



NEW ZEALAND'S EXCHANGE
TE PAEHOKO O AOTEAROA

Director Independence

Consultation Paper

May 2023

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This Consultation Paper has been prepared by NZX to seek comment on the proposals contained in the paper, with a view to ensuring that the proposals will enable NZX to operate its markets on a fair, orderly and transparent basis. The proposals set out in this paper do not reflect NZX's concluded views of the matters raised. Capitalised terms which are not defined in this Consultation Paper have the same meanings given to them in the NZX Listing Rules.

Introduction

NZX is consulting on proposed amendments to its policy settings relating to director independence. This consultation seeks in principle feedback that will be used to consider potential amendments to the director independence settings that are contained in the NZX Corporate Governance Code (**Code**) and NZX Listing Rules (**Rules**).

NZX has received feedback from stakeholders who consider that the current regulatory settings (summarized in the Appendix to this paper) relating to director independence could be reviewed to ensure the settings give investors, and other stakeholders, further confidence that board independence settings are sufficient to protect the interests of all shareholders and the company.

Objectives of the review

In response to this feedback NZX is undertaking this review, with the objectives of ensuring that NZX's regulatory settings:

- appropriately articulate the purpose of the director independence requirements,
- are correctly calibrated to appropriately manage the inherent conflict of interest that they are designed to address, in the context of the relative value of independence as a performance factor,
- enable access for investors and other stakeholders to information about issuers' corporate governance practices relating to director independence to facilitate efficient allocation of capital, and
- promote good governance practices that support the generation of long-term benefits for issuers' shareholders.

These objectives have been designed to enable NZX to enhance the operation of its markets on a fair, orderly, and transparent basis, consistent with NZX's obligations under the Financial Markets Conduct Act 2013 (**FMCA**).

This is a first principles review of the assumptions contained in the director independence settings, to explore the purpose and rationale for the requirements. NZX is not considering changes to other operative Listing Rules (such as the capital raisings related party and major transaction requirements) as part of this review.

Structure of the review

This consultation forms the first phase of the review. We are initially consulting with stakeholders in relation to the principles and concepts that underpin the director independence requirements. A subsequent round of consultation will be undertaken later in the year, which will include more detailed proposals for submitters consideration and feedback.

NZX is consulting on the following matters, some of which are described in more detail in this consultation paper (with other aspects to be included in the second phase of the consultation):

- the purpose of the director independence requirements, to enable better articulation of the conflicts of interest that the settings seek to manage (including in relation to shareholder groups with competing interests such as majority and minority shareholders),

- the benefits of director independence requirements, to ensure that the level of director independence is appropriately calibrated within board and board committee composition requirements,
- the nature of the test for director independence and considerations relating to the assessment of director independence,
- whether amendments should be made to the board and audit composition requirements contained in the Rules and recommendations contained in the Code,
- whether differential settings should apply to certain categories of issuer (for example those in the S&P/ NZX 20 Index or S&P/NZX 50 Index),
- whether changes are required in relation to the director independence settings to better manage the conflicts between majority and minority shareholders, and
- whether changes should be made to the requirements and recommendations relating to the reporting of a director's independence status.

Consultation questions are included with the discussion of each of these proposals. In addition, NZX welcomes submitters' more general views relating to the director independence settings. We have included a summary of the current settings relating to director independence as an Appendix to this paper.

The feedback we receive through the initial consultation process, will be used alongside other inputs such as academic research to develop a more detailed set of proposals with the support of the NZX Corporate Governance Institute (**NZX CGI**).

We will then undertake a second round of consultation that will include an exposure draft of potential changes to the Rules and Code later this year.

Role of the NZX CGI

As an outcome of the 2021 review of the Code, NZX established the NZX CGI in late 2022. The NZX CGI is comprised of a broad cross-section of members representing institutional and retail investors, corporates, board directors, a cross-over member from the ASX Corporate Governance Council, legal advisors and academics. The NZX CGI's role is to assist NZX in developing its regulatory policy that relates to corporate governance.

