NZ | **CORPORATE GOVERNANCE** | FORUM

28 January 2022
Kristin Brandon
Head of Policy and Regulatory Affairs
Email: kristin.brandon@nzx.com

NZX Corporate Governance Code Review 2021

Dear Kristin,

We welcome the opportunity to submit on the NZX Corporate Governance Code review (**Code**).

The New Zealand Corporate Governance Forum (**NZCGF**) is committed to promoting good corporate governance of New Zealand companies for the long-term health of the capital market. We believe that good governance improves company performance and increases shareholder value, which is a core focus for NZCGF members as custodians of public/client capital.

We recommend that in the next phase of this process NZX considers the potential revisions holistically and in the context of other demands on boards, with a view to ensuring the changes:

- are realistic in the context of available governance budgets and other pending regulatory change (e.g. mandated TCFD reporting); and
- will, on an overall basis, meaningfully enhance corporate governance and support increased shareholder value.

Our answers to the selected questions outlined in the Discussion Document are contained below, and draw on the NZCGF guidelines, available at www.nzcgf.org.nz. Our responses build on our ongoing discussions with NZX on many of these topics. Our key observations are:

- We support the proposed deep-dive review of director independence in H2 2022, and in the meantime have proposed some interim refinements to the Code;
- Due to ESG developments since the Code was last updated, certain elements of ESG reporting should be elevated from commentary/guidance into Code recommendations;
- Principle 8 should be updated to better reflect the shareholder–issuer relationship and shareholder rights. We also recommend bringing this principle nearer to the front of the Code;
- We welcome NZX's proposal to establish the NZX Corporate Governance Institute, and shareholders and the Forum's participation in the Institute;
- To ensure the comply/explain regime is as effective as possible, it is important that NZX/NZ RegCo monitors compliance with Code recommendations and the quality of issuer comply/explain notices, and;
- We note that there are some important governance topics that are out of scope for this consultation process as they relate to the Listing Rules, but these would benefit from a stand-alone review.

The NZCGF would be happy to meet with you to discuss our feedback and looks forward to participating in the workshops on the exposure draft of the updated Code.

Please note that individual Forum members may make their own submissions directly to NZX.

Yours sincerely,

Sam Porath
Chair
NZ Corporate Governance Forum

Context for the Review and Consultation Process

We note that this Code Review is occurring against the following backdrop:

1. The Covid-19 pandemic is in its second year and has taken a significant toll on shareholders, issuers, exchanges, directors and employees;
2. Institutional investors are becoming more conscious of responsible investing, sustainable finance and externalities/ESG issues and practices in these areas are evolving rapidly. Investors are more explicit in their weighing of responsible investment considerations with capital efficiency, as seen through the introduction of investor stewardship codes and the pricing of externalities (using ESG scores and data) in valuation and allocation models. As a result, shareholders are putting even greater emphasis on their principal-agent relationship with issuer boards, and of boards' relationships with management and stakeholders.
3. Issuers and shareholders continually face lower barriers to investing and raising capital offshore as a result of technology and reduced brokerage costs. As a result, the Code needs to be appropriate within a global context as well as Australasian context.

The New Zealand Corporate Governance Forum (**NZCGF**) is committed to promoting good corporate governance of New Zealand companies for the long-term health of the capital market. We believe that ensuring the NZX Corporate Governance Code is focussed on the key corporate governance issues minimises the compliance burden placed on Issuers and will attract global responsible investors to New Zealand's listed equity market as well as improve outcomes for shareholders.

We believe the context of the review should fully support the "comply or explain" concept – that is, implement the recommendations or explain why not - which could be seen to be undermined by the statement that the NZX "intends to retain the Code's regulatory settings as recommendations that issuers may adopt and adhere to on a voluntary basis".

1. Do you agree with the objectives of the review?

The objectives are broadly appropriate. We suggest that NZX:

- includes new stand-alone objectives that:
    - the updated Code and the Listing Rules recognise and expand on the relationship and responsibilities between boards/issuers and shareholders (see our comments on this below);
    - the Code recommendations are clearly set out, such that the recommendations and underlying rationale are understood and issuers either implement them or provide relevant, considered and comprehensive disclosures on why they have not done so; and
- broadens the objective around the Code ensuring that issuers provide investors with information about governance practices. As currently drafted, the objective implies that the information is only required for efficient allocation of capital. It should also recognise that shareholders require such information for the purposes of shareholder engagement with issuers, for responsible investment purposes and to make informed voting decisions.

2. Do you have any comments on the timeline for the review?

The timeline seems reasonable.

3. Are there any review areas where NZX should undertake a 'deep-dive' to review the adequacy of the current Code settings?

We broadly agree with the review areas.

Areas for Deep Dive Review

We would like to see deep dives in the areas of director independence, codes of ethics, the relationship between issuers/boards and shareholders. We also see the case for

"upgrading" some ESG reporting obligations from guidance/commentary to formal recommendations.

