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1. Introduction

In November 2015, NZX Limited (NZX) released a discussion paper to commence a review of the NZX Corporate Governance Best Practice Code within the NZX Main Board Listing Rules (NZX Code). A copy of the discussion paper is available to be viewed on NZX’s website https://www.nzx.com/regulation/consultation.

NZX has reviewed the submissions that were received from interested parties and NZX thanks those parties who made a submission on the discussion paper.

This consultation paper includes a discussion of the submissions received, and outlines NZX’s proposed amendments and the reasons for these decisions.

A copy of this consultation paper, and the proposed updated reporting code, can be viewed on NZX’s website https://www.nzx.com/regulation/consultation.

NZX proposes the following timetable for the remainder of the review:

- **31 August 2016** Publication of this consultation paper and proposed amendments
- **14 October 2016** Deadline for submissions on this consultation paper and the proposed amendments
- **Q4 2016** Consideration of feedback and finalisation of proposed amendments
- **Q1 2017** Proposed implementation of amended rules \(^1\)

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\(^1\) This is subject to feedback on proposed timing for implementation and will also follow a period for approval of proposed rule amendments by the Financial Markets Authority under section 331 of the Financial Markets Conduct Act 2013
2. **Request for comments**

Please provide comment (in electronic format) on the consultation paper and accompanying draft code, which should be read together.

NZX may publish comments received. Please indicate in your submission if you have any objection to the release of information contained in your submission.

Please send your submission before 5.00pm Friday, 14 October 2016 to consultation@nzx.com

If you have any queries in relation to this consultation document and the draft NZX Code, please contact:

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3. Executive Summary

The proposed updates to the NZX Code are the first substantive updates since 2003.

Objectives of Review

The key objectives NZX has identified for an updated NZX Code are to:

- improve corporate governance practices;
- promote time-efficient delivery of quality information by listed issuers to help investors make informed decisions in respect of the corporate governance practices of an issuer;
- balance the costs and challenges of disclosure requirements with requiring disclosure which provides value for investors;
- create a code for New Zealand listed issuers which has greater alignment with other relevant reporting frameworks; and
- provide listed issuers with clear recommendations that are fit for purpose, flexible and easy to put into practice.

Currently there is fragmentation of reporting requirements in New Zealand given the existence of a number of different reporting guidelines. The aim of the review is to update NZX’s Code to ensure it reflects current best practice, to improve comparability and consistency between various reporting practices among issuers listed on the NZX Main Board. This is also intended to streamline requirements for issuers by ensuring that the NZX Code is the primary source of corporate governance guidelines for NZX Main Board issuers.

Stakeholder Engagement to date

In response to the November 2015 discussion paper, NZX received 45 formal submissions. The feedback indicated the importance NZX’s capital markets’ participants place on NZX’s corporate governance requirements.

NZX has carefully reviewed the feedback received and has developed an exposure draft of the proposed updated corporate governance code (the draft Code) which is included as a separate attachment to this document. The draft NZX Code aims to complement the mandatory Main Board Listing Rules (Listing Rules) relating to corporate governance requirements. NZX seeks feedback on the draft Code.
Areas of focus

NZX has chosen to focus on several areas of importance to investors as part of developing the proposed updates. The areas of focus are:

- Board diversity;
- ESG and health and safety reporting; and
- Remuneration reporting.

Environmental, social and governance (ESG) reporting is now common place in many countries and others have pledged to produce guidance on ESG disclosure by the end of 2016. New Zealand currently has no ESG reporting requirements. To make direct comparison to different overseas issuers easier, NZX proposes to develop specific guidance for NZX Main Board Issuers based on the model guidance provided by the Sustainable Stock Exchange Initiative to ensure that issuers who do choose to report ESG issues are reporting information which is comparable between New Zealand issuers. As an alternative, NZX has suggested reporting against a widely accepted international framework, the Global Reporting Initiative (GRI). The GRI is an international independent standards organisation that helps businesses, governments and other organizations understand and communicate their impacts on issues. The GRI framework also provides flexibility given that issuers will have different environmental and social concerns.