NZX Policy has designed the proposals outlined in this paper with the support of the NZX CGI which has provided valuable insights from across the market eco-system. The NZX CGI will continue to assist NZX in the next stages of the review, including through assisting NZX in the consideration of the submissions being sought through this consultation, and the finalisation of the proposals.

Evidence based regulatory policy

One of NZX's objectives in establishing the NZX CGI was to enable NZX to develop regulatory policy that is supported by evidence and academic research. NZX Policy is conducting a desktop benchmarking exercise of the comparative director independence settings of foreign exchanges to assist with the development of the consultation proposals.

In addition, the NZX CGI has commissioned academic research that will provide a comparative benchmark of the existing research relating to the purpose and benefits of the director independence requirements of stock exchanges. This research, along with the views of submitters, will be pivotal in

enabling NZX to ensure that its settings in relation to director independence deliver on the objectives of the review.

Consultation Process

We invite interested parties to provide their views on the proposals contained in this paper by emailing a written submission to policy@nzx.com. Alternatively, if you would prefer to provide a verbal submission, please email NZX Policy to arrange a time to speak with us.

The closing date for submissions is **Friday, 9 June 2023**.

NZX may publish the submissions it receives, so please clearly indicate in your submission if you do not wish for your submission to be published, or if part of your submission contains confidential information. If you have any queries in relation to the review, please contact:

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Message from the NZX Corporate Governance Institute Chair

The NZX Corporate Governance Institute was established in late 2022, to assist NZX in the development of its regulatory policy relating to corporate governance.

The review of NZX's corporate governance policy in relation to director independence is one of two flag-ship reviews for the NZX CGI this year.

We have been involved in the development of this consultation and we are focused on the delivery of evidence based regulatory policy. One of the ways we are helping to do this is by commissioning academic research in relation to key aspects of the purpose and benefits of director independence to use as an input to the review.

The role of the NZX CGI is to make recommendations to NZX that are consistent with the NZX CGI's purposes which include assisting NZX to deliver corporate governance regulatory policy:

- that enables NZX to become a leading, innovative, regional securities exchange regulator that enhances the reputation of, and promoted the development of New Zealand's capital markets,
- that is proportionate to the size of the NZX Main Board and the compliance burden imposed on issuers, and reflect that issuers on the NZX Main Board compete for capital in the context of the Australasian capital markets,
- that provides investors and other stakeholders access to appropriate information about issuers' corporate governance practices to enable informed voting and investment decisions, and
- that promotes the fair, orderly and transparent operation of NZX's markets to support NZX in complying with its market operator licence obligations under the Financial Markets Conduct Act 2013.

We will follow these principles as we consider the research findings, and stakeholder feedback received through this consultation, to make recommendations to NZX as to the design of its director independence settings.

We look forward to receiving your feedback in relation to the matters outlined in this consultation paper. You can find out more about the NZX CGI [here](#). Please get in touch with us if you'd like to discuss the review.



Hamish Macdonald
Chair

Purpose of the Requirements

Background

NZX last reviewed our regulatory settings relating to director independence as part of the 2018 holistic review of the Rules, when the Code recommendation that a majority of directors be independent was introduced, and the definition of a Disqualifying Relationship was amended so that it operates to remove certain deeming provisions as a principles-based test.

NZX is undertaking this review as we have received feedback from stakeholders that the director independence settings should be reviewed to ensure that they provide better protections to shareholders and other stakeholders, and manage the conflicts that they are designed to address.

In particular, stakeholders have noted that neither the Code nor the Rules clearly articulate the purpose of the director independence requirements. Stakeholders also supported a clear articulation of the conflict that the director independence settings are intended to address.

NZX agrees that it is appropriate for the Code to state the purpose of the director independence settings, which will also support boards in the consideration of how to interpret the Disqualifying Relationship¹ test.

