NZX Corporate Governance Code Review

Second Consultation Paper
3 August 2022

CONTENTS

This consultation paper has been prepared by NZX to seek comment on the proposals contained in the paper, and the accompanying exposure draft of the Code, 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 and the exposure draft of the Code do not reflect NZX's concluded views of the matters raised. Capitalised terms which are not defined in this discussion document have the same meanings given to them in the NZX Listing Rules.

Context for the review

What is the NZX Corporate Governance Code?

The NZX Corporate Governance Code (**Code**) provides NZX issuers with guidance on NZX's expectations in relation to corporate governance practices. The NZX Listing Rules (**Rules**) require issuers to publicly report the extent to which the issuer has followed the recommendations set out in the Code.

This approach, known as 'comply or explain' recognises that an issuer's board is best placed to determine its own corporate governance practices, that are appropriate for its investors and other stakeholders. This is an internationally recognised approach to exchanges' regulation of corporate governance, and is designed to ensure that investors receive sufficient information regarding an issuer's governance practices to enable them to make informed investment decisions, and enable investors to appropriately engage with the boards of listed companies.

Why are we reviewing the Code?

We are reviewing certain settings within the Code to assess their effectiveness, now that issuers have had at least three reporting cycles against which to report against the settings that were last amended as part of the 2018 holistic Rule review. This review also provides us with an opportunity to respond to stakeholder feedback in relation to key aspects of the Code, and to consider international developments in the context of New Zealand market conditions, to ensure that the settings in the Code are correctly calibrated to promote good corporate governance for our listed issuers.

NZX wishes to ensure that the settings in the Code continue to support the operation of NZX's markets on a fair, orderly and transparent basis, by promoting good governance and recognising that boards act as a mechanism to promote shareholders' interests and provide long-term value. NZX considers that a fundamental aspect of the Code is its recognition that the board of an issuer remains best placed to consider the governance settings that are appropriate for its business, and intends to retain the Code's regulatory settings as recommendations that issuers may adopt and adhere to on a voluntary basis.

Introduction

Background to this consultation

NZX commenced this review in November 2021 with the release of an initial discussion document that sought early-stage feedback on the scope and direction of travel for the review.

NZX received excellent engagement in relation to the initial consultation, receiving 23 submissions from a broad range of submitters across issuers, wholesale and retail investors, industry interest groups and law firms. Many submitters took advantage of the opportunity to provide verbal submissions to NZX, which was beneficial in enabling NZX to discuss with submitters the views they represented. We would like to thank those who contributed to the initial phase of the consultation process.

NZX also undertook sample testing of issuers' disclosure practices across a number of metrics that were designed to assess the extent to which the Code recommendations that were within the scope of the initial review had been adopted, and the quality of issuers' reporting practices in disclosing non-adoption of the relevant Code recommendations. We have also further reviewed the current Code settings against those of ASX, given that New Zealand's capital markets form part of the broader Australasian capital markets.

This consultation paper provides an explanation for the proposed amendments to the Code that are contained in the exposure draft of the Code that has been released in tandem with this consultation paper. The amendments have been designed after careful consideration of the submission feedback we received, along with our sample bench-marking exercise and review of international practice (particularly in Australia).

We are also consulting on changes to the ESG Guidance Note, and have separately released an exposure draft of proposed changes to that guidance which are complementary to the proposed amendments to Principle 4 of the Code that are further described in this paper. It is proposed that once the amendments to the Code have been determined that consequential changes will also be made to other relevant Guidance Note, including the Guidance Note relating to Governance.

How can I contribute to this consultation?

Provide a submission

We invite interested parties to provide their views on the proposals raised in this consultation paper and that are contained in the exposure draft of the Code, by emailing NZX Policy. We are interested in general feedback on the proposals outlined in the paper, and have raised specific consultation questions to prompt feedback in certain areas.

Alternatively, if you would prefer to provide a verbal submission, please email NZX Policy to arrange a time to speak with us. You can contact NZX Policy at: policy@nzx.com.

The closing date for submissions is **Friday, 23 September 2022**.

NZX may publish the submissions it receives, so please clearly indicate in your submission if you do not wish your submission to be published, or identify any part of your submission that contains confidential information.

Participate in one of our workshops

We intend to hold workshops on certain areas of the Code that we are proposing to amend in late August and early September.

If you have previously provided us with a submission as part of the initial discussion document, we will automatically invite you to participate in these sessions. If you would like to be added to our contact list for these sessions, please email us at policy@nzx.com.