We have commented on director independence and ESG reporting in the relevant consultation questions below.

Regarding codes of ethics, we note that:

- the initial discussion document does not focus on Principle 1 of the Code.
- We believe that it should now be compulsory for issuers (above a certain size) to adopt a code of ethics.
- The broader area of codes of ethics would benefit from a deep dive review. This should cover market practice in adopting Recommendation 1.1 both in terms of documentation and the ethical procedures adopted.
- Recommendation 1.1 could be enhanced to include external reporting procedures for any breach of ethics such as the utilisation of confidential third-party agencies for whistle blowing.

In terms of the shareholder-issuer/board relationship, we note that the Recommendations in respect of Principle 8 are largely administrative and confined to the back of the Code. We consider that:

- Principle 8 should be brought forward within the Code to give it greater prominence;
- The Principle/Recommendations should be expanded to more fully describe the relationship – i.e. that:
    - the board is accountable to shareholders;
    - boards have an agency obligation to represent shareholders' interests;
    - in general terms the board's objective is to grow long-term sustainable value for shareholders.
- Recommendation 8.2 should be strengthened to make the engagement efforts more proactive – i.e. boards should ensure effective engagement with, and encourage participation from, shareholders. This is more consistent with the UK FRC Corporate Governance Code.

We also suggest that NZX considers expanding the guidance such that it more explicitly records that the board should consider the interests of relevant stakeholders (taking into account the entity's ownership type and its fundamental purpose) as part of its duty to act in the best interests of the company and consistent with its obligations to shareholders.

Other Review Areas

The review is limited to Code settings but there are several important governance issues which would benefit from a comprehensive review and would involve potential changes to the Listing Rules and/or Guidance Notes.

Guidance note on Major and Related Party Transactions

As previously communicated to NZX and NZ RegCo, the NZCGF has concerns with certain recent NZ RegCo waiver decisions which removed important shareholder approval rights over related party transactions undertaken by issuers.

We have previously requested that NZX review the Guidance Note on Major and Related Party Transactions, and we support NZX's decision to include this in its 2022 work plan.

More broadly, we suggest that NZX adopts a scheduled programme for updating Guidance Notes at set intervals.

Major and related party transaction thresholds

NZX should review the thresholds for major/related-party transactions, which are out of step with comparable markets. As part of the 2017/18 holistic review of the Listing Rules, NZX initially proposed a reduction of the threshold for major transaction approvals from

50% to 25%. This was ultimately not implemented, in part because of complexities in developing a revised approval threshold that was workable across a range of different issuers within the timeframes available at the time.

However, the result is that the current major transaction threshold is set too high for many issuers, leaving shareholders with little control over potentially very significant changes to their company. Further consideration should be given to a reduced threshold for most issuers while recognising that a higher threshold may be appropriate for particular categories of Issuer where a reduced consent trigger may result in core transactions or activities requiring shareholder approval (e.g. property or infrastructure investment companies). Refer to our previous submission on the 2017/18 holistic review for further details.

Analogously the related-party threshold of 10% for related party transactions also merits review in our opinion.

Director independence

While we have provided feedback on the director independence questions below, this is a complex topic that spans beyond the Code settings and we welcome NZX's planned thematic review of director independence for Q3/Q4 in 2022. We will seek to engage with NZX ahead of that process.

In the meantime, we recommend that NZX and NZ RegCo monitor director independence assessments, particularly in the context of boards with extended tenure or dominant shareholders in order to ensure that boards are undertaking a holistic and meaningful assessment of independence. We would also believe that a qualitative analysis of Issuer approaches may help inform the thematic review.

Auditor tenure and board's management of potential conflicts and risks arising from long tenure is another area the NZX should include in its review.

Extent of monitoring by NZ RegCo

While not necessarily a matter for NZX given the separation of functions, we recommend that there is a review of NZ RegCo's role in monitoring compliance with the Code. The Forum noted its submissions to the 2017/18 holistic review that ongoing monitoring of how issuers were applying aspects of the Code would be important – particularly on independence assessments and reporting. We recommend again that this occurs, ideally with publication of case studies on good/bad practice.

4. Do you have any other feedback on the proposed engagement framework for the review?

The framework seems sensible, and we particularly welcome the proposed workshops and bilateral engagement.

Review Area One: 'Comply or Explain'

1. What are your experiences of reporting under a 'comply or explain' model?

   Not applicable.

2. What is the overall quality of issuers' 'comply or explain' reporting practices?

   Our sense is that Issuer reporting has been mixed. Over 2020/21, key observations are:

   - There is a wide variance in the quality of issuer practices;
   - Where practices fell short of our expectations this varied as follows: no explanation at all; superficial explanations, and; inadequate attention to the recommended action (most often Recommendation 8.4);
   - Where Issuers have multiple disclosures, these are not always logically sequenced and/or easily identifiable in annual reports. We would like them presented in a manner that they can be readily identified – i.e. by providing a list of recommendations that were not complied with at the beginning at the corporate governance section of the annual report with links to the explanations (in the report or elsewhere).