Consideration of the purpose of the director independence requirements

The Code currently recognises that directors with an independent perspective are more likely to constructively challenge each other and executives, however there is no clear articulation of the purpose of the requirements, including the nature of the inherent conflicts that director independence settings are designed to address.

The international exchanges benchmarked by NZX commonly cite the need for a director to be able to exercise an independent business judgement in carrying out the director's duties in order to be considered independent. However, most exchanges do not explain what the director's business judgement should be independent from.

NZX's preliminary view is that there are several conflicts of interest that the director independence settings are designed to address, which are described below:

- **Management and board**
If a director has a strong relationship with the management of an issuer, the director may be influenced to favour a management view which conflicts with the interests of an issuer's shareholders. These types of relationships are already identified in the factors contained in the table to Recommendation 2.4 of the Code that issuers should consider when determining a director's independence, such as those relating to past executive employment relationships and tenure.

¹ The Appendix to this paper provides an overview of the current settings, including the Disqualifying Relationship test.

- Shareholder groups**

This conflict is already recognised in the definition of a Disqualifying Relationship, which recognises that an independent director should be able to represent the interests of an issuer’s financial product holders generally. In situations where conflicts manifest between major and minority shareholders an independent director will be able to make decisions in a non-partisan manner. This conflict is recognised in the Code factors where a director’s substantial product holding or senior management role with a substantial product holder of an issuer, is an indicator of a lack of independence.
- Inter-board**

A lack of independent perspective may arise where directors have personal or professional relationships with one another, such as cross-directorships. These inter-board relationships may result in directors having similar perspectives, or failing to dissent from one another resulting in ‘group-think’. This type of conflict may interfere with a director’s ability to bring an independent view in relation to decisions in respect of the issuer.
- Related parties**

If a director has an interest in or relationship with a material supplier or customer of an issuer, the director could be conflicted by being motivated to make decisions in a manner that benefits that party to the detriment of the issuer and/or its shareholders. These relationships are currently reflected in the Code factors as relationships that may indicate a lack of independence.
- Personal interests**

The Code factors identify that where a director has derived a significant portion of income from the issuer within the last 12 months, that this may indicate a Disqualifying Relationship. This reflects that the director independence settings may in-part seek to address the conflict between a director’s personal interests and the director’s ability to act in the best interests of the company or in the interests of shareholders generally. Nasdaq prevents a director from being classed as independent if an issuer makes a significant payment to a charity of which a director is an executive, indicating that a director’s personal interests may also be a conflict that is sought to be managed via the director independence settings.

In each case, an issuer would need to assess the conflict of interest to be material to the director in order to cause the director to be assessed as non-independent. Issuers are best placed to make this assessment by exercising judgment as to the nature of the interest or relationship that gave rise to the conflict of interest.

We will use submitters feedback, along with the academic research commissioned by the NZX CGI to design amendments to the Code commentary to better articulate the purpose of the 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?
2. What do you consider an appropriate purpose statement to be?
3. Are there any disadvantages with including a clearer articulation of the purpose of the requirements in the Code?
4. Do you agree that the conflicts of interest articulated above reflect the concerns that the director independence settings are designed to address?
5. Should any of the interests or relationships set out be articulated differently?
6. Are there additional purposes that should be reflected in the Code?

Benefits of Director Independence

Background

The Code commentary currently states that directors with an independent perspective are more likely to constructively challenge each other and executives – increasing their effectiveness. We wish to consider this assumption more fully.

As part of the 2022 review of the Code, NZX considered feedback from stakeholders that there is often a stigma associated with a determination that a director is not independent and amended the Code commentary to note that non-independent directors may be high-performing stewards. The Code commentary was also amended to note that the consequence of a determination that a director is not, or is no longer independent, is that an issuer should ensure that it has appropriate conflict management arrangements to manage the relationship or interest that has given rise to the conflict of interest.