If you have any queries in relation to the review, please contact:

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Executive Summary

Summary of Proposals

NZX is proposing a number of amendments to the Code which are contained in the exposure draft of the Code that accompanies this paper. It is intended that the revisions to the Code will take effect for a listed entity's first full financial year commencing on or after 1 April 2023. The proposed amendments relate to a number of Code Principles, and are summarised below:

Operation of the Code

We propose retaining the 'comply or explain' framework for the Code and providing further guidance as to how disclosures against the Code should be made.

Ethics

NZX is proposing to include Principle 1 within the review, and to amend the relevant Code commentary to provide guidance as to the frequency at which issuers should undertake training in relation to Codes of Ethics. We are also recommending changes to encourage larger issuers to consider adopting formal whistle blowing arrangements, including access to third-party agencies.

Director Independence

We are proposing amendments to recommendation 2.4, that the board of an issuer should provide disclosure of its reasons for a determination of director independence when one of the factors contained in the Code commentary is present. We are also proposing that issuers carefully consider the independence status of a director whose tenure on the board is twelve years or more.

Remuneration

NZX proposes to amend recommendations 5.1 and 5.2 so that they more clearly relate to director remuneration and executive remuneration, respectively. We are also recommending that issuers disclose how their remuneration arrangements align with the issuer's strategy and performance objectives. Where an issuer has sought independent advice in relation to the design of its remuneration arrangements for directors, we are encouraging issuers to provide a summary of that advice, through amendments to the Code commentary.

Shareholder Meetings

NZX is proposing amendments to the Code commentary to encourage issuers in the S&P/NZX 50 index or with a geographically diverse shareholder base to hold hybrid meetings, and to provide guidance as to when virtual only meetings may be appropriate.

Non-financial reporting

We are proposing amendments to clarify the operation of the Code's recommendations in relation to non-financial reporting, and to reflect the new legislative climate related disclosures framework. We are not proposing changes to reflect modern slavery reporting requirements in recognition on the Government's current consultation regarding legislative change in this area.

Diversity

We are also proposing changes to the Code recommendations to encourage issuers in the S&P/NZX 20 Index to set a measurable objective for gender diversity which is for their board to be comprised of at least 30% men and at least 30% women, within a specified period. This would apply on a 'comply or explain' basis, and aligns with the approach taken in the ASX Corporate Governance Council's

‘Corporate Governance Principles and Recommendations (4th Edition)’ (**ASX Code**) for issuers in the S&P/ASX 300 Index.

NZX Corporate Governance Institute

NZX received strong endorsement for the establishment of the Institute, and we are providing further details of the role and purpose of the Institute in this paper. NZX expects to convene the Institute in early Q4 2022, for a one year initial establishment period.

Capital Raisings Review

In our initial discussion document, we sought feedback on the operation of recommendation 8.4, which recommends that issuers undertake offers on a pro-rata basis. NZX received a number of submissions, particularly in respect of the disclosures provided by issuers when non pro-rata structures are utilised. As a result of recent transactional activity, and stakeholder interest, NZX has prioritised the review of the capital raising settings contained in the Rules, and will consider the feedback received on recommendation 8.4 though that review process.

Operation of the Code

This section of the Consultation Paper describes the changes that are proposed to the introduction to the Code and Rule 3.8.1, which creates the framework in which issuers must report their corporate governance practices against the recommendations contained in the Code. We welcome general feedback on these proposals.

Retention of the 'comply or explain' framework

In our initial discussion document, we noted that NZX intended to retain the current 'comply or explain' reporting framework for the recommendations contained in the Code. This framework requires an issuer to provide a corporate governance statement on the extent to which it has followed the recommendations in the Code in the current financial year. Issuers may provide these disclosures in their annual reports, on their websites, or through a combination of both mechanisms.

While submitters had differing views in relation to aspects of the Code that should be elevated as mandatory requirements under the Listing Rules, there was general support for the retention of the 'comply or explain' approach, with submitters noting the correlation between an issuer's market capitalisation and good governance practices, including the quality of reporting under the 'comply or explain' framework. Our sample testing indicated that over the last 3 years there has been a general shift to a greater adoption of the Code recommendations, under a 'comply or explain' regime.

NZX remains of the view that a 'comply or explain' regime is appropriate because it recognises the primacy of an issuer's board to adopt corporate governance practices where the board consider those practices to be more suitable than those recommended in the Code, while ensuring that investors and other stakeholders are provided with an appropriate level of information about an issuer's governance practices to enable them to make informed decisions and have a meaningful dialogue with the boards of listed companies.

