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Dear Hamish,

Proposed updated NZX Corporate Governance Code

The Institute of Directors (IoD) appreciates the opportunity to provide comment on the proposed updated NZX Corporate Governance Code (the Code), and with reference to questions in the Consultation Paper dated 31 August 2016.

We reiterate our comments in our submission dated 25 February 2016 endorsing the review.

About the Institute of Directors

The IoD's purpose is to drive excellence in governance. We are a non-partisan voluntary membership organisation with a diverse membership of about 8,000 members drawn from NZX-listed companies, unlisted companies, private companies, small to medium enterprises, public sector organisations, not-for-profits and charities. Our chartered membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

General comment

Good corporate governance promotes investor and stakeholder trust and confidence in listed companies and in our financial markets. Principles of accountability, transparency, ethical behaviour and long-term business sustainability underpin good corporate governance.

We generally support the proposed updated Code, including the new tiered approach and 'comply or explain' recommendations. However the real value is when companies go beyond compliance and focus on continuous improvement in corporate governance and meaningful reporting. We encourage NZX to promote the purpose of the Code to raise corporate governance standards.

Our comments focus on particular recommendations. We also provide brief comments to the specific questions in the Consultation Paper in the attached table.

Board Composition and Performance (Principle 2)

Raising corporate governance standards

The IoD is committed to raising corporate governance standards in New Zealand. We strongly support the proposed Code recommendation that directors should undertake appropriate training to remain current on how to best perform their duties as directors.

Ongoing learning is a critical part of being a director and supports good corporate governance. Continuing professional development is a requirement for members, Chartered Members, and

Chartered Fellows of the IoD. It ensures that they stay current by continuing to undertake training and development opportunities to improve their skills and board competencies.

We also support the recommendation that boards should establish a formal procedure to regularly assess director, board and committee performance. Evaluations should be undertaken regularly to help boards, committees and directors identify their strengths and weaknesses, assess their performance and determine opportunities for continuous improvement.

We support the recommendation that companies develop and disclose a diversity policy.

Separation of CEO and chair roles

The current NZX Code provides that a director should not simultaneously hold the positions of CEO and chair of the board of the same company. It is not clear to us why this is excluded in the proposed Code.

The separation of roles provides for an appropriate division of responsibilities and ensures no one person has unfettered powers of decision. This also promotes independent leadership of the board and facilitates more effective monitoring and oversight of management.

The IoD *Code of Practice for Directors* states (3.14) that 'as a general rule the roles of the chairman and managing director or chief executive officer should be kept separate and not held by one person at the same time.' We consider this should be a covered by a recommendation in the proposed Code rather than a mandatory rule.

Board Committees (Principle 3):

Director attendance

Principle 3 on Board Committees in the proposed Code provides that directors who are not members of the audit committee and employees should only attend at the invitation of the audit committee.

The IoD *Code of Practice for Directors* states (3.18) that 'Any non-executive director should be invited to attend meetings of any board committee should they so wish, whether appointed to that committee or not, provided the director is not excluded by reason of conflict of interest.'

Directors who are not members of committees should be able to attend committees, notwithstanding whether they have an invitation. This is because directors (the board) remain liable under the Companies Act 1993 for actions of committees (except in limited circumstances). Activities of committees are generally restricted to making recommendations for the board's approval, rather than the committee being empowered to make decisions in its name or on the board's behalf.

We support a recommendation that non-executive directors have a standing invitation to attend all committee meetings (provided they do not have a conflict of interest) and that employees may attend committee meetings at the invitation of committees.

Reporting and Disclosure (Principle 4):

Non-financial disclosure

We support the recommendation that issuers provide both financial and non-financial disclosure, and that they should indicate how non-financial targets are measured.

Demand from consumers, stakeholders and investors for greater transparency about corporate activities and for more holistic reporting is gaining global traction. Financial information alone does not tell the whole story, and scrutiny is extending beyond the bottom-line to examine what businesses are doing, how they are doing it, and their impact on the environment and society.

Many listed companies are already reporting non-financial information, including using established frameworks such as the international Global Reporting Initiative (GRI) or Integrated Reporting.

Given that companies already reporting non-financial information (ie on social or environmental matters) would be meeting basic requirements that are appropriate to their business and to the interests of shareholders and stakeholders, then they should not be required to change the form of their reporting to comply with this recommendation.

We support NZX providing commentary guidance, including links to existing frameworks, such as ESG, GRI, and Integrated Reporting.

Risk Management (Principle 6):

Risk management is a critical element of the board's governance role. Commentary in Principle 6 discusses health and safety and cyber breach reporting.

Health and safety reporting

Significant reforms, including the Health and Safety at Work Act 2015, have been introduced to try and improve health and safety in New Zealand.

Health and safety governance is a critical responsibility for directors and we re-iterate our previous submission and support for a Code recommendation on reporting on health and safety performance, accompanied by commentary on what this should look like – allowing flexibility for what is appropriate and meaningful for different entities.

Cyber-risk reporting framework

NZX has asked for feedback on implementing a cyber-risk reporting framework to help prevent cyber breaches.

Cyber-risk is a significant concern for many companies and is gaining attention globally. The IoD has published a Cyber-Risk Practice Guide to help boards understand and monitor cyber-risk.

The New Zealand National Cyber Security Centre (an arm of the Government Communications Security Bureau) currently deals with serious cyber incidents in large corporates (and government bodies). The newly established National Computer Emergency Response Team (CERT) will take over this function with respect to large corporates in 2017. We understand that disclosure to the CERT will be voluntary.