Discussion

As part of this review NZX wishes to better understand the benefits that independent directors bring to the board of an issuer and how this interacts with the other considerations for overall board composition. We are particularly interested in views as to the relative importance of director independence compared to other factors that relate to a director's capability, in relation to an issuer's governance arrangements and issuer's performance, and the times at which director independence is particularly important (such as in the context of a takeover, or the determination of a particular offer structure).

While appropriately calibrated independence settings should address the conflicts that underpin the purpose of the requirements, it is unclear the weight that should be placed on a director's independence relative to other factors (for example: detailed knowledge of the issuer's business and stakeholders, and alignment with founders) to enable a board to operate effectively.

We are also interested in submitters' views as to the level of independence that is necessary for the board as a whole to operate effectively, for example: whether there is a minimum number or proportion of directors that should be independent, and whether it is necessary for the Chair to be independent. We expect that an issuer's standard conflict management arrangements would

include that directors disclose their interests and relationships in an interests register, and appropriately abstain from discussing and voting on matters in which they are interested. This is a relevant consideration when determining the role of the director independence settings more broadly, and the thresholds at which they should be set.

In addition, we wish to better understand whether there is unnecessary stigma and consequences for an issuer when a director is determined to be non-independent, for example in relation to assessments by ESG ratings agencies.

The NZX CGI intends to commission research to support NZX's consideration of this aspect of the review, including research relating to the impact that different levels of board independence have on overall company performance. This research along with submitters views will help us to consider the board and committee composition settings as part of the second phase of this review.

1. What benefits do independent directors bring to a board?
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?
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)?
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?
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)?
6. Do you consider that issuers whose boards have a larger number of independent directors perform better?
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)?
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?

Nature of Director Independence

Background

The current regulatory settings contained in the Rules and Code require an issuer to consider the relationships, interests and positions held by a director in order to determine whether the director has a Disqualifying Relationship, including by considering the non-exhaustive factors contained in the Code.

We received feedback through the 2022 Code review that there is a tendency for issuers to solely consider the factors in the Code when assessing director independence which is not consistent with the Rule requirements. As a result, we modified the definition of Disqualifying Relationship to clarify that the factors in the Code are inclusive considerations, and modified the Code to emphasize that the Code factors are non-exhaustive considerations, and the importance of an issuer's board considering all relevant factors and interests that may be relevant to the assessment of a director's independence status.

Where a factor contained in the table to Recommendation 2.4 of the Code applies to a director, an issuer may still determine the director to be independent. In that instance the Code recommends that the issuer provides disclosure of why the board has determined the director to be independent along with a description of the interest, relationship, or position that triggers the application of the relevant factor.

The Code operates on a comply or explain basis in accordance with Rule 3.8.1. This means that issuers of equity securities may elect to disclose why they have adopted an alternative governance practice to that recommended by the Code in their annual report. In the context of assessing a director's independence, this means that an issuer could elect not to provide the disclosures relating to the application of a Code factor to a director so long as they explained why they have elected not to make the recommended disclosure.

NZX has received feedback from stakeholders that the test for director independence should be reconsidered in light of further consideration of the purpose of the requirements.

Alignment with the purpose of the requirements

As noted earlier in the paper, the current definition of Independent Director, is a director who is not an Employee and has no Disqualifying Relationship. While the definition of Disqualifying Relationship implicitly refers to the conflicts that the director independence requirements endeavour to address, we are interested in submitters views as to whether the definition could be better aligned to the purpose of the requirements.

Our benchmarking revealed that it was more common for exchanges to focus the assessment of whether a director is independent on the director's interests and relationships, but that SGX also referred to an independent director as someone who is independent in conduct and judgment. We are interested in the views of submitters as to whether the definition of an Independent Director should be amended to refer to the director's ability to conduct themselves and exercise judgment in an independent manner, as well as not being an Employee and having no Disqualifying Relationship.

We are also interested in the extent to which the conflicts sought to be addressed by the requirements should be brought within the Independent Director test. In this regard we note that the ASX Corporate Governance Code refers specifically to independence from management and substantial shareholders. We are interested in submitters views as to the extent to which this should be reflected within the definition of Independent Director contained in the Rules (noting that the Code factors refer to these types of relationships).

