



23 May 2019

Angus Armour
Managing Director & CEO
Australian Institute of Company Directors
18 Jamison Street
Sydney NSW 2000

Dear Angus

Forward Governance Agenda

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, self-managed superannuation fund (SMSF) trustees and investors generally seeking ASA's representation and support. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

ASA will not respond to all aspects of the consultation paper, *Forward Governance Agenda* (the paper), but only those with particular relevance to our members.

Standards and professionalism, including whether the AICD should review our Code of Conduct and revise/strengthen Director Professional Development expectations

ASA is not in a position to comment on the Code of Conduct applicable to AICD members. We are of the view that this is a matter for the management and membership of AICD to decide.

ASA believes that directors should undertake professional development. At present this is optional, given that there is no legal requirement for directors to acquire continuing professional development points, as occurs in other professions (for example, lawyers and accountants).¹ AICD provides professional development at present, with members requested to log professional development points. Random checks on compliance are undertaken by AICD. ASA also notes that AICD education and director professional development is self-accredited and there is therefore also no regulatory requirement (from Tertiary Education Quality and Standards Agency) attached to director education.

¹ ASA notes that some industries, for example, clubs, require director professional development to be undertaken and organise the training that is available to club directors.

Directorship is clearly now a profession, as are law and accountancy. ASA would therefore be supportive of AICD mandating professional development for its members. Directors come from a multiplicity of backgrounds and many will already have professional qualifications. However, ASA is of the view that AICD should mandate that directors undertake, at a minimum, professional development in:

- financial reporting and audit
- governance practice (not just the theory), including culture and remuneration
- understanding the legal framework applicable to companies
- strategy formulation
- managing risk.

ASA recognises that these topics are already covered in the Company Directors' Course and Foundations of Directorship courses. However, ASA is of the view that, from a shareholder perspective, these courses also need to cover:

- leadership (that is, driving culture, shareholder engagement etc)
- remuneration (frameworks, effect on corporate culture and TSR etc)
- ethics (changing expectations of society and how to test this).

These are matters of great concern to ASA and its members. The belief that directors come from backgrounds in business that provide this training has been proven false, not only with the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, but also through ASA's company monitoring. We have found that many directors do not consider many aspects of these matters (for example, culture, ethics) to be part of the director's role or that education in matters such as leadership is required. ASA is also concerned that remuneration consultants provide advice that is not independently tested by directors. The question that Commissioner Hayne recommended be asked by all directors — 'Should we do that?', rather than 'Can we do that?' — has also shown that directors need education to understand and question whether business decisions are ethical. We note that ethics is taught in philosophy courses in university, but rarely in business courses except for some MBAs.

Directors' duties and stakeholders, where we confirm the AICD's support for the current framing of the law and commit to testing and explaining the application of the best interests duty and promoting measured debate

ASA holds to the view that directors must act in the best interests of the company and that, in a narrow sense, is seen as acting in the best interests of shareholders. Directors are expected to protect those interests. As the providers of capital, shareholders have rights and regard directors as custodians of their investment.

Notwithstanding that, Australia's corporate law currently allows directors to take account of the interests of stakeholders other than shareholders. It has been argued that a change in the law is not required to permit directors to consider stakeholder interests (a permissive clause) and that

the duty to act in the best interests of the company provides the flexibility for directors to consider and balance the interests of stakeholders.

Two earlier inquiries into this topic both reported that a change to directors' duties was not required.² The Corporations and Markets Advisory Committee's (CAMAC) view was that the law need not change, as stakeholders can be considered if they are instrumental in benefiting shareholders. The Parliamentary Joint Committee on Corporations and Financial Services was also of the view that the law need not change, but that stakeholders can be considered without necessarily linking to shareholder benefit. However, ASA notes that both reports were released 13 years ago.

It has been argued that a change to directors' duties will ensure an alignment between the law and community expectations. The argument is that a change to directors' duties is essential to ensure that companies maintain their social licence to operate. This has come to prominence in light of the egregious misconduct witnessed during the hearings of the Royal Commission into

Misconduct in the Banking, Superannuation and Financial Services Industry, where financial services companies were revealed to be focused on profit at almost any cost, disregarded norms of acceptable behaviour and were run for the primary benefit of the people who manage them, rather than their shareholders and other stakeholders.