Clarification of explanatory reporting expectations

There was a general sentiment expressed by submitters that the quality of 'explain' disclosures could be improved. Submitters considered that issuers should be providing more detail as to the reasons for the non-adoption of a recommendation, and should provide clearer disclosure where an issuer has adopted only aspects of a recommendation. NZX agrees that it is appropriate to provide greater guidance in the introduction of the Code, as to how the non-adoption of a recommendation should be reported. We also note that we have made specific changes to the commentary in relation to particular recommendations to enhance disclosure (for example, the commentary to recommendation 5.2 which relates to executive remuneration disclosure).

Some submitters suggested that it would be appropriate for issuers to sequence reporting against the Code recommendations, where a different governance approach had been taken. While NZX considers that such an approach is helpful, we are mindful of the different ways that issuers may want to structure their corporate governance reporting, either to avoid duplication, or to fit within a recognised ESG reporting taxonomy. We are therefore proposing an amendment to the Introduction to the Code that would encourage issuers to consider providing an index or using sub-headings to ensure that readers of the issuer's corporate governance statement can easily navigate disclosures in relation to the recommendations (including those that an issuer has not adopted).

We are also proposing a technical amendment is required to Rule 3.8.1(b) to ensure that 'explain' disclosures are provided for past reporting periods where an issuer has failed to explain a different approach in the relevant reporting period. We have set out the proposed form of the amendment in the Appendix to this paper.

Ethics

NZX did not propose any changes to Principle 1 in the initial discussion document relating to this review of the Code. Principle 1 contains a number of recommendations that are designed to ensure that directors set high standards of ethical behaviour, model this behaviour and hold management accountable for the ethical standards being followed through the organisation.

A number of submitters suggested the inclusion of Principle 1 in the review, given that ethical considerations are fundamental to good governance. As a result of submitters' feedback we propose renaming Principle 1 'Ethical Standards' to better reflect that recommendation 1.1 relates to ethical standards more broadly than a Code of Ethics.

We welcome general feedback on these proposals, and have raised a number of specific consultation questions, below.

Mandatory code of ethics

Certain submitters favoured NZX elevating recommendation 1.1 to a mandatory requirement through a Rule amendment that would require issuers to adopt a code of ethics. NZX considers that it is appropriate to retain its current conduct expectations through recommendation 1.1 which operates on a 'comply or explain' basis, noting that it is not common internationally for a requirement for a code of ethics to be mandated through listing rule settings. NZX is therefore not proposing any amendments to the Code's settings in relation to the expectation that issuers should adopt a code of ethics.

Training

Recommendation 1.1 notes that training should be provided regularly in relation to an issuer's code of ethics. The commentary to recommendation 1.1 currently notes that an issuer should provide training on its code of ethics to new and existing staff, and that providing training helps to ensure employees actively engage with the issuer's code of ethics.

NZX is proposing updates to the commentary to recommendation 1.1 to note that it expects issuers to provide training to staff at least every three years, and to reinforce NZX's expectations around disclosure relating to the frequency of training.

Whistleblowing

Recommendation 1.1 currently notes that the code of ethics should outline internal reporting procedures for any breach of ethics, and that the code of ethics should require that an issuer's employees and directors adhere to any procedures about whistleblowing. NZX received submissions that this recommendation could be enhanced to include external reporting procedures for any breach of ethics, such as the utilisation of confidential third-party agencies for whistleblowing purposes.

NZX has considered those submissions in the context of the Protected Disclosures Act which came into effect on 1 July 2022. The new legislation includes provisions that allow employees of private sector organisations to report serious wrongdoing directly to an appropriate authority and provides protections to disclosers from retaliatory actions. NZX is proposing updates to the Code commentary to recommend issuers consider whether it is appropriate to provide access to an external agency for whistleblowing purposes, and to note that issuers should ensure they understand their legislative responsibilities in relation to protected disclosures.

Consultation Questions

1. Do you consider it appropriate for issuers to disclose their practices in relation to providing employees with training in relation to their Code of Ethics, including the frequency of that training?

2. Are the costs involved for issuers providing access to their employees to third-party whistleblowing services proportionate to the benefits of those services?

Director Independence

NZX is proposing a number of changes to the recommendations underpinning Principle 2 that relates to board composition and performance. A number of these changes relate to NZX's requirements for independence and include technical changes to the Rules and Code. We note that NZX Policy plans to undertake a 'deep-dive' in relation to the Rule settings for independent directors in 2023. The proposed material amendments arising from the current review are described below.