Diversity has been another area of focus. NZX proposes to build upon its current requirements in this area by introducing a new recommendation (to be met on a “comply or explain” basis) that issuers have a published policy on diversity. This will lead to more detailed reporting of diversity by issuers. Feedback also indicates that stakeholders have a wider interest in diversity, so we have suggested that diversity be considered beyond simply gender. NZX has also suggested within commentary certain matters for issuers to consider in the context of developing a diversity policy, including gender pay equality. NZX will also consider whether further updates are needed to its current guidance note in this area, particularly with a view to ensuring that issuers are reporting appropriate data to the market. NZX will also consider its current reporting of gender diversity data with a view to improving the current aggregated data reported by NZX.

Health and Safety is a particularly important issue for some issuers. It is important that the NZX Code supports recent legislative changes via the Health and Safety at Work Act 2015. Therefore, there is a proposed recommendation regarding risk management which is supported
by specific commentary in respect of health and safety. Commentary to the recommendation also suggests that issuers may wish to set up a board or management committee, if appropriate, to ensure that health and safety risks are regularly reported on.

Finally, NZX has sought to update its director and CEO remuneration reporting requirements. New Zealand is generally acknowledged as being behind other comparable jurisdictions in this area and this is an area of significant interest to investors and other stakeholders, particularly given that the structure of CEO remuneration is a key driver of company performance. Submitters generally agreed that there should be additional reporting requirements for remuneration arrangements. NZX considered remuneration disclosure carefully to propose a suitable level of disclosure for a New Zealand context, while also providing flexibility for issuers.
4. Summary of NZX Code

The proposed updated NZX Code (included in full as an attachment to this consultation paper) follows a tiered approach. The structure is similar to the FMA Handbook and the ASX Corporate Governance Council’s own Principles and Recommendations (ASX Code). An illustration of how it is intended to operate is outlined below:

The top tier outlines the key principles that describe an overarching theme or concept. The principles are closely based on those contained in the FMA Handbook so that issuers who are currently choosing to report against the FMA Handbook do not have to try and match their reporting to two different reporting codes. NZX expects that if issuers are complying with the updated NZX Code they will also be meeting the guidelines within the FMA Handbook.

The recommendations are the next layer of the tiered framework. The recommendations will apply on a “comply or explain” basis, which is an approach adopted in other jurisdictions. If an issuer meets each of the recommendations, they can state in their annual report that they meet all of the recommendations of the NZX Code. However, the “comply or explain” feature of the regime also allows issuers the flexibility to explain why a particular recommendation may not be appropriate for them and to explain the alternative measures they have in place.

The third tier under each principle provides commentary in respect of the application of each recommendation. The commentary does not need to be met on a “comply or explain” basis, but
explains how issuers can meet the recommendation and outlines additional optional guidance for issuers in areas where NZX thinks the suggested approaches reflect good practice.

The proposed structure for an updated NZX Code received strong support from submitters. It is designed to provide enough flexibility to set appropriate standards but also to acknowledge that corporate governance arrangements will necessarily differ between issuers. Based on this positive feedback, NZX proposes to adopt this structure.

**Key Changes**

Since NZX’s initial discussion document, there have been three key changes:

1. Within the overall structure of the proposed new regime, the description of the third tier has changed to “commentary” as opposed to “best practice commentary” based on feedback from submitters. While some submitters were comfortable with the former description, other feedback indicated “best practice” could confuse the purpose of the commentary, and indicate that it was based on a scale of merit (i.e. “good”, “better” and “best”) rather than as a general explanation and guidance.

2. Principle 9 (Stakeholder Interests) has been merged with principles 4 (Reporting and Disclosure) and 8 (Shareholder Rights and Relations). Many submitters noted that stakeholder relations are less of a focus in the context of listed issuers, and that these issues can be considered under other principles in any event, such as principle 1. A significant aspect of principle 9 (Stakeholder Interests) focused on issuers measuring and reporting their social, ethical and environmental impact. We have included commentary relating to environmental, social and governance reporting under recommendation 4.1.