Material breaches should be covered by continuous disclosure requirements in the Listing Rules. We submit that NZX develop guidance about mandatory reporting of material breaches when it reviews the Listing Rules in 2017.

Code commentary could refer to disclosure of material breaches under the Listing Rules and encourage issuers to report other cyber incidents to the CERT.

Remuneration (Principle 5):

Improving consistency and transparency

Consistent and open reporting of director and CEO remuneration helps build trust and confidence in corporate governance.

We support recommendation 5.1 that actual director remuneration should be clearly disclosed and Code commentary that this should include a breakdown of remuneration for committee roles and for fees and benefits for any other services.

The IoD is pleased to be able to support improvement in the quality of reporting on director remuneration through the inclusion of a link to the IoD's framework for a standard form of disclosure. We are finalising the framework and will provide it to NZX shortly.

We support recommendation 5.3 about the disclosure of CEO remuneration and that this include disclosure of the base salary, short term incentives and long term incentives. The inclusion of performance criteria should be at a high level.

Stakeholder Interests:

The proposed Code has adopted 8 of the 9 FMA Principles of Corporate Governance. The 9th Principle dealing with stakeholder interests has been merged with other principles (ie with principles on reporting and disclosure and shareholder rights and relations).

The FMA says 'managing stakeholder interest should be viewed as simply good business' and:

> *'Company law requires directors to act in the best interests of the company (subject to certain exceptions). However advancing the interest of other stakeholders, such as employees and customers, will often further the interests of an entity and its shareholders. We encourage listed companies to report on how they have affected stakeholders.'*

We are concerned that the proposed Code dilutes the importance of stakeholder interests and runs contrary to global trends where stakeholder interests are receiving increasing attention in corporate governance. This can be seen in various areas including:

- strategy and the focus on long-term sustainability
- more holistic reporting and the greater focus on ESG, GRI and Integrated Reporting
- concepts such as conscious capitalism where stakeholders are at the heart

The IoD's *Code of Practice for Directors* provides that directors should adopt policies governing the management of relationships with key stakeholders that are consistent with the nature of the company, its mission or purpose and interests of shareholders.

Companies should recognise and respect the legitimate interests of stakeholders. Engagement with key stakeholders should assist directors to act in the best interests of the company.

Consistent with our previous submission we support including commentary about fostering stakeholder relations.

Conclusion

We understand that NZX intends to issue the new Code in Q1 2017. It is important that listed companies have adequate time to be able to comply with the new Code after it has been approved, for example at least 6 months. Earlier compliance would be optional.

The IoD thanks the NZX for the opportunity to make a submission on behalf of our members. We would be happy to discuss this submission and we look forward to continued engagement with the NZX as the review progresses.

Yours sincerely

Simon Arcus
Chief Executive
Institute of Directors

Comments on NZX Consultation Paper	
Principle 1: Ethical Standards	**Do stakeholders agree that a more detailed recommendation about ethics is useful?** Yes
	Is there anything further that should be recommended in the code of ethics or discussed in commentary? We support one ethics code for employees and directors but flexibility should be permitted so that employee ethics can be separate from a code for directors if appropriate.
Principle 2: Board composition and performance	**Are there any further matters in relation to board composition that stakeholders would like covered?** See the comments above on the separation of the roles of chair and CEO.
	Do stakeholders consider a recommendation that directors undertake training to be important? Yes, see comments above
	Do stakeholders consider that the board should establish a formal procedure to regularly assess director, board and committee performance? Yes, see comments above.
Principle 3: Board committees	**Do stakeholders consider it is still appropriate to include a recommendation that directors who are not members of the audit committee, and employees, should only attend audit committee meetings at the invitation of the audit committee? Alternatively, is this something that would be better as commentary?** See comments above
	Do you consider that the level of overlap between the mandatory Listing Rules and the Code is appropriate? Would submitters prefer some of the other committee related matters to be covered in the NZX Code as opposed to the mandatory Listing Rules? Note that this would have the impact of making these requirements non-mandatory. It would be helpful to include Listing Rules requirements about audit committees in the NZX Code so all requirements are in the same place. However, we do not want the requirements to become non-mandatory. As an alternative, we suggest that the requirements could be cross referenced in the NZX Code.
Principle 4: Reporting and disclosure	**Do you agree with the proposed recommendations?** See comments above.
	Do you agree with the proposal to address ESG reporting within commentary? Yes
	Do you agree NZX should develop its own ESG reporting guidance based on the SSEI's model guidance or alternatively allow for issuers to use the GRI framework? See comments above.
	Do you think another framework should be used instead? See comments above.
	Do you agree that issuers should make key governance documents available to interested investors and stakeholders? Yes

Comments on NZX Consultation Paper	
Principle 5: Remuneration	**Do you agree with the proposals outlined above?** Yes
	Do you agree that it is appropriate to require heightened disclosure in respect of CEO remuneration as proposed? Yes
Principle 6: Risk management	**Are there any other risk concerns you think should be specifically addressed in commentary?** See comments above.
Principle 7: Auditors	**Are there any other concerns you think should be specifically addressed in commentary about audit requirements?** No
Principle 8: Shareholder rights and relations	**Do you have any concerns about principle 8 and 9 being merged into a single recommendation regarding shareholder interests?** See comments above.
	Are there any other concerns you think should be specifically addressed in relation to shareholder rights and relations? No