We welcome general feedback on these proposals, and have raised a number of specific consultation questions, below.

Matters to be considered when determining director independence

A 'Disqualifying Relationship' is defined in the Rules as 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. The Rules currently require that this definition is interpreted having regard to the factors described in the Code that may affect director independence, if applicable.

As a result of submission feedback we are proposing a technical amendment to the definition of a Disqualifying Relationship, to clarify that the factors contained in the Code are not the only factors that a board should consider when making an assessment of a director's independence. This is in response to the concern expressed by a number of submitters that the current factors identified in the Code are applied on a 'tick-box' basis by issuers when determining independence, rather than being included as part of a more holistic assessment, and to align with the approach taken under the ASX Code.

This amendment will be supported by clarifying edits to the Code commentary to emphasise that the factors contained in the Code are examples of interests and relationships that may preclude a director from being regarded as independent.

Disclosures relating to an independence determination

NZX received general submission feedback that issuers only provide a disclosure in relation to a director's independence when that director had been determined not to be independent. NZX's sample testing also identified that a large proportion of issuers sampled did not explain the basis for a determination of independence.

NZX appreciates that it may not be appropriate for an issuer to provide disclosure of all of a director's interests and relationships that have been considered as part of an independence determination, and that there are legislative requirements for a company to include details of a director's interests as disclosed in its interests register in the annual report. In this context, and after considering submission feedback, NZX is proposing a new Code recommendation as part of recommendation 2.4, to encourage issuers to provide disclosure when a director is determined to be independent despite the presence of one of the factors identified in the Code. NZX considers that this proposal will enhance the information available to investors regarding director independence determinations (noting that the Code operates on a 'comply or explain' basis, which would allow an issuer to explain why it is appropriate not to provide the recommended disclosure). NZX considers that this proposal strikes a balance in enabling an appropriate level of detail regarding the independence determination to be provided to the users of the corporate governance statement provided under Listing Rule 3.8.1, and also notes that it aligns with the approach taken in Australia.

Consequences of a determination that a director is not independent

NZX considers that security holders place importance on the board's assessment that a director is considered to be independent, and submitters noted that there is often a stigma associated with a determination that a director is not independent. NZX agrees with the feedback of submitters that non-independent directors may be high-performing stewards, and 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 conflict that has given rise to the director's lack of independence.

NZX intends to clarify in the Code commentary that the Listing Rules set the board composition requirements, and that an issuer is permitted to have a certain number of non-independent directors in accordance with those requirements.

Changes to the independence assessment factors

NZX is proposing technical amendments to the drafting of some of the factors listed in the Code as inclusive considerations that should be used to determine a director's independence, including changes to the length of time within which previous relationships with an external audit firm are relevant, for consistency with recommendation 3.1 relating to the audit committee chair's independence.

NZX is also proposing changes to the factor relating to close family ties, to refer to close personal relationships, which includes personal, business or social connection, reflecting that these relationships can also affect a director's independence, and aligned with the approach taken in Australia.

As part of the 'deep-dive' into the review into director independence that is scheduled to occur in 2023, NZX intends to more fully consider the nature of the agency conflicts that the director independence requirements are intended to address, to ensure that the factors relating to the assessment of a director's independence are appropriately calibrated.

Tenure

NZX received general feedback from a number of submitters that it would be helpful for the Code to provide greater clarity as to the point at which a director's tenure should be considered by an issuer as a factor that may preclude a determination of independence. As part of the sample testing NZX conducted to support the review of the Code, NZX identified six issuers who had determined a director to be independent despite the director's tenure exceeding 12 years, with only two of those issuers providing an explanation of the reason for that determination.

NZX proposes clarifying in the Code that where a director's tenure exceeds twelve years, that the director's tenure may be a factor that precludes the director from being regarded as independent. The inclusion of this change (along with the recommendation noted above) is not intended to prevent a board from making a determination that a long tenured director is independent, but if so, will encourage greater disclosure of the issuer's reasons for such a determination.

Succession planning

NZX received submission feedback that it would be useful to suggest in the Code commentary that issuers publish information relating to the succession planning arrangements for the issuer's board. NZX agrees that this information could be useful information, particularly where an issuer's board includes long tenured directors, and is interested in submitters views in relation to this proposal.

Requirements relating to the independence of the chair

Code recommendation 2.9 requires that an issuer of equity securities should have an independent chair of the board. It also states that if the chair of the board is not independent, that the chair and chief executive officer should be different people. NZX is proposing to split recommendation 2.9 into separate recommendations, to ensure that appropriate disclosures are provided in relation to both limbs of the current recommendation.