   The UKFRC study cited on Pg. 9 is consistent with our observations. Our sense is that issuers are more likely to meet the comply or explain obligations when the "non-comply" is unambiguous, and the quality of the explain is both mandated and monitored.

   As noted above, we recommend greater monitoring of comply/explain practices. We encourage NZ RegCo to undertake ongoing sampling and engagement with issuers in respect of their disclosures.

3. Are there any specific recommendations where additional guidance should be given as to how to explain non-adoption of a Code recommendation?

   We suggest that:

   - Recommendation 2.9. be more clearly expressed to make it clear that there are two separate recommendations – i.e. that both 1) issuers have an independent chair and 2) that the chair and the CEO should be different people;
   - The discussion of Recommendation 3.1 should make it clearer that if either an executive director or an executive is a member of the audit committee, the Code is breached and an explain is required;
   - Recommendation 3.1 should provide that at least one of the audit committee members be both independent and have an accounting or financial background. We believe there is a good case to add "independent" to member in Listing Rule 2.13.2(d) – i.e. that it is mandatory to have an independent member with an accounting or financial background.
   - Recommendation 4.3 should bring the guidance on the strategic report into the recommendation – or a separate specific recommendation. Financial reporting should be balanced, *describe the issuer's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and use key performance indicators that are linked to strategy and facilitate comparisons.*

   See also our comments below on comply/explain notices in the context of director independence and capital raisings, where we consider more detailed disclosure is required.

4. Are there any recommendations that should be compulsory that should be addressed by way of an amendment to the Listing Rules?

   Listing Rule 3.8.1 should be updated so that if an Issuer does not meet comply/explain disclosure requirements in one reporting period, the obligation carries forward so that the Issuer must make the disclosure in the subsequent reporting period.

As currently drafted, Issuers only need to provide comply/explain notices in respect of the relevant financial year, which has meant that on certain occasions Issuers which have failed to report non-compliance in their annual report were not required to do so in subsequent reports. This deprives investors of important information.

We would like the Code to require that comply and explains are provided to shareholders, (either through the NZX platform or the following year's annual report) when breaches of Listing Rule 3.8.1 are corrected.

More generally, while we have not repeated them in this section, we have in the remainder our submission recommended that certain items should be compulsory (e.g. having a Diversity Policy) which necessitate changes to the Listing Rules. We have also identified Listing Rules that we believe would benefit from a stand-alone review.

Review Area Two: Director Independence

Before addressing the consultation questions, we comment briefly on three underlying observations pertaining to director independence.

1. While there is a range of practice in the market, we have observed relatively frequent instances of Issuers undertaking independence assessments in a narrowly focused manner that that was not intended in the 2017/18 reforms.
2. The protections which shareholders expect independent directors to provide under the Listing Rules and Code (i.e. resolving conflicts that can arise between the issuer and management or certain shareholders) are not entirely consistent with the definition of independence. In other words, the definition of independence does not ensure independent directors have the qualities required to address the underlying conflicts.
3. As a general observation, there appears to be an unhelpful stigma in the market associated with directors being classified as non-independent which mischaracterises the importance of these classifications.

Current Practice

The changes to the definition of, and approach to assessing, independence[1] was one of the more substantive shifts in the 2017/18 Listing Rule review. As you're aware, NZX moved from a more prescriptive test of independence (under which a director was deemed to be non-independent if certain prescribed factors applied) for the following reasons:

- The prescribed factors were considered overly rigid in certain situations, and result in directors being improperly classified as non-independent;
- Issuers tended to focus only on the deeming provisions when making independence assessments, and;
- A principles-based test was considered to work better. Such a test was considered more outcomes focused, and to facilitate a more 'holistic' approach where boards would assess the substance of the director's relationships and interests.

Our perception is that the reforms have not resulted in the consistent application of the holistic approach that NZX intended.

In many instances, Issuers, in completing independence assessments, appear to apply only the objective/qualitative thresholds in Recommendations 2.4 of the Code and to do so in a relatively technical/checklist-type manner. In other words, the director is non-independent if they or their family meet any of the following conditions:

- Employed within the last three years by the issuer or subsidiaries;
- Senior provider of material professional services over the last year to the Issuer or its subsidiaries;
- Material business relationship with the Issuer or its subsidiaries within the last three years;
- Substantial product-holder or associate of a substantial product-holder (>5% of capital), and;
- Material business relationship over the last three years (supplier or customer).