A tailored approach to independence

It has been suggested to NZX that the factors contained in the Code could be calibrated to the particular conflict that is sought to be managed by the relationship the factor identifies. A director could then be determined to be independent in relation to decisions relating to the matters in respect of which the director is not conflicted, given the nature of the factor or relationship that gave rise to the assessment of non-independence. For example, a director who is a substantial holder but to whom no other Code factor applies would be determined not to be independent in relation to decisions relating to conflicts between majority and minority shareholders, but could be assessed to be independent in relation to matters between the issuer and other interested parties (such as suppliers and customers).

We consider that this approach would be complex and difficult to apply in practice. It would require the board composition requirements to prescribe a certain number of independent directors for each of the conflicts that the requirements seek to address, and calibration of the factors contained in the Code with the relevant conflicts.

We are also concerned that it would result in a compliance approach being taken to corporate governance where issuers considered only the factors contained in the Code rather than a director's broader interests and relationships, which is not the intention of the requirements.

We note from our international benchmarking to other international exchanges, that no other exchange adopts such a tailored approach.

Effect of shareholdings on independence

Code factor 6 in Recommendation 2.4 suggests that a director who has a substantial shareholding (or is associated with a substantial shareholder) may not be an Independent Director. The threshold for assessing a substantial shareholding is 5%, which is consistent with the threshold used in the FMCA.

We are interested in submitters views as to the extent to which small holdings could affect the assessment of a director's independence, and views as to whether the 5% threshold referred to in the factors is appropriate.

We are aware of views that shareholdings in an issuer can result in better aligning a director's interests with the shareholders the director represents, and that the thresholds in the Code could be increased (perhaps to reflect the control thresholds contained in the Takeovers' Code).

We are also aware that some exchanges regard a 5% holding as a threshold at which a director's interest in an issuer is likely to represent significant value to the director which could cause a director to have a qualitatively different interest to those of other shareholders.

Tenure

As part of the 2022 review of the Code, NZX consulted on the role of tenure in affecting the assessment of a director's independence. As a result of that consultation, NZX amended Code factor 8 in Recommendation 2.4 to clarify that NZX considers long tenure to be tenure of 12 years or more.

NZX is conscious that some submitters considered that 12 years was the upper end of the range for long tenure, and that SGX has recently imposed a requirement in its Listing Rules that a director whose tenure exceeds 9 years cannot be determined to be independent.

Although NZX has recently consulted on the effects of tenure on a director's independence, we are interested in submitters further views as part of this review given the potential interaction of tenure alongside other factors. We also note that as part of this review we are interested in the relative weight that should be placed on a director's independence compared to other factors, such as tenure. This discussion is pertinent to the consideration of tenure where long tenured directors will have a deep knowledge of the issuer's business and stakeholders.

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

Minority Shareholder Interests

Background

NZX has received some stakeholder feedback that the director independence settings may not adequately ensure sufficient independence to protect the interests of minority shareholders.

As part of this review, we are consulting on whether the management of conflicts between shareholder groups is a key purpose of the independent director requirements, and if so whether changes should be made to the definition of Independent Director to better address the potential conflict between majority and minority shareholders. We are also seeking to obtain submitters' views as to the minimum levels of director independence that are necessary to enable a board to perform effectively. Any changes in these areas may go some way to addressing the concerns around the adequacy of the director independence requirements in protecting the interests of minority shareholders.

Enhancing minority shareholders protections

Under Rule 2.6, the assessment of a director's independence is made by the Board rather than shareholders. Although shareholders do have rights to vote on the appointment of directors through the operation of Rule 2.2 and the director rotation requirements contained in Rule 2.7.1, they do not have a role in the assessment of a director's independence.

We are interested in stakeholders' views on whether minority shareholders should have a role in relation to the assessment of a director's independence. We would be interested in understanding the practicality of recommending that issuers engage with minority shareholders in relation to the assessment of a director's independence.