NZX is also proposing to amend new recommendation 2.10, to recommend that the chair of the board should be independent of the board's CEO, whether or not the chair is independent. This amendment is consistent with the corporate governance expectations of ASX, SGX and the UK Financial Reporting Council, and recognises the importance of the separation between the management of an issuer and the chair's governance role, in enabling a board to effectively challenge management.

Recommendation 3.1 – audit committees

In order to enhance the visibility of the skills and experience of audit committee members, NZX is proposing an amendment to the Code commentary, similar to the approach taken in Australia, that issuers should disclose the qualifications and experience of audit committee members.

Recommendation 3.3 – remuneration committees

While NZX did not consult on the Code recommendations relating to the composition of board committees, NZX did receive submissions in relation to recommendation 3.3 which recommends that a majority of remuneration committee members should be independent, and notes that management should only attend remuneration committee meetings at the invitation of the committee.

Some submitters suggested that it is implicit in recommendation 3.3, that executive directors should not be members of the remuneration committee. While NZX acknowledges that there is an inherent conflict in an executive director considering remuneration matters in relation to his/her own remuneration, NZX is interested in views of submitters as to whether executive directors should be able to form part of the remuneration committee. We note that the ASX Corporate Governance Code does not restrict executive directors from acting as members of a remuneration committee, but notes that if a remuneration committee includes an executive director the committee should consider the potential conflicts of interest that may arise.

Recommendation 3.6 – takeover committees

Currently recommendation 3.6 recommends issuers have protocols that include the establishment of an independent takeover committee and the likely composition of that committee. The commentary currently explains that the takeover committee should be independent of the bidder. NZX is proposing an amendment to the commentary to encourage issuers to disclose the composition of its takeover committee, once the committee has been established, as this information is important to stakeholders.

Consultation Questions

3. Do issuers have any concerns with the revised recommendation that the issuer discloses its reasons for determining a director to be independent in the presence of a Code factor?

4. Do you have any comments in relation to the amendment to the factors described in the Code?

5. What is the utility of information relating to an issuer's succession planning arrangements for its board, are there any difficulties that issuers face in providing this information?

6. Should executive directors be able to sit on an issuer's Remuneration Committee?

Remuneration

This section of the paper describes the changes that NZX is proposing to the recommendations that underpin Principle 5 of the Code, which relates to an issuer's remuneration practices. We welcome general feedback on these proposals.

Non-financial goals when setting executive performance-based remuneration

A number of submitters supported expanding the Code to include ESG matters as relevant considerations for setting remuneration, and particularly performance-based remuneration, as this was regarded as enabling issuers to better align their remuneration practices with their long-term strategy.

NZX is proposing to amend the commentary to recommendation 5.2 that relates to the elements that are relevant considerations when setting performance-based remuneration for executives, to expand those considerations to include non-financial goals which have been identified by an issuer as integral to its strategy, and the values of the issuer. We also propose a change to the commentary to encourage issuers to disclose how its executive remuneration arrangements align with its strategy and performance objectives, and generic eligibility and vesting hurdles for any long-term incentive scheme that forms part of those arrangements.

Independent advice

The commentary to recommendation 5.2 currently states that where an external consultant is used to develop a director remuneration proposal, and an issuer wishes to publicly refer to reliance on an independent consultant's remuneration report, that an issuer should also make then a summary of the findings of the report public.

A broad range of submitters supported greater disclosure in relation to an issuer's reliance on independent remuneration reports, which was regarded as important information to enable shareholders to make an informed decision in relation to director remuneration proposals. It was also noted that Australian investors and proxy advisers are increasingly interested in this information and that NZX issuers may be at a disadvantage if they failed to seek independent advice in relation to director remuneration arrangements, and to publish a summary of that advice.

NZX is therefore proposing a change to the Code commentary, such that where an issuer has relied on an independent remuneration report in formulating its director remuneration arrangements, that the issuer should disclose a summary of the report.

Clarification of recommendations applying to directors and executives

NZX is proposing drafting changes to recommendations 5.1 and 5.2, and the associated commentary to clarify the recommendations and commentary that apply to director and executive remuneration, respectively.

Gender pay gap reporting

NZX is proposing that issuers within the S&P/NZX 50 Index and with more than 50 employees consider providing gender pay gap reporting information. Submitters expressed a view that this should be considered under principle 2 which relates to diversity. These proposed changes are discussed in more detail in relation to the proposed amendments to the Code for issuers' diversity practices.