This practice conflicts with the Listing Rules/ Code in three ways:

1. These conditions are only a non-exhaustive list of factors that may impact on independence – they are not determinative;
2. The broader definition in the Listing Rules (i.e. that the independent director has no disqualifying relationship) does not appear to drive the classification decision;

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[1] The changes were to the definition of "Disqualifying Relationship", but for simplicity in this submission we simply refer to "independent" and "independence", etc.

3. The tenure consideration added in the previous review appears to have had no impact on Issuers' classifications of director independence. We are unaware of any Issuer classifying a director as non-independent as a result of long tenure, and certain directors have been reclassified as independent despite very lengthy tenures and other relationships with Issuers.

We have also observed that Issuers have supported more contentious determinations with statements to the effect that the board has confidence that the director "acts in the interests of the business". While that is important, it does not address other aspects of the definition of disqualifying relationship, which is that there are matters that could reasonably influence, or could reasonably be perceived to influence, in a material way, the director's capacity to bring an independent view to decisions and to represent the Issuer's shareholders generally.

Purpose of Independent Directors

In determining how independent director status should be defined and determined, it is important to understand the underlying reasons for referencing independence in the Listing Rules and Code recommendations.

We consider that the concept of independence relates principally to the resolution of conflicts which arise at the board. Specifically, two main conflicts arise:

- conflicts between management and the board (the separation of governance and management and wide-ranging agency issues, which sit at the nexus of corporate governance); and
- conflicts between various groups of shareholders – most commonly between a major (often controlling) shareholder and other shareholders.

While the references in the Listing Rules and the Code bear some consistency with the conflicts above, the definition of independence does not seem to be as well-related.

Managing conflicts with appointment of suppliers is also inherent in the first point.

Stigma on non-independent status

As previously noted, there appears to be an unhelpful perception that a determination that a director is non-independent is an aspersion on their character or integrity. This is not the case, and in fact non-independent directors may be high-performing stewards. The classification merely recognizes that their circumstances/relationships mean they are not necessarily sufficiently independent for the purpose of resolving the conflicts previously identified or reducing this risk to shareholders, including from a broader portfolio and market perspective. Shareholders cannot easily make judgements on how boards or directors manage this conflict.

This stigma may in part be driven by voting policies adopted by proxy advisors who may recommend votes against directors primarily on their independence status without adequately incorporating further corporate governance considerations in their decision-making process. Investors could be clearer on how they take these additional considerations into account.

Finally, we suggest that NZ RegCo's feedback on the consultation questions (and analysis on director independence) is published alongside other market feedback so that it can be considered as part of the next stage of the review.

1. What difficulties do issuers have in applying the current principles-based assessment of a director's independence?

Our experience is that Issuers often apply the Recommendation 2.4 criteria narrowly – as though it is an exhaustive test – rather than undertake a holistic, principles-based assessment of the totality of the circumstances.

The changes to the Listing Rules and Code in the previous NZX review that were intended to encourage the principles-based assessment appear to have had little effect in places

(e.g. we know of no issuers which have classified directors as non-independent as a result of tenure). Some of our suggestions are aimed to help reinforce the holistic approach. Also, we recommend that NZX and NZ RegCo monitor director independence assessments and conduct a qualitative analysis of issuer approaches, as this may help identify barriers to the principles-based approach.

2. What is the overall quality of issuers' 'comply or explain' reporting practices in relation to the director independence recommendations in the Code?

   Mixed at best, as set out in our summary of comply/explain above.

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?

   The factors are broadly appropriate as the definition is currently framed, but could be revisited in a deep-dive review of the approach to independence.

   We suggest including additional commentary regarding the reference to substantial product holder status (i.e. as per ASX) as on its face, a small 5% shareholding may suggest alignment between the director and other shareholders.

4. Are there any additional factors that should be included in the Code that issuers should consider in relation to director independence?

   Pending the deep-dive review of the Listing Rules, we suggest the following two changes in order to reinforce the principles-based nature of the test, and ensure that it is undertaken having regard to the fundamental nature and purpose of independent directors:

   - Updating the definition of *disqualifying relationship* in the Listing Rules to record that the assessment of independence should be undertaken "**including** having regard to the factors described in the NZX Corporate Governance Code";
   - Updating the guidance in the Code to specifically include the underlying purpose of the definition of *independent directors* (i.e. resolution of the conflicts we have identified above) and to further reinforce the importance of an overall holistic assessment having regard to the definition of disqualifying relationship and that underlying purpose.

   In terms of the specific factors in the Code, we also recommend:

   - Providing guidance around time period for which extended tenure may lead to loss of independence. This would not automatically result in a director ceasing to be independent, but the Issuer would need to provide enhanced reporting to support the board's decision. We recommend ten years, which is consistent with ASX guidance (and close to the NZCGF guidance and the UK Corporate Governance Code which are set at nine years);
   - Changing the reference to "close family ties" to "close personal ties" to reflect recent changes to the equivalent test for ASX;
   - Broaden tenure wording so it picks up compromising independence from management and substantial shareholders to align with recent ASX refinements;
   - As a minor matter, removing the following words since they are redundant given the first reference to three years: "being currently, or within the last three years, employed in an executive role by the issuer, any of its subsidiaries~~, and there has not been a period of at least three years between ceasing such employment and serving on the board~~."