3. NZX has also considered the process for updating the revised NZX Code, in light of several submissions made in support of forming an NZX corporate governance council. NZX has outlined in this paper a proposal to consider convening a panel of industry participants to consult with in respect of reviewing the operation of the commentary to the NZX Code following its implementation via the current consultation process. NZX proposes to consider this matter further after it has had an opportunity to assess the impact of the updated NZX Code two years following implementation of an updated NZX Code, so that we have sufficient data to determine how the updated requirements have been operating in practice.
5. **Summary of feedback received and proposed outcomes**

Following a summary of the general feedback received, this section of the consultation paper outlines each proposed principle, followed by the relevant set of proposed recommendations for the updated code. These proposed outcomes are accompanied by a summary of the feedback received to each recommendation, and an explanation of how NZX has developed the recommendations based on this feedback.

**Summary of general feedback**

A list of the parties who made a submission to the first stage of the review is outlined in appendix 1 (except for those parties who chose to keep their submission confidential). This includes issuers, investors, governance groups, professional bodies (lawyers and accounting/auditing bodies) and sustainability, diversity and health and safety groups.

In conjunction with the feedback received as part of the main review, NZX engaged a third party provider (TNS Qualitative research) to obtain feedback from 15 small to medium sized issuers. This feedback was received by face to face interviews with the relevant issuers, and was summarised into the report prepared by TNS. It was generally very supportive of the proposed updated reporting framework and the review process. However, these issuers noted that NZX should not seek to introduce too many new recommendations.

There was reasonably broad consensus within the feedback received on many of the issues. The issues which attracted the most feedback related to independence and diversity in the context of board composition (principle 2), remuneration reporting (principle 5) and health and safety and ESG reporting (principles 4 and 6).
Principle 1: Ethical Standards

“Directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation.”

“1.1 The board of an issuer should adopt a code of ethics (to be regularly reviewed by the board) to which the issuer’s directors and employees should adhere. A code should be communicated to the issuer’s employees and training should be provided regularly. It should outline internal reporting procedures of any breach of ethics, and describe the issuer’s expectations about behaviour, namely that every director, executive and employee:

(a) acts honestly and with personal integrity in all actions;
(b) declare conflicts of interest;
(c) undertake proper receipt and use of corporate information, assets and property;
(d) give proper attention to the matters before them, particularly for directors;
(e) acts honestly and in the best interests of the issuer and as required by law;
(f) adheres to any procedures around giving and receiving gifts; and
(g) adheres to any procedures about whistle blowing.

“1.2 An issuer should have a staff share dealing policy which extends to directors. This policy should be disclosed.”

Summary of feedback

This principle was generally uncontroversial with all submitters acknowledging that it is appropriate to recommend that issuers have (and disclose) a code of ethics which applies throughout an organisation and that this includes procedures for dealing with breaches of such codes. Submitters also agreed with suggestions for the general content of a code of ethics i.e. it should address whistle blowing and employee share dealing (if not under a code of ethics then in a separate policy or elsewhere).
An area of difference was whether issuers should be required to report against compliance with a code of ethics. Investors were in favour of such a recommendation but there was reasonably strong opposition from issuers and law firms on the basis that this would impose substantial compliance costs, would lack relevance to shareholders, would likely involve the disclosure of sensitive information and could potentially affect employees’ willingness to report ethics breaches. Some submitters suggested a middle ground of only requiring disclosure of material non-compliance.

**Development of proposed recommendations**

Ethics can be widely interpreted so it is important for the NZX Code to provide a clear framework with clear measures while also allowing issuers to be flexible. An organisation can set clear expectations about employee and director behaviour. Supporting commentary describes some of the key matters that NZX considers issuers may wish to address within a code of ethics An issuer’s code of ethics should be regularly reviewed to keep it current so issuers take ownership of their code of ethics and has a clear process for evaluating compliance and dealing with breaches. For more details, refer to the Draft Code attached as appendix 1 to this document.