Shareholder Meetings

NZX is proposing amendments to recommendation 8.2 of the Code, and the associated commentary to promote shareholder meeting arrangements being designed in a manner that encourages shareholder participation, including through the use of hybrid meetings, and to provide additional guidance in relation to the virtual aspects of a shareholder meeting. We welcome general feedback on these proposals.

Hybrid meetings preferred

It is becoming increasingly common for issuers to hold hybrid or virtual meetings rather than purely physical meetings, in part as a response to COVID-19. NZX considers that this evolution is also a natural result of the availability of modern technology, and reflective of the ability for shareholders to engage with the boards of issuers on a continuous basis through an issuer's investor relations channels, rather than solely at the annual shareholders' meeting each year.

The vast majority of submitters supported a hybrid meeting model, noting the benefits of shareholder access and engagement, despite a small to moderate increase in the time and costs associated with additionally facilitating the virtual aspects of a hybrid meeting. Some submitters suggested that a hybrid model should be mandatory and opposed the use of virtual only meetings.

NZX is proposing changes to the Code commentary that would encourage issuers, particularly those in the S&P/NZX 50 Index, or those with geographically diverse registers to facilitate hybrid meetings.

NZX agrees with submitters' views that there are investor relation benefits associated with a hybrid model.

Virtual meeting guidance

NZX is also proposing changes to provide guidance as to when it may be appropriate for an issuer to hold a virtual only meeting. A number of submitters supported additional guidance in relation to virtual meetings (including when part of a hybrid meeting). Submitters considered that the publication of a virtual meeting guide ahead of the meeting would be beneficial in providing greater clarity for investors as to the virtual meeting arrangements. It was submitted that the guide should contain the issuer's arrangements for voting and the moderation of questions at the meeting, amongst other matters. NZX is proposing updates to the Code that reflect this feedback, which NZX considers will better enable investors how to participate in a meeting that is being conducted virtually.

Environmental, Social and Governance Reporting

NZX received extensive feedback in response to the initial discussion document in relation to environmental, social and governance (**ESG**) reporting, reflecting the increasing importance to investors and other stakeholder in understanding an issuer's ESG practices.

NZX is proposing a number of amendments to the Code and the ESG Guidance Note, which are summarised below, in addition NZX is proposing a number of technical drafting changes to the commentary that supports the recommendations contained in Principle 4 of the Code.

We welcome general feedback on these proposals.

Split recommendation 4.3 – financial and non-financial reporting

NZX is proposing to split recommendation 4.3, so that the Code contains be-spoke recommendations relating to financial and non-financial reporting, to increase the prominence of the Code's endorsement of non-financial reporting.

Website as the primary location for ESG reporting

While a small number of submitters expressed a preference for ESG reporting to be contained in an issuer's annual report to aid comparability, there was a general view that an issuer should have the discretion to provide reporting on its website so long as the reporting was referenced in the annual report. Sample testing indicated it was common for more detailed ESG reporting to be available on an issuer's website.

NZX is proposing amendments to the Code commentary relating to the location of ESG disclosures, to note that where an issuer provides ESG reporting on its website that its annual report should include a clear statement as to where that information is available.

Process for non-financial disclosures

NZX considers that investors are increasingly relying on sustainability and other ESG reporting disclosures which may not be subject to formal review or audit by an external auditor. NZX understands that in relation to climate related financial reporting, that the XRB will be consulting on certain assurance standards in relation to aspects of climate statements that relate to GHG emissions during 2022.

Submitters were supportive of NZX expanding the Code commentary to encourage issuers to report the process by which their non-financial reporting disclosures had been prepared where it has not been subject to formal review of audit by an external auditor. This reflects amendments made by ASX to the ASX Code in 2019. NZX has proposed changes to reflect this feedback in the exposure draft of the Code, and is interested in submitters' views of this proposal.

Description of risk management framework

In the context of NZX's consultation on the Code's ESG reporting recommendations, NZX received a submission that it would be helpful for the commentary to recommendation 6.1 (which relates to an issuer's risk management framework) for the Code to clarify that an issuer should report its risk management framework.

NZX agrees that this could be a useful disclosure, in order to provide investors with more clarity as to how an issuer has identified the material risks to its business. NZX is therefore proposing additional commentary to recommendation 6.1 to address this consideration.

Climate-related disclosures

The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act[1] was enacted in October 2021. The legislation will require climate reporting entities, which will include all NZX issuers (other than small listed issuers[2]) to mandatorily report using the framework to be implemented by climate standards that are being developed by XRB in line with the principles of the TCFD framework for financial years commencing in 2023, with initial reporting required in 2024.

