicts therein). We are supportive of any attempt to incorporate both concepts within the NZX Listing Rules as key definitions.
4. **Negative labelling:** NZSA notes the reaction of directors to being labelled as ‘non-independent’ as a pejorative description. It is unclear why this reaction occurs – within the context of broader Board Composition elements, a non-independent director is likely to add significant value to a company’s Board and is still bound to act in the best interest of the company.
5. **Performance and Independence:** We note that the Corporate Governance Institute (CGI) is researching the link between performance and independence. NZSA notes that this is not the only correlation – a key purpose of independence is also **representation** for shareholders.
6. **‘Purpose’:** We are broadly supportive of introducing a ‘purpose’ statement within the NZX Listing Rules related to director independence. We believe that this will offer clarity to investors and issuers alike, and set clear expectations for all participants.
7. **Independent Chair:** NZSA reiterates that it continues to support an Independent Chair as a recommendation within the Corporate Governance Code.
8. **Constitution:** We expect provisions relating to director independence within an issuer’s Constitution to not conflict with the NZX Listing Rules or to explicitly state that where there is a conflict, the Listing Rules have priority.

Consultation Questions – Purpose of Director Independence Requirements

1. Do you consider that a clearer articulation of the purpose of the director independence requirements would assist issuers in assessing a director’s independence?

Yes.

Additionally, NZSA believes a clear statement that director non-independence should not be seen as negative in its own right would help create a more balanced conversation amongst the director community – as noted in the “Board Culture” comments above, a non-independent director is likely to add significant value to a company’s Board and is still bound to act in the best interest of the company.

2. What do you consider an appropriate purpose statement to be?

NZSA supports the “best interests of the company” test enshrined within the Companies Act.

For a publicly-listed issuer, however, this test should be able to be publicly evidenced in a manner that removes any perception of directors acting with a conflict of interest. NZSA believes that in this context, a key purpose of director independence is to provide **confidence** to markets and investors.

Whether independent or not, NZSA believes that thought diversity is important for a Board – independence is a means of encouraging diversity as it incorporates individuals with no inside relationship. NZSA believes that any purpose statement relating to director independence should be bound within the broader concept of overall Board Composition. A ‘balanced Board’ should strive to maintain a balance of experience with constructive innovation and challenge, and minimise succession risk/sudden loss of knowledge for shareholders.

NZSA also believes that a ‘balanced board’ assists in developing decisions and responses that are in the best interests of the company, where different board members may be unable to act due to visible conflicts of interests.

3. Are there any disadvantages with including a clearer articulation of the purpose of the requirements in the Code?

No.

4. Do you agree that the conflicts of interest articulated above reflect the concerns that the director independence settings are designed to address?

Yes.

5. Should any of the interests or relationships set out be articulated differently?

No.

6. Are there additional purposes that should be reflected in the Code?

The only clear purpose stated is to manage **conflicts of interest**.

In line with our commentary in [Question 2](#) above, we also believe that a key purpose of director independence is to provide **confidence in markets** and greater **thought diversity and effectiveness in decision-making** through a ‘balanced board’ approach.

Consultation Questions – Benefits of Director Independence

1. What benefits do independent directors bring to a board?

The wider benefits of director independence are outlined in our answer to [Question 6](#) above.

We note that this is achieved through the collective input of ALL directors (including non-independent directors), with benefits including balance, experience and constructive challenge created by thought diversity.

We also note the strong link to effective representation of minority shareholder interests where a major or controlling shareholder may be conflicted in their assessment. This allows a Board to

visibly ensure it makes decisions in the best interests of the company, with non-conflicted decision-makers thereby not subject to further challenge or scrutiny by affected shareholders.

2. How important do you consider a director's independence is to enable the director to fulfil the director's duties, compared to other factors?

NZSA believes that given the legal obligations of ALL directors to act in the best interests of the company, regardless of status, that a director's independence does not per se affect the ability of a director to fulfil their obligations.

In practice, it may be easier for an independent director to consider the interests of the company first, unfettered by other relationships. Additionally, a decision made by a non-conflicted director is less likely to be challenged by shareholder groups.

3. In what specific circumstances is the independence status of a director particularly important (for example consideration of takeover proposals, or the determination of a particular offer structure)?

There are many decisions made by a Board where independence is a key factor. There are also likely to be further situations that cannot be anticipated.

NZSA believes that ALL directors need to be aware of potential conflicts of interest.

Independence, whether by interests or unfettered judgement, increases the probability of objectivity in determining an outcome.

Specifically;

- Takeovers and/or schemes of arrangement, purchase of another company or similar major transaction – especially in regard to valuations, any transaction where the non-independent directors may have an interest.
- De-listing transactions should also be considered by independent directors.
- While we are unaware of recent examples on the NZX, we believe director independence is also important in considering additional purchases of shares as a 'buyback' arrangement, underwritten or facilitated by a majority shareholder, resulting in a further degree of control by the major shareholder.

4. In relation to the consideration of takeovers, what is the importance of a director being an Independent Director under the Rules (i.e. not an Employee and having no Disqualifying Relationship) compared to independence from the bidder?