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?

   Again, this depends on the conflict being addressed. Relationships between directors and management and substantial shareholders developed over many years would appear to be relevant factors in assessing independence in addressing agency conflicts.

Review Area Three: Remuneration

We suggest that the Code separates the references to executive and director remuneration. The Code notes there should be clear differentiation between the two.

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.

   We suggest that:

   - Recommendation 5.1 addresses the director remuneration issues currently set out under Recommendation 5.2, leaving Recommendation 5.2 to focus on executive remuneration;
   - The discussion regarding independent remuneration reports for directors be moved from Recommendation 5.2 to Recommendation 5.1;
   - Recommendation 5.1 includes the requirement to provide a summary or a copy of the remuneration report;
   - The guidance to Recommendation 5.1 addresses the content of the summary, which should include the peer group used and the relationship between the report output conclusions and the proposal. If remuneration proposed is higher than remuneration for peer companies, the premium (in dollars), and rationale/justification for it, should be disclosed in the notice of meeting;
   - Recommendation 5.2 (for directors and officers) and Recommendation 5.3 (for CEOs) requires clear disclosure of metrics, targets and outcomes for any incentive remuneration;
   - Recommendation 5.3 requires clear disclosure and explanation of one-off payments to CEOs.

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?

   The use of Executive Search firms, or other agencies for director searches and remuneration, should be discussed within the Code. The identity and professional fees paid to Executive Search and Human Resource firms should be disclosed, as well as a description of the search process and remuneration services received. Shareholders should be able to understand the process of reviewing executive and director remuneration. Shareholders should also be able to assess and verify whether Executive Search and Human Resource firms have been used at all.

   The use of Executive Search and Human Resource firms also impacts Principle 2: Board Composition. Shareholders should be able to understand the process of executive and director appointment.

   Issuers should also have to breakdown employee costs between wages and salaries paid to Management and those paid to Other Employees on an annual basis, with consideration given to pay ratios (both of remuneration and increases over time).

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?

   Yes, the commentary should address virtual meetings specifically and the services available to virtual attendees at hybrid meetings. It is important that virtual attendees can enjoy two-way communication. Specifically, the processes in place should:

   - Ensure all shareholder questions are presented to the board;
   - Enable shareholders to respond to answers to questions. Oral questions with options to follow up are desirable (subject to a good technological solution), and;
   - For clarity, the NZCGF supports hybrid meetings, but not virtual-only meetings (apart from Covid-related reasons for virtual-only).

2. Do you have any objections to NZX's proposal to prefer hybrid meetings over physical meetings?

   No – the only negatives would appear to be:

   - incremental costs; and
   - the risk of inferior access which we would encourage Issuers to address via technology solutions (see above).

   We expect that the incremental costs for Issuers should be relatively small (this should be confirmed in the next stage of the review), but in any event the proposed approach would allow smaller Issuers to continue with physical meetings if the cost was prohibitive.

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?

   Key expected benefits:

   - More convenient to attend (especially from other cities), and allows dual-tasking;
   - Seems to encourage investor participation – both by higher attendance and number of questions;
   - The option to attend virtually alleviates concerns on the health risk from Covid virus spread at physical gatherings.
   - Reduced hosting costs for physical meetings.

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?

   No.

Review Area Five: Shareholder Participation in Capital Raisings

Recommendation 8.4 reflects the principle that, as owners of the company, existing shareholders should be offered the first opportunity to participate in capital raisings on a pro-rata basis. It is consistent with this principle that the value attributable to any unexercised rights to participate belongs to, and the associated value should be received by, those shareholders.

The NZCGF recognises that issuers can and should legitimately raise capital via non-pro rata methods in certain circumstances (e.g. where a pro-rata offering is not possible or a non-pro-rata offer will add demonstrable shareholder value), albeit they should endeavour to replicate pro-rata outcomes so far as possible in the circumstances.