NZX wishes to support issuers in ensuring that they meet their legislative obligations in relation to making climate related disclosures. NZX is proposing consequential changes to the Code commentary to alert issuers of to the new legislative obligations, and to update the ESG Guidance Note to provide additional material to support issuers in becoming familiar with the new reporting requirements.

A number of submitters suggested that NZX update the Code to refer to sustainability reporting rather than non-financial reporting on the basis that this would encourage issuers to apply a 'double-materiality' standard to their climate related disclosures. The concept of double materiality is that issuers consider not only the material effects of climate change on the issuer, but also the issuer's material effects on climate change. NZX notes than in its consultation on the climate standards that the XRB is not proposing that climate reporting entities be required to apply a double materiality standard to their disclosures, noting that compliance with the new climate reporting regime will in itself be a significant change for climate reporting entities. NZX agrees with this view, and has therefore retained the references to non-financial reporting in the Code.

Modern Slavery

In its initial discussion document, NZX consulted on the extent to which modern slavery reporting should be brought within the non-financial recommendations contained in the Code. Submitters generally supported modern slavery reporting, in the absence of a New Zealand legislative requirement, with some submitters noting it was more appropriate for the Government to introduce reporting requirements by way of a legislative amendment.

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[1] The legislation is available here.

[2] There is an exemption for issuers who have a market capitalisation of $60 million or less.

Subsequently, in April 2022, MBIE commenced a consultation[3] in relation to new legislation designed to address modern slavery and worker exploitation. It is proposed that these requirements would apply to all New Zealand entities (listed and non-listed), with cascading obligations applying to medium ($20-$50m annual revenue) and larger (over $50m annual revenue) organisations. Medium and large organisations would be required to disclose the steps they are taking to address modern slavery in their supply chains, and large organisations would be required to undertake due diligence to prevent modern slavery in their supply chains.

We consider that given the Government's recent consultation on modern slavery reporting, it would be inappropriate to amend the Code at this time, while the obligations are being designed through a legislative review process.

Diversity

NZX is proposing a number of changes to recommendations in the Code under Principle 2 that relate to diversity. There was a general acceptance by submitters of the value of diverse boards and leadership teams in driving long term business sustainability and success. NZX considers that its proposal are validated by the academic research in relation to the benefits of a diverse board and leadership team[4], and the acceptance by proxy advisors in the benefits of reporting the effectiveness of an issuer's diversity practices.

NZX is proposing specific changes to its diversity settings for issuers in the S&P/NZX 20 Index, that would include a new Code recommendation that those issuers report against a diversity target.

We welcome general feedback on these proposals, in addition to the responses to the consultation questions set out below.

Diversity is broader than gender

NZX's Code currently recognises that diversity is broader than gender. This was endorsed by the majority of submitters, with some suggesting that NZX should also require reporting of ethnic and cultural diversity factors.

NZX agrees that when designing an issuer's diversity governance practices, it is appropriate for the board of an issuer to consider the issuer's diversity needs, based on the issuer's size, the nature of its product or service offering, its customer base and the jurisdictions in which it operates, to determine how it can bring broad perspectives in leadership and thought to its governance and management arrangements, and workforce. NZX considers that it is appropriate for issuers to consider factors beyond gender (such as factors including ethnicity, social background, sexual orientation, skills, and age) when designing their diversity practices.

NZX's proposed amendment reflects the current language in the Code recommendation 2.5, which recognises that gender diversity is a minimum consideration. The proposal is also consistent with the ASX Code's suggestions that a diversity policy should 'express the organisation's commitment to inclusion at all levels of the organisation regardless of gender, marital or family status, sexual orientation, gender identity, age, disabilities, ethnicity, religious beliefs, cultural background, socio-

[3] MBIE's consultation in relation to modern slavery and worker exploitation is available here.
[4] See 'Board Diversity and Effectiveness in FTSE 350 companies' published in 2021 by the UK Financial Reporting Council.

economic background, perspective and experience.'

Submitters also noted that a culture of inclusion is an important element in fostering diversity, and enabling issuers to deliver the diversity targets they have designed. NZX agrees that an inclusive culture is fundamental to the success of an issuer in delivering the diversity targets it sets for itself.

NZX is proposing amendments to the Code commentary to reflect this approach.