NZSA believes it should be clear that there must be independence from the bidder.

If a director is non-independent by virtue of major shareholding, their own personal energy or financial situation may influence the nature of offer that may be accepted.

5. What are your views as to the necessary levels of director independence to enable a board to operate effectively? Are these levels affected by the size or complexity of an issuer (e.g. for issuers in the S&P / NZX 20 Index, or S&P/NZX 50 Index)?

NZSA has a long-standing policy that an issuer should maintain a majority of independent directors, regardless of ownership status, size or complexity.

We believe this creates the balance of interests that meets the needs of all shareholders, and also creates the right balance of internal interests versus an external 'fresh perspective' that optimises decision-making. It is also a clearly visible structure that creates confidence for minority investors that their interests are represented on a Board in determining the best decision for a company.

This is clearly linked to our response to [Question 6 under "Purpose"](#) above.

6. Do you consider that issuers whose boards have a larger number of independent directors perform better?

NZSA believes that good governance is correlated to good performance over the long-term. Independent directors are one of the many factors that underpin good governance practice.

Therefore, there are likely to be other factors (besides director independence) that impact performance. Also, director independence is likely to correlate to other outcomes - for example, market confidence and minority shareholder outcomes.

We look forward to the outputs of the research in improving knowledge within New Zealand's investment community of director independence.

We would consider this just the 'start' of the research journey, however – as noted above, additional research questions into the impact of representation for minority and majority shareholders and the impact of effective conflict/interests management between those two groups is also relevant.

7. Do you consider that the benefits of independent directors are affected by the size and complexity of an issuer (e.g. for issuers in the NZX 20, or NZX 50)?

As a general observation, NZSA would note that greater size does not always equate to greater complexity.

The greater the complexity, the likelihood is that there is a greater need for a diverse range of experiences from independent directors to supplement the strong institutional knowledge brought by non-independents.

Complexity, however, does not necessarily correlate to NZX20 or NZX50.

8. Do you consider the current hybrid regulatory model to be appropriate whereby the Rules contain mandatory director independence requirements, and the Code contains settings which issuers may elect to adopt on a voluntary basis?

In general, yes.

However, there are specific principles that NZSA believe should form part of the NZX Listing Rules. These include:

- A requirement for disclosure as to the nature of a director's interests and their ability to maintain independent judgement, that have formed the decision-making and Board assessment as to independence.
- A requirement for a majority of independent directors should be contained within the NZX Listing Rules for NZX50 companies. **However, were a minority shareholder regime to be introduced as part of the Listing Rules related to director independence (as discussed in our initial commentary), we would reconsider this.**
- A requirement for provisions relating to director independence within an issuer's Constitution to not conflict with the NZX Listing Rules or to explicitly state that where there is a conflict, the Listing Rules have priority.

Consultation Questions – Nature of Director Independence

- 1. Do you consider that the definition of an Independent Director should be expanded to include a director who is able to conduct themselves in an independent manner and exercise an independent judgment, as well as having no Employee relationship or Disqualifying Relationship?**

Yes.

This reflects a core principle of a board culture in developing '**independence of thought**' unfettered by conflicted interests or personal relationships. Examples where judgement could be impaired is where a director has become emotionally aligned ('captured') with either management or other non-independent directors.

In practice, however, NZSA notes that it will be difficult for shareholders (outside the Board) to assess for themselves and validate directors' statements as to whether a director can act "*in an independent manner and exercise an independent judgment*" as per the Consultation paper.

NZSA believes this will essentially come down to investor trust in a given Board or company. To address this, NZSA believes it may be appropriate for NZX to publish guidance as to the types of evidence that an issuer can disclose to underpin / prove their assessment.

- 2. How would the change to the definition of Independent Director referred to in question 1 change the manner in which the board of an issuer assesses a director's independence?**

In practice, NZSA would expect very little change in most issuers. There may be some issuers where the nature of alignment with non-independent interests by independent directors may result in re-classification.

3. Do you consider that the purpose of the requirements needs to be better reflected in the definition of an Independent Director in the Rules, for example by referring to independence from the interests of management and substantial holders?

Yes, as per the discussion presented in the “[Purpose](#)” section of this submission and an expanded role to consider ‘independent judgement’ as per [Question 1](#) in this section.

While NZSA appreciates that most disclosure and assessment is likely to be contained within the Corporate Governance Code, the two tests outlined in [Question 1](#) (conflicted interests, independent judgement) should be explicitly stated in the Listing Rules, with further disclosure requirement contained within the Code.

4. Do you have any comments around the advantages and disadvantages of tailoring the director independence composition settings so that an assessment of a director’s independence is tied to the conflict of interest that a factor indicates?

Firstly, NZSA notes that the definition offered in the consultation document is based on both **conflicts of interest** and **independent judgement**.

We would always expect an assessment of directors independence to be based on an assessment of all factors.