We would also be interested in views as to whether shareholders who are not associated with a director should be given the ability to vote on the board's assessment of the independence of the director, with the result that if the resolution was not passed the director could not be determined to be independent. We are interested in views of the effects of this type of control, on issuers ensuring that they remained compliant with the board composition requirements and the appropriateness of this proposal in general.

1. Do you consider that the current director independence requirements do not appropriately protect the role of minority shareholders?
2. Should issuers be encouraged to engage with minority shareholders in relation to the assessment of a director's independence?
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?
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?

Disclosure

Director independence disclosures in notices of meeting

Rule 7.8.3(a) currently requires that the Board's view as to whether a candidate would qualify as an Independent Director be included in the notice of meeting that contains a resolution to elect or re-elect a director². We are interested in submitters' views as to whether the Rules should expressly require the Board's reasons for its determination to also be included in the notice of meeting.

Updating determinations of director independence

Rule 2.6.3 requires that if at any time a Board makes a determination in relation to a director's independence which differs from the position most recently announced through the markets' announcement platform (MAP) that it must make a supplementary MAP disclosure.

Implicit in this Rule is an expectation that issuers ensure (by operation of Rule 2.6.4) that arrangements are in place to ensure that directors provide sufficient information about their relationships and interests that are relevant to an independence determination, if those interests change, and that an issuer should re-assess a director's independence at that time. We are interested in submitters' views as to whether these expectations should be included as explicit obligations in the Rules.

Changes to encourage greater disclosure

As part of the 2022 Code review, NZX amended Recommendation 2.4 to encourage issuers to provide greater disclosure in relation to the reasons for the board's assessment of a director's independence.

The Code now recommends that where an issuer has determined a director to be independent despite the presence of a factor contained in the Code, that the issuer discloses the reasons for its determination, along with a description of the interest, position or relationship that triggered the application of the Code factor. As issuers are only required to report against this recommendation for financial years commencing on or after 1 April 2023, the effectiveness of this change in increasing the quality of disclosure relating to director independence cannot yet be assessed.

We are interested in the views of submitters as to whether there are additional changes that should be made to the Rules or the Code at this time to enhance the quality of director independence disclosures.

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?
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?

² The Rule provides that if a Board is unable to make such an assessment due to a lack of information regarding a candidate nominated by an Equity Security holder that a statement to that effect is included in the notice of meeting.

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?
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?
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?

Appendix: Current settings

The Code and Rules contain NZX's current regulatory policy in relation to director independence.

Assessing independence

Rule 2.6.1 requires the board of an issuer³ to identify which Directors it has determined to be Independent Directors by having regard to the non-exhaustive factors described in the Code which may impact director independence.

An Independent Director is defined in the Rules as a Director who is not an Employee of the Issuer and who has no Disqualifying Relationship.

The term Disqualifying Relationship is defined in the Rules. This is a key definition in defining a director's independence.

Disqualifying Relationship

means any direct or indirect interest, position, association or relationship that could reasonably influence, or could reasonably be perceived to influence in a material way the Director's capacity to:

- (a) bring an independent view to decisions in relation to the issuer,
- (b) act in the best interests of the issuer, and
- (c) represent the interests of the issuer's financial product holders generally

including having regard to the factors described in the NZX Corporate Governance Code that may impact director independence, if applicable.

There are several important points relating to the interpretation of this definition. The first is that the board of an issuer should assess a director's independence by considering all of the director's interests, positions and relationships. Rule 2.6.4 notes that an issuer is responsible for ensuring that a director provides sufficient information to make the independence determination.

The Code⁴ contains a number of factors that may indicate a lack of independence. These factors are not exhaustive, and are not the only factors that an issuer should consider when determining a director's independence.

³ This requirement only applies to issuers of Equity Securities, issuers who solely have Quoted Debt Securities or Quoted Fund Securities do not need to comply with this requirement.