NZX proposes to adopt the recommendations consulted upon but not to recommend that issuers report against compliance with a code of ethics. NZX proposes that staff (and director) share dealing be covered within a code of ethics or a separate standalone policy. A specific recommendation about disclosing staff share dealing policies was supported because it promotes a culture of transparency within an issuer’s organisation and would hold an issuer accountable for employee share schemes.

**Further specific feedback requested about the proposed outcome**

1. Do stakeholders agree that a more detailed recommendation about ethics is useful?

2. Is there anything further that should be recommended in the code of ethics or discussed in commentary?
Principle 2: Board composition and performance

“To ensure an effective board, there should be a balance of independence, skills, knowledge, experience and perspectives”

“2.1 An issuer should clearly distinguish and disclose the respective roles and responsibilities of the Board and management. The board of an issuer should operate under a formal written charter which sets out the roles and responsibilities of the board.

“2.2 Every issuer should have a formal and transparent method for the nomination and appointment of directors to the Board.

“2.3 An issuer should enter into written agreements with each Board member establishing the terms of their appointment.

“2.4 Issuers should disclose information about each director, including a profile of experience, length of service, independence and ownership interests.

“2.5 An issuer should develop and disclose its diversity policy, which at a minimum should address gender diversity.

“2.6 Directors should undertake appropriate training to remain current on how to best perform their duties as directors of an issuer.

“2.7 The board should establish a formal procedure to regularly assess director, board and committee performance.”

Summary of feedback

Although submitters generally supported a recommendation that issuers should disclose the respective roles and responsibilities of the Board and management, a large number of submitters objected to any suggestion this should extend to disclosure of formal delegations to management given that these might be commercially sensitive in some cases, and of limited value to investors in any event. This opposition came from issuers, law firms and investors (including NZSA and NZCGF).

Submitters also generally supported the recommendation that issuers conduct appropriate checks before appointing, or proposing for election, a director, and that issuers should provide all material information in relation to proposed appointments. However, some submitters noted that this recommendation should not apply to re-election of directors or for shareholder
nominated directors. Some submitters also suggested NZX should recommend issuers use a skills matrix when appointing new directors.

We received feedback that while written agreements with directors would be valuable, most issuers would have existing employment agreements with their senior executives so the recommendation should not extend to employees. There was also support for a recommendation that reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests.

**Board Composition**

Board independence requirements are outlined in the mandatory Listing Rules, which require at least one third independence. With a view to a proposed broader review of the Listing Rules, we sought initial feedback on whether an issuer’s chairperson should be independent and whether an issuer’s board should be comprised of a majority of independent directors, which reflect measures in other jurisdictions.

There was some support for these types of measures (particularly the former) but we also received reasonably strong feedback that this could create problems for a number of issuers given the challenges finding suitably skilled and experienced directors, particularly given a perception that New Zealand has a limited pool of directors currently. These views were also expressed by some investors, including NZSA. This was also reflected in the feedback from smaller issuers within the TNS Report.

On the other hand, ISS provided a particularly strong view that NZX’s existing requirements are out of step with international practices and that investors generally require a majority independent board, particularly for larger issuers – see page 7 of the ISS submission.

Following specific requests for feedback on this issue, we also received feedback that the definition of independence within the Listing Rules may currently be too broad. This is currently addressed via the definitions of ‘Disqualifying Relationship’ and the ‘Associated Persons’ test.2

Given this fact, seeking to introduce additional recommendations in relation to chair and majority board independence immediately could be problematic. NZX considers that these issues will be best addressed together as part of the broader review of the Listing Rules planned to commence later in 2016 (as originally intended).

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2 Listing Rules 1.6.1 and 1.8
Some submitters noted that a more suitable alternative in the meantime could be to recommend or suggest that boards are comprised of a majority of non-executive directors. This was a suggestion from IOD.