NZSA and others would find it difficult to accept that a director who represents a major shareholder to be considered ‘independent’ in all matters except in decisions regarded as related-party transactions; this appears to be a possible scenario that may emerge from the consultation question. We believe this would not support market confidence, as per our comments under the “[Purpose](#)” section.

On the other hand, a long-serving Director who is independent in all respects other than the length of relationships may be considered non-independent for most decisions under this same scenario.

We would expect that an ‘individual factor-based’ approach would be difficult to apply in practice and may also result in unwarranted complexity of disclosure.

5. Should a director’s shareholding in an issuer be considered as a factor that indicates non-independence? If so, what level of shareholding or relevant interest in shares should trigger this as a consideration?

Yes, but at a level of **personal** wealth, rather than a shareholding percentage of the issuer. For example, if a director holds 2% of a company, but this is 80% of personal wealth, it is unlikely that a director could be considered independent.

NZSA recognises that this is likely to be impractical in terms of evidenced disclosure, but nonetheless believes this should be a factor in a Board’s assessment of director independence.

6. How do you consider the benefits of long tenure should be weighted against the effects of long tenure on a director’s independence, when considering the effects on board and director performance?

As noted in the [introductory commentary](#) to this submission, NZSA has adopted a risk-based approach to director related to succession planning, knowledge transfer and a balance of institutional knowledge with fresh perspectives.

This is a broader concept than director independence.

An ‘independent judgement’ becomes more difficult to maintain when a director has a strong relationship with other directors, the CEO or other company staff. There may other factors influencing this strong relationship besides tenure.

Therefore, director tenure is one of many objective factors that can be used to support an assessment of ‘independent judgement’ (see [Question 1](#)).

Tenure in and of itself should be considered within the context of the wider Board.

7. Are there any additional matters that should be considered in relation to the definition of director independence?

No

Consultation Questions – Minority Shareholder Interests

1. Do you consider that the current director independence requirements do not appropriately protect the role of minority shareholders?

NZSA believes that the current director independence requirements do not effectively consider the relationships of independent directors who serve with the ‘patronage’ of a major or majority shareholder.

2. Should issuers be encouraged to engage with minority shareholders in relation to the assessment of a director’s independence?

No.

We expect this would be difficult in practice, and would require an approach to shareholders ahead of a company’s shareholder meeting. Any shareholder discontent with the Board’s assessment of independence is ultimately likely to manifest as a negative shareholder vote.

3. What benefits and disadvantages would arise if minority shareholders were able to veto a board’s assessment as to the independence of a director?

NZSA believes this ‘veto’ has an existing ability to occur within a shareholder meeting.

Currently, however, a Resolution to elect or re-elect a Director is conflated with the status of that Director. For example, a typical Resolution might propose “*To elect [name] as an Independent Director*”.

NZSA proposes that these resolutions are separated into their component parts. For example;

- Resolution 1A: To re-elect [name] as a Director of [company]
- Resolution 1B: To confirm the assessment of [name] as an Independent Director

We believe that this approach would encourage a more transparent approach to the assessments of independence or non-independence.

4. Are there alternative or additional changes that you consider should be made to the director independence settings more appropriately address the conflicts between majority and minority shareholders?

As noted in the [introductory comments](#) to this submission, NZSA believes that there is justification for a change to the Listing Rules to include a **minority shareholder regime**, stipulating that where a company has 30% or more of its shares owned by a single shareholder, that shareholder (or shareholders) is/are **unable to vote on the election or re-election of independent directors**.

While NZSA recognises the potential impact in terms of shareholder class, we note that investors are well-used to this approach as part of a Scheme of Arrangement. We do not believe this causes a loss of rights for the major or majority shareholder, as they are still served by directors acting in the best interests of the company and (potentially) their own non-independent directors. We also believe that this will improve the standing of the director community, with removal of any perceived association with majority interests.

Consultation Questions – Disclosure

1. Do you consider that there are changes to the Rules or the Code that should be made to enhance the quality of director independence assessment disclosures?

Yes.

NZSA supports a disclosure that offers true consideration of the multiplicity of factors that can impact on director independence, compared with ‘templated’ disclosures.

2. Should further disclosures be required by Rule 2.6.2. within 10 business days of a director’s initial appointment, beyond the determination of a director’s independence?

We support the disclosure of the rationale/assessments that have determined that the director is independent.

3. Should the Rules require an issuer to disclose the reasons for its assessment of a director's independence in a notice of meeting that contains a resolution to elect or re-elect a director?

Yes.

Please see our response to [Benefits, Question 8](#) above. NZSA has on occasion queried issuers as to how they came to determine a director's independence; we believe the rationale for this assessment should be clearly disclosed.

4. Should the Rules place more direct obligations on issuers to ensure that directors provide updated information in relation to changes to interests and relationships that are relevant to an assessment of whether the director has a Disqualifying Relationship?

Yes, for both "Interests" and "independent judgement" tests.

5. Should the Rules place more direct obligations on issuers to re-assess a director's independence when the issuer becomes aware that a director's interests or relationships that relate to the independence assessment have changed?

Yes. See [Question 4](#) above.

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