Before commenting on the quality of Issuers' disclosures, we note that:

- Despite recommendation 8.4, prevailing market practice is for boards/Issuers to prefer non-pro-rata offer structures, most commonly a placement combined with a share purchase plan (SPP);
- For non-pro-rata offer structures, Issuers typically adopt allocation and scaling preferences that are intended to more closely replicate a pro-rata allocations;
- The benefit of these offer structures for Issuers is that they are marginally easier to implement, allow for a slightly expedited offer period as compared to a true pro-rata offer and, due to the abridged risk period, may enable better pricing and underwriting terms (although we note that any difference in issue price may not ultimately matter, given that any pro-rata offer would likely be renounceable);
- Importantly, however, non-pro-rate offers do not have the same Listing Rule controls around achieving equitable outcomes for all investors. Instead, this hinges upon:
    - the issuer/broker correctly sizing of different components of the offer and having appropriate allocation policies and methods, and
    - for larger retail shareholders (with a nominal pro-rata entitlement exceeding the SPP cap) to have broker relationships, such that they can participate in the placement via the retail broker channel;
- Our perception is that allocation practices differ depending on the lead manager for the capital raise, potentially resulting in different outcomes;
- The allocation processes are often opaque, and investors rely upon anecdotal feedback from the organising broker as to how the process was enacted (levels of over-subscription, how the scaling process worked and how new shareholders were treated as compared to existing shareholders);
- Despite best endeavours groups of shareholders may be unable to apply and lose the value of unexercised rights (some overseas holders, some index funds, less sophisticated or disadvantaged investors);
- Usually institutional investors such as NZCGF members are not prejudiced by non-pro-rata offers and receive (at least) pro-rata allocations. However, there is a wider market integrity issue in that, because the offers are non-renounceable, the cost of the offer is effectively sheeted home to those who cannot or do not participate.

The disclosures we recommend below reflect the principles that: the right to subscribe belongs to the shareholder; that the shareholder should receive the value for that right, and; that clear disclosure addresses the reasons for the loss of that value when other offer structures are used.

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?

It is critical that comply/explain notices present comprehensive reasons for the choice of offer structure and the steps taken to achieve fair and equitable outcomes. Our observation is that there is a wide variance in the nature and quality of comply/explain disclosures to date, with some being cursory and potentially non-compliant, whilst others providing

comprehensive and relevant information. We believe more guidance is needed in this area including NZX developing a template form of disclosure.

2. Is there particular information that issuers have difficulty in disclosing when explaining an approach that differs from recommendation 8.4?

   Not applicable.

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?

   We would like to see the following matters disclosed in respect of non-compliance with Recommendation 8.4:

   - The reason for the decision to not follow Recommendation 8.4, including details of the benefits of the chosen offer structure as compared to a pro-rata offer;
   - The process to set the placement price;
   - The groups of shareholders which were disadvantaged by the choice of structure and the measures taken to mitigate those disadvantages;
   - If an SPP was used, was the SPP fully subscribed? If the SPP was scaled how was the scaling done and if done on shares cum issue, the effective dilution after the scaling for the investors that were scaled;
   - The percentage of shares held by shareholders which was diluted;
   - The change in the registry composition resulting from the capital raising;
   - The objectives of the allocation process and how well these were met;
   - The role of the Issuer in the allocation process, including details of key influencers and decision-makers within the process;
   - The number of shares allocated to new shareholders, and;
   - The number of shares allocated to the underwriters and sub-underwriters.

   Issuers should also need to explain why they undertook a non-pro rata offer at the company annual general meeting.

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?

   No.

Review Area Six: Environmental, Social and Governance Reporting

Environmental, Social and Governance (ESG) reporting is a complex area because:

- investor/stakeholder requirements for ESG information are increasing;
- there are a range of voluntary reporting approaches globally, but no single accepted approach or standardised set of ESG terminology;
- there is significant regulatory reform on ESG matters, with New Zealand being at the frontier in some areas such as developing mandated climate reporting standards;
- reporting standards are still being developed and assurance processes remain nascent, and;
- there are currently limitations in robust data available to issuers.

As a result, while ESG reporting is significant and important for the NZCGC, we do respect that it represents a significant resourcing and implementation challenge for many Issuers and their boards.

For the most part, we are not proposing additional information or disclosure, but rather adjustments in the approach and presentation of data to make it more relevant and comparable for investors.

1. What is your purpose for reviewing an issuer's ESG reporting information?

Investors assess ESG reporting information alongside financial information to form a view of the entity's historical performance to enable informed decision making on the Issuer's future earnings prospects and whether it represents a viable investment proposition.

Data is used to quantify the exposure and performance of different aspects of ESG (e.g. GHG emissions as an indicator of exposure to climate regulation risk) while qualitative information is useful to describe the entity's strategy in managing an Issuer's ESG risks and opportunities.

In addition, ESG disclosure provides information that may inform:

- investors' engagement and voting strategies in respect of Issuers, which is important because this can in turn improve company performance;
- perspectives on whether an Issuer aligns with end-investor values, e.g. involvement in business activities like fossil fuels that an investor may wish to avoid;
- investment strategies focused on sustainable finance, impact investment or measuring ESG performance across a portfolio level, and;
- TCFD/climate-reporting requirements and/or targets.