Diversity

There was a very high level of engagement on this issue, including a significant amount of support for an additional recommendation that issuers should have a policy on diversity. This would broadly align with the position in the ASX Code. A number of submitters noted that NZX should ensure diversity is considered more broadly than just gender.

Development of proposed recommendations

NZX proposes to adopt all four of the new recommendations suggested in the discussion paper. In addition, we propose to adopt recommendations that directors should undertake training, that issuers should develop a diversity policy and that the board should have formal procedures to regularly assess director, board and committee performance. Commentary provides further detail about what is to be expected.

Board Composition

The rationale behind the additional changes is that the board should ensure directors are receiving the appropriate training (including CPD, as applicable) they require and are fit-for-purpose. NZX will revisit the issue of board independence as part of the upcoming review of the Listing Rules which may result in additional recommendations or commentary within the NZX Code and/or amendments to the mandatory Listing Rules. In the meantime further detail has been included in commentary to the draft Code suggesting that issuers should have a majority of non-executive directors. NZX also notes that there is clearly significant interest in this issue from investors. Issuers should be considering opportunities to introduce additional independent directors to their boards where appropriate because it is widely recognised that objective and independent judgement is critical for effective boards.

Diversity

NZX has proposed a recommendation that issuers develop a diversity policy. This is supported by commentary explaining how this recommendation can be met, which incorporates by reference NZX’s existing diversity policy guidance. This is intended to ensure that issuers who have developed a policy in reliance on our existing guidance can benefit from this early adoption (i.e. general diversity policies). The recommendation does not seek to prescribe what should be in a diversity policy but instead leaves it to issuers to determine appropriate metrics.
and targets to report and seek to meet. This seeks to ensure that issuers are committing themselves to targets that are appropriate to their circumstances.

This proposed additional recommendation to the NZX Code will complement the existing rules relating to reporting against an issuer’s diversity policy, and should lead to increased reporting of diversity metrics.

A number of submitters opposed moving existing reporting requirements from the Listing Rules, such as Listing Rule 10.4.5(j), into the NZX Code if this meant they were no longer mandatory. Therefore NZX proposes to retain Listing Rule 10.4.5(j) in its current form. An explanation of the actual proposed rule amendments to give effect to an updated NZX Code is included in the final section of this consultation paper.

**Further specific feedback requested about the proposed outcome**

1. Are there any further matters in relation to board composition that stakeholders would like covered?

2. Do stakeholders consider a recommendation that directors undertake training to be important?

3. Do stakeholders consider that the board should establish a formal procedure to regularly assess director, board and committee performance?
Principle 3: Board committees

“The board should use committees where this will enhance its effectiveness in key areas, while still retaining board responsibility.”

“3.1 Membership on the audit committee should comprise solely of non-executive directors of the issuer. The chair of the audit committee should not also be the chair of the Board.

“3.2 Directors who are not members of the audit committee and employees should only attend audit committee meetings at the invitation of the audit committee.

“3.3 An issuer should establish a remuneration committee.

“3.4 An issuer should establish a nomination committee to recommend director appointments to the Board. At least a majority of the nomination committee should be independent directors.

“3.5 An issuer should consider whether it is appropriate to have any other committees. All committees should operate under published written charters. An issuer should identify the members of each of its committees, and periodically report member attendance.”

Summary of feedback

This is an area where there is a significant amount of overlap between NZX’s mandatory Listing Rules and the NZX Code. The existing code requirements are reasonably strong and submitters generally agreed that NZX’s existing requirements in this area are sufficient. Therefore we are not proposing significant changes in this area.

The feedback focused on whether NZX should continue to recommend that issuers have a remuneration and nomination committee. Overall, the feedback supported retaining these recommendations with the ability to explain why it may not be appropriate for some issuers under the “comply or explain” approach. Some submitters noted that it is unnecessary to retain the explicit “unless constrained by size” caveat given the ability to “explain”.