ASA rejects the argument that executive misconduct, as was argued by various parties, was undertaken in order to generate shareholder returns. This suggestion can only be considered as misguided and an attempt to defray responsibility for individual executive actions and failure of director oversight. Shareholders are neither indifferent to how corporate profit is generated, nor do they want or seek unethical behaviour or misconduct to generate returns. Shareholders expect that executives and directors will act lawfully and ethically while producing shareholder returns and to act any other way does not produce sustainable or long-term shareholder returns.

It has been argued that, if shareholder value is an end, not a means, inserting a permissive clause provides clarity as to directors' capacity to consider other stakeholders in decision making. A positive indicator that other interests exist is a matter of good risk management. A permissive clause does not specify how directors should take into account other stakeholders, only that they consider them. It provides an educational function for those companies that have not yet reached this view. Such a clause could be similar to s 172(1) in the UK Companies Act 2006 that provides that the interests of non-shareholders need to be considered by directors but only to the extent that such consideration promotes the interests of shareholders.

ASA is of the view that AICD should commit to testing and explaining the application of the 'best interests of the company' fiduciary duty. This requires more than education. Testing means setting

² Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, June 2006, Canberra; Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations*, Report, December 2006, Ch 3

measurable objectives. AICD should make public any such measurable objectives as well as the results of testing of these. This should be undertaken for ASX listed companies in the first instance.

In 2014, ASA expressed support for a permissive clause allowing directors to consider stakeholder interests to be included in the Corporations Act as it provides clarity. It also requires all companies (whether listed or not) to take regard of stakeholder interests and be seen to do so through reporting requirements. In 2014, ASA noted that the current position is not strong enough to meet community perceptions or at times reality. ASA's view remains the same in 2019 as it was in 2014.³

ASA is of the view that, if AICD does not provide evidence that directors are considering other stakeholders in decision making, it is likely that a call for legal reform of directors' duties will arise.

Demonstrating accountability, including inviting member views on annual elections as a reform measure for listed entities (at least)

ASA does not support annual elections of directors. While we are keen to see new directors at AGMs stand up and explain their suitability for the role (and also those standing for re-election), we would not want to see annual elections implemented as a procedural matter that occupies excessive time at the AGM at cost to:

- questions from shareholders to the board about their stewardship of the company and
- meaningful descriptions of what directors bring to the role and why they should occupy a seat at the table.

The AGM as an event in its current form is all about the engagement of retail shareholders. Institutional shareholders rarely attend but utilise other forms of engagement with companies. Given that the AGM is most frequently the sole forum available to retail shareholders for engagement with the boards of investee companies⁴, it is imperative that the shareholders who attend are provided with the opportunity to question directors and hear from those standing for election. ASA is of the view that, in the interests of not extending the length of the AGM, chairs would seek to move through the director election process as quickly as possible, which in turn would reduce director elections to a procedural matter. Reducing elections to a procedural matter would disenfranchise retail shareholders

Governance of culture and remuneration, proposing additional member tools and guidance, and greater engagement by the AICD with investor groups and stakeholders.

ASA believes that executive remuneration is an area that should be determined by the board of directors, having regard to the views of shareholders and other stakeholders. The introduction of the two-strikes rule has put in place sufficient mechanisms for shareholders to voice concerns

³ ASA response to Governance Institute of Australia's consultation on *Discussion Paper — Shareholder Primacy: Is there a need for change?*, 2014

⁴ ASA recognises that some companies hold non-statutory shareholder briefings, but they are few and far between.

about remuneration at listed companies and we have witnessed improved engagement between company boards and shareholders on remuneration issues and a willingness by companies to explore different ways to design effective remuneration structures.

Where such engagement is ineffective, shareholders have expressed their concerns through the voting mechanism attached to the two strikes rule.

ASA is of the view that AICD has a role to play in providing additional member tools and guidance on director oversight of culture and remuneration. AICD can assess shareholder views across sectors and industries and provide members with feedback to help them understand shareholder views. This is particularly important when new approaches to remuneration are recommended by remuneration consultants, and individual companies may be unaware that shareholders are expressing dissatisfaction with the recommended scheme across industries and sectors. For example, the trend towards hybrid incentive schemes, combining long- and short-term incentives, was being introduced in a range of companies that seemed unaware that shareholders were expressing concerns with these schemes to a number of different types of companies.

Kind regards

A handwritten signature in black ink, appearing to read 'J Fox', with a long horizontal stroke extending to the right.

Judith Fox
Chief Executive Officer