⁴ Note this reflects the Code as at 1 April 2023, against which issuers must report for financial years commencing on or after 1 April 2023.

The factors are set out in the table below:

Examples of factors that may cause a board to determine that a director is not independent include that the director:

1. is currently, or was within the last three years, employed in an executive role by the issuer, or any of its subsidiaries;
2. is currently deriving, or within the last 12 months derived a substantial portion of his, her or their annual revenue from the issuer;
3. is currently, or was within the last 12 months, in a senior role in a provider of material professional services (other than an external auditor) to the issuer or any of its subsidiaries;
4. is currently, or was within the last three years, employed by the external auditor to the issuer, or any of its subsidiaries;
5. currently has, or did have within the last three years, a material business relationship (e.g. as a supplier or customer) with the issuer or any of its subsidiaries;
6. is a substantial product holder of the issuer, or a senior manager of, or person otherwise associated with, a substantial product holder of the issuer;
7. is currently, or was within the last three years, in a material contractual relationship with the issuer or any of its subsidiaries, other than as a director;
8. has close family ties or personal relationships (including close social or business connections) with anyone in the categories listed above;
9. has been a director of the entity for a period of 12 years or more.

The Code recommends that where an issuer has determined a director to be independent despite the presence of a factor contained in the Code, that the issuer discloses the reasons for its determination, along with a description of the interest, position or relationship that triggered the application of the Code factor.

The Code operates on a 'comply or explain' basis. Rule 3.8.1(b) requires an issuer⁵ to disclose in its annual report which Code recommendations it has not followed along with an explanation of the reasons for not following the recommendation, and the issuer's alternative governance arrangements. Therefore, an issuer could elect not to make the disclosure recommended by recommendation 2.4, so long as the issuer discloses its reasons for doing so.

Rule 2.6 requires a board to determine whether a director is an independent director having had regard to the non-exhaustive factors described in the Code and to announce that determination to the market within 10 business days' after a director's initial appointment. An issuer's board must also update the market if its determination as to a director's independence changes.

Board composition requirements

Rule 2.1.1 requires that the Board of an issuer of quoted equity securities must, at all times, have at least two Directors who are Independent Directors (excluding alternate Directors). In addition, Code recommendation 2.8 recommends that a majority of the board of an equity issuer should be independent. As the Code operates on a 'comply or explain' basis, an issuer may elect not to have a majority of Independent Directors on its board so long as it explains the reasons for not doing so.

Rule 2.1.1 also requires that at least two directors of an issuer be ordinarily resident in New

⁵ This requirement only applies to issuers of Equity Securities, issuers who solely have Quoted Debt Securities or Quoted Fund Securities do not need to comply with this requirement.

Zealand.

Audit Committee composition requirements

Rule 2.13.2 requires that the Audit Committee of an issuer must have a majority of independent Directors and that at least one member of the Audit Committee has an accounting or financial background. Code recommendation 3.1 also recommends that members of the audit committee should be non-executive directors.

Takeover Committee composition requirements

Code recommendation 3.6 recommends that the board of an issuer should establish appropriate protocols that set out the procedure to be followed if there is a takeover offer for the issuer including the option of establishing an independent takeover committee and the likely composition and implementation of an independent takeover committee. As part of the amendments that were made to the Code commentary to that recommendation as part of the recent 2022 review, the commentary encourages issuers to disclose the composition of its takeover committee at the time the takeover committee is convened in relation to the bid and to confirm that the committee's members are independent of the bidder.

Independent director obligations

The Rules do not create specific obligations on Independent Directors⁶ (although voting restrictions do apply to certain resolutions in which a director is interested). However, it is a standard condition of certain waiver decisions granted by NZ RegCo that Independent Directors provide certifications in support of the waiver application (for example: as to the arm's length nature of a transaction).

⁶ It is noted that Rule 5.2.2(e) provides an exception from the Related Party requirements where the Independent Directors approve employment contracts or contracts for personal services with Related Parties, in certain circumstances.