Development of proposed recommendations

NZX proposes to retain the existing substantive requirements within its existing mandatory Listing Rules and NZX Code in relation to the use of board committees. To supplement these, NZX proposes to include an additional recommendation that board charters, membership and attendances should be disclosed by issuers and that issuers may establish additional committees if they see fit.
Further specific feedback requested about the proposed outcome

1. Do stakeholders consider it is still appropriate to include a recommendation that directors who are not members of the audit committee, and employees, should only attend audit committee meetings at the invitation of the audit committee? Alternatively, is this something that would be better as commentary?

2. Do you consider that the level of overlap between the mandatory Listing Rules and the Code is appropriate? Would submitters prefer some of the other committee related matters to be covered in the NZX Code as opposed to the mandatory Listing Rules? Note that this would have the impact of making these requirements non-mandatory.
Principle 4 – Reporting and disclosure

“The board should demand integrity in financial and non-financial reporting and in the timeliness and balance of corporate disclosures.”

“4.1 An issuer’s board should develop and publish a written policy in relation to continuous disclosure.

“4.2 An issuer should make its code of ethics, board committee charters and other key governance documents available to interested investors and stakeholders.

“4.3 An issuer should provide both financial and non-financial disclosure and should indicate how non-financial targets are measured.”

Summary of feedback

The NZX Code currently contains no specific requirements in relation to reporting and disclosure practices. However, the Listing Rules include a number of mandatory requirements as outlined at pages 16/17 of the discussion document.

There was broad support from submitters for a proposed recommendation that issuers have a policy on continuous disclosure.

Environmental, social and governance (ESG) reporting

NZX sought feedback on whether to introduce any additional recommendations or commentary in relation to non-financial reporting matters, including ESG reporting. Although there was a lot of support for ESG disclosure, nearly all respondents emphasised the need for flexibility to ensure that NZX did not impose a disproportionate compliance burden on issuers where these measures might be of limited materiality. The majority of submitters supported introducing this as commentary initially, which is an approach supported by guidance published by the Sustainable Stock Exchange Initiative.

Development of proposed recommendations

Disclosure and reporting is important for listed issuers. It is a key measure of good corporate governance. Reporting and disclosure keeps issuers accountable to stakeholders and is a key measure of good corporate governance. NZX supports robust disclosure by issuers of information regarding financial and non-financial matters. This information should be accurate and timely.
Note that recommendations or suggestions throughout the NZX Code to disclosure or publication of corporate governance matters can be made either within an issuer’s annual report or on its website. NZX would like the regime to offer flexibility for issuers to determine the best place to present information to shareholders and other stakeholders. This is intended to avoid overloading annual reports with information and is proposed as a key feature of the updated regime. This will be made clear within introductory and explanatory references of the final updated NZX Code.

Continuous disclosure

NZX proposes to introduce a recommendation that issuers have a policy on continuous disclosure and that this policy be published. This approach received majority support from submitters. NZX also notes that it has published guidance in this area, which is available to issuers to assist to develop relevant policies and procedures – see here.

Disclosure of key governance documents

Investors, governance groups, and advisors are generally strongly in favour of publishing governance documents. In order to retain some flexibility we propose to recommend that only “key” governance documents should be available. This approach has been proposed as opposed to referring to “material” governance documents, which has a specific meaning in the mandatory Listing Rules, or for all governance documents to be published which is unduly onerous.

ESG reporting

NZX does not propose to adopt a specific recommendation in relation to ESG reporting. However, we have proposed a broader recommendation in relation to financial and non-financial disclosure, and we have incorporated commentary under this principle which outlines that non-financial reporting may extend to ESG reporting. This commentary contemplates that NZX will develop specific ESG reporting guidance, as suggested by the Sustainable Stock Exchange Initiative who have developed model guidance for stock exchanges to use to develop their own guidance – see here.