Gender diversity targets – S&P/NZX 20 Issuers

In its initial discussion document, NZX consulted on whether it should introduce targets for gender diversity within the Code, against which issuers could report on a 'comply or explain' basis. The majority of submitters who commented on this proposal were supportive, with a minority of submitters supporting an approach that would see issuers set their own gender diversity targets.

NZX is proposing an amendment to recommendation 2.5 that if an issuer was in the S&P/NZX 20 Index at the commencement of the reporting period that it should have a minimum measurable objective for achieving gender diversity in the composition of its board that is to have at least 30% male and at least 30% female directors, within a specified period. This is consistent with recent changes made to the ASX Code in 2019, in relation to S&P/ASX 300 Index issuers.

The proposal would allow issuers in the S&P/NZX 20 Index to set additional objectives, and also allow the issuer to adopt a different target on a comply or explain basis if it considered that this target was inappropriate for its business.

Gender pay gap reporting

A significant number of submitters provided feedback in respect of gender pay gap reporting in response to NZX's initial discussion document. Submitters were broadly supportive of NZX encouraging gender pay gap reporting as an ESG disclosure.

In response to this feedback, NZX considers that it is appropriate to highlight in the Code commentary to recommendation 2.5, that issuers (particularly issuers within the S&P/NZX 50 Index with more than 50 employees[5]) may wish to provide gender pay gap information either on their website or in their annual report.

Consultation Question

7. What difficulties will issuers in the S&P/NZX 20 Index face in reporting against a target over a specified period for its board to be comprised of persons 30% of whom are male and 30% of whom are female, noting the comply or explain nature of this recommendation?

NZX Corporate Governance Institute

[5] We note that Mind the Gap recommends gender pay gap reporting for entities with more than 50 employees – see 'Ethnic and Gender Pay Gap Reporting for Aotearoa/New Zealand', December 2021.

In its initial discussion document NZX consulted on the establishment of the NZX Corporate Governance Institute, comprised of individuals representing key industry stakeholders, to provide NZX with recommendations in relation to the development of the Code and Rule settings that apply to the corporate governance practices of issuers on the NZX Main Board.

Submitters strongly supported the establishment of the Institute, including its status as an advisory body particularly in its establishment phase. Some submitters identified additional organisations and stakeholders whom could usefully be included as part of the composition arrangements for the Institute.

NZX therefore intends to proceed in forming the Institute as a preeminent corporate governance body for New Zealand.

The role of the Institute will be to provide recommendations to NZX relating to NZX's corporate governance regulatory settings, for the NZX Main Board. In order to enable the Institute to become a centre for excellence for corporate governance in New Zealand, it is envisaged that it will also commission research and publish reports into its findings.

The purposes of the Institute will be to assist NZX in delivering corporate governance policy settings for the NZX Main Board:

- in order to assist NZX in becoming a leading, innovative, regional securities exchange regulator that enhances the reputation of, and promotes the development and success of New Zealand's capital markets;
- that are proportionate to the size of the NZX Main Board and the compliance burden imposed on issuers (noting that approximately over one-third of NZX's issuers have a market capitalisation of less than $50 million), and reflect that issuers on the NZX Main Board compete for capital in the context of the Australasian capital markets;
- that will enhance issuers' corporate governance practices to improve performance and increase shareholder value in a sustainable manner, including by lowering issuers' cost of capital;
- to provide investors and other stakeholders access to appropriate information about issuers' corporate governance practices to enable informed voting and investment decisions; and
- to ensure that NZX's corporate governance policy settings promote and facilitate the fair, orderly, and transparent operation of NZX's markets to support NZX in complying with its market operator license obligations under the FMCA.

The Institute will initially be convened for an establishment phase of one year, after which NZX will assess its effectiveness and determine whether to continue the Institute on a permanent basis.

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Appendix: Proposed Listing Rule Amendments

Operation of the Code

NZX is proposing the following amendments to **Rule 3.8.1**:

Further to the requirements of Rule 3.7.1, the annual report of an Issuer of Quoted Equity Securities must also contain:

(b) if the Issuer has not followed a recommendation in the NZX Corporate Governance Code for any part of the relevant financial year (or for the most recent past financial year with a balance date occurring after 31 March 2022 in respect of which a disclosure has not been made under this Rule), the Issuer must separately state:
- (i) which recommendation, or recommendations were not followed,
- (ii) the period over which this occurred,
- (iii) the issuer's reasons for not following the recommendation,
- (iv) what, if any, alternative governance practice was adopted in lieu of the recommendation during that period, and
- (v) that the alternative governance practice has been approved by the Board, …

Director Independence

NZX is proposing the following amendment to the definition of **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.