Finally, ESG reporting also provides a picture of the extent of a company's externalities from their business operations i.e. the effect on the environment or people. This information may be used to understand the true costs and benefits of the organisation and its long-term sustainability.

2. How frequently do you review an issuer's ESG report?

As most companies tend to update ESG information on an annual basis, this is usually reviewed intensively once a year then periodically referenced other times of the year. This would be augmented by both in-house and external ESG provider research.

3. What is your primary source of an issuer's ESG disclosures?

Company annual reports or sustainability reports. We access these through company websites or NZX announcements. Other supporting documents like TCFD reports and policies are usually accessed through company websites as well.

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?

In our view the annual report is provided at a well-signalled point of time at which shareholders can reasonably expect to access new information on the company to inform their decision making. It therefore makes sense that ESG information be provided at the same time to ensure shareholders get a complete view of company performance and to avoid ESG information being siloed or going unnoticed.

There are multiple reporting frameworks that companies adopt for their ESG reporting such as integrated reporting, GRI, separate sustainability reports, etc. and given there are currently no mandatory universal sustainability reporting standards, we do not necessarily advocate one over another.

However, if a company chooses to provide a separate sustainability report to their annual report, this should be provided at the same time and/or there should be specific reference to the sustainability report in the annual report. The report should also continue to be available on the issuer's website. If the company were to produce its sustainability report at a different date to the annual report, notice of the approximate timing of this release should be signalled to investors. This disclosure would ensure that shareholders are alerted to the new ESG information and prevent it from being hidden away on a company website where it may not be frequently checked or sufficiently communicated. Regardless of whether there is a separate sustainability report, the annual report should contain a core set of ESG performance data. The Listing Rules for example already require reporting on gender. Data on (carbon) emissions and health and safety statistics would be an obvious extension for minimum base data to be provided in the annual report.

We suggest that in developing its exposure draft of the updated Code, NZX consider identifying core ESG performance data that would be set out in the annual report. We are, however, conscious of the compliance burden this could place on Issuers and boards in what is already a fast-evolving and demanding governance area. We envisage that the core performance data should already be available to Issuers as part of implementing their employee, supply chain, HSE and climate policies. The suggested metrics could be iterated over time, as data becomes more available and reporting and assurance processes become more established.

5. Does the Code contain appropriate guidance for issuers in relation to ESG reporting, if not what amendments should be made?

The Code should:

- recommend that the board establishes the company's purpose and strategy with respect to all ESG risk and opportunities which are material to the company;
- focus to a greater extent on the interdependencies between environmental, social and economic performance – as opposed to drawing a distinction between 'financial' and 'non-financial'.

As currently drafted the Code recommendations relating to ESG reporting are relatively limited and generic, with most of the detail set out in the accompanying guidance. We suggest that NZX considers adopting a stand-alone recommendation on ESG reporting to give this greater prominence.

NZX ESG guidance should recommend reporting of performance data and metrics – including standard metrics expected from all companies. It is currently too vague on ESG considerations and since there is no glossary like the ASX code where E and S risk can be defined, there should be references to examples of ESG risk like climate change, modern slavery, cultural heritage, biodiversity, etc. It is important to ensure that there is a high level of consistency in reporting approaches and terminology used by issuers.

6. Should the ESG Guidance Note or Code be updated to reflect the New Zealand legislative requirements for TCFD reporting?

Yes. There should be consistency between all non-financial reporting information requirements/recommendations, and as TCFD will be a mandatory aspect of reporting covering many NZX listed entities there should be specific reference to climate change.

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?

   We note that issuers with substantive offshore activities are already captured by Australian or other modern slavery regimes and therefore undertake modern slavery reporting.

   As to other issuers, the Code should recognise modern slavery as an ESG risk (as noted above) and the NZX ESG Guidance materials updated accordingly. However, the more prescriptive disclosures would be better left to a law change or reporting standard-setters, e.g. XRB, which we expect would apply more broadly than just to Issuers.

8. Should there be greater alignment between the Code and the ASX Code in relation to ESG reporting?

   Yes, in particular:

   - Agree with ASX recommendation 4.3 that a "listed entity should disclose its process to verify the integrity of any periodic corporate report it releases to the market that is not audited or reviewed by an external auditor". Given the low assurance rates for ESG disclosure, it is important for investors to understand the limitations and potential inaccuracies in self-reported data;
   - Specific comment on climate disclosure (including reference to legislative requirement as per question 6), and;
   - Modern slavery should be defined as one of the social risks.

Other observations:

We consider there is a greater need for better standardisation and data on social metrics e.g. staff turnover, modern slavery incidents, diversity levels, injury frequency rates.

There is a growing uptake of climate related disclosure especially given new legislation but minimal reporting on nature-related and biodiversity considerations.

There is large variation in what reporting framework NZX issuers use to report against on ESG, but the standardisation of sustainability reporting will likely be facilitated by the newly established International Sustainability Standards Board.

There are a rising number of companies reporting alignment with the UN Sustainable Development Goals (SDGs), however some of this tends to be more superficial reporting and Issuers should remain conscious of risks of greenwashing. There should be greater evidence and justification for a company's contribution to the SDGs and equal weight applied to reporting on risks to the SDGs and how these are measured and managed.

Review Area Seven: Diversity Practices

1. Are the Code's settings appropriate in relation to diversity practices? If not, what amendments should be made?

   This is an area that has continued to evolve since current the current Code settings were implemented.

   In broad terms, global companies are beginning to implement recommendations/rules reflecting a broader formulation of diversity than gender and consciously monitor diversity. Some are implementing diversity targets/objectives and seeking to improve access to equal opportunities. In particular, the Code is now out of step with other markets such as the ASX and the UK.

   We consider that:

   - it should now be compulsory for issuers of a certain scale (e.g. those on the NZX 50) adopt a diversity policy, recognising that most of them do so already;
   - the diversity policy should cover both the board and the Issuer's employees;
   - NZX should take further steps to broaden the minimum diversity factors beyond gender. The commentary to Recommendation 2.5 already recognises that diversity is broader than just gender, and we would encourage the NZX to provide additional examples of diversity in the commentary to this recommendation.

   Since the listing rule updates, we note that the UK Financial Reporting Council (FRC) issued a report on impacts from diversity efforts on company performance and boardroom culture[2]. The report found that increased gender diversity had resulted in improved financial benefits (by EBITDA margin) and a reduction in shareholder dissent, suggesting that there was a higher level of board effectiveness. The Code could include a reference to the FRC study to supplement its reference to the 2015 McKinsey study.

2. Are the Code's settings appropriate in relation to diversity reporting? If not, what amendments should be made?

   As noted above, we recommend:

   - Broadening the diversity metrics that issuers report on; and
   - Making diversity policies compulsory (at least for larger issuers), meaning that all affected issuers are required to report on their performance against the policy.

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?

   We support a recommendation for issuers to report against a minimum diversity target, which appears to be consistent with the general direction of travel in other markets. We suggest that NZX recommends a minimum target that is appropriate for the market but allows flexibility for boards to adopt a more ambitious target, and targets based on other diversity characteristics should they wish to do so.

4. Does the Code's guidance in relation to ESG reporting appropriately take account of diversity considerations?

   The guidance should be refreshed and considered in the Aotearoa/New Zealand context, including cultural diversity.

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[2] https://www.frc.org.uk/getattachment/3cc05eae-2024-45d8-b14c-abb2ac7497aa/FRC-Board-Diversity-and-Effectiveness-in-FTSE-350-Companies.pdf

Review Area Eight: NZX Corporate Governance Institute

1. Do you support the introduction of the NZX Corporate Governance Institute?

   In principle the NZCGF supports the introduction of the NZX Corporate Governance Institute but will need to understand the terms of reference and implementation detail.

   The Institute could, if the settings are correct, provide NZX with a more balanced composition of stakeholder input by better reflecting investor/shareholder perspectives.

   The Institute may also provide a feedback loop that includes more active debate and interaction between different stakeholder groups, which may allow for more well-rounded input than the current process under which different stakeholder groups tend to submit to NZX on a more discrete basis.

   It is not clear to us why the Institute's role is confined to advising on the NZX Corporate Governance Code. The Institute could usefully contribute to other processes, such as updates to the Listing Rules and Guidance Notes and providing feedback on broader governance issues and on shareholder rights. We suggest that NZX considers expanding the Institute's mandate.

   The ASX Corporate Governance Council's charter recognises that its role includes undertaking such other activities on corporate governance practices as the Council may approve.

2. Which stakeholder groups do you consider should comprise the NZX Corporate Governance Institute?

   The membership should be set and reviewed periodically to reflect a diverse and representative range of views on corporate governance practices, ensuring robust and balanced representation for shareholders and investors.

   The indicative groups seem broadly appropriate, although there should be a balanced approach to representation from different interest groups. By way of example, the consultation paper suggests that Issuers be represented directly, whereas investors are only represented through industry collectives. Given the focus on the Code, it is important that shareholders/investors are broadly represented.

   The paper suggests that specific individuals (not the organisations they represent) would be appointed to the Institute. It may make sense for the organisations to act as members, and for those organisations to nominate a representative to attend meetings. This allows greater flexibility to allocate resource to particular matters based on skill-sets and is more resilient to people movement over time.

3. Do you agree that the mandate of the NZX Corporate Governance Institute should act as an advisory body to NZX?

   We agree that, at least from the outset, the Institute should act as an advisory body.

   Over time, if the initiative is successful, we suggest considering whether the Institute's role should evolve from an advisory body to one that has a more formal role/responsibility in setting standards (i.e. as per other markets such as ASX).