Alternatively the commentary encourages issuers to report against the Global Reporting Initiative (GRI) framework, which is based on the Principles for Responsible Investment initiative (PRI). This approach would ensure consistency and comparability with GRI disclosures from overseas companies and allows issuers who are currently reporting against this existing recognised framework to continue with their current reporting practices.
The issue of ESG reporting is also raised in the context of risk management but advocates of ESG reporting have noted it has broader application so we have raised it in this section of the draft Code. NZX welcomes further feedback on this issue to understand whether the proposed approach of producing specific voluntary guidance on ESG reporting, while also allowing issuers to the existing GRI reporting framework, is workable. NZX would develop this guidance following completion of the current review.

**Further specific feedback requested about the proposed outcome**

1. Do you agree with the proposed recommendations?

2. Do you agree with the proposal to address ESG reporting within commentary?

3. Do you agree NZX should develop its own ESG reporting guidance based on the SSEI’s model guidance or alternatively allow for issuers to use the GRI framework?

4. Do you think another framework should be used instead?

5. Do you agree that issuers should make key governance documents available to interested investors and stakeholders?
Principle 5: Remuneration

“The remuneration of directors and the CEO should be transparent, fair and reasonable.”

“5.1 Every issuer should have a formal and transparent method to recommend director remuneration packages to shareholders. Actual director remuneration should be clearly disclosed.

“5.2 Issuers should publish a remuneration policy dealing with remuneration of directors and senior executives. The remuneration policy in relation to executive remuneration should outline the relative weightings of remuneration components and relevant performance criteria.

“5.3 Issuers should disclose the remuneration arrangements in place for the CEO. This should include disclosure of the base salary, short term incentives and long term incentives and the performance criteria used to determine performance based payments.”

Summary of feedback

A number of submitters noted that there is a level of disclosure required already given the requirement under the Companies Act 1993 to disclose remuneration bands – and CEO remuneration can be worked out by default. Investors generally supported an increased level of disclosure but noted that the level of disclosure for executives could be less than for CEO level.

Issuers and law firms indicated reluctance to disclose details of specific remuneration arrangements and noted that these might be commercially sensitive in some cases. These submitters were generally comfortable with disclosure of the general proportions of base salaries, short term incentives and long term incentives.

Although the suggestion to include a recommendation or commentary that an element of executive/CEO remuneration should be performance based was not fully supported, with some respondents noting particular concerns for smaller issuers, it received a significant amount of support. Some submitters also suggested NZX should recommend an explanation of how the remuneration policies and practices of the issuer align with the long term strategic objectives of the issuer and that performance based arrangements should not be available to directors (e.g. options).
A number of respondents also noted that NZX should consider an additional recommendation in relation to hedging arrangements for share based plans, similar to the ASX Code, which recommends that “an issuer has an equity based policy should have a policy on whether participants are permitted to enter into arrangements to hedge that risk and disclose such policy.”

Some investors also suggested issuers should disclose their policy concerning ownership of shares by the CEO and executives. Submitters did not generally support specific recommendations in relation to the use of remuneration consultants.

**Development of proposed recommendations**

This was an area of focus for submitters as part of this review and NZX has also identified it as a key focus area for the review. We note that the current requirements for remuneration reporting are minimal. This puts NZX out of step with global standards, particularly when compared to the position in Australia where legislation in particular contains extensive requirements and in some jurisdictions where there is greater “say on pay”. This is an area where investors would like to see a significant increase in reporting requirements regarding director and CEO remuneration.

NZX is aware of concerns that the current remuneration reporting requirements in Australia may require too much detailed disclosure, which is reducing the benefit of disclosure. NZX is keen to avoid a similar outcome in the context of an updated NZX Code. We have therefore sought to propose measured amendments seeking to balance the interests of investors for greater transparency with the needs of issuers to retain a level of confidentiality of potentially commercially sensitive information and ensuring a focus on the most useful information.

**Director remuneration packages**

Separately, under the mandatory Listing Rules issuers must have director remuneration approved by shareholders. The feedback received to the discussion document also indicated that there is significant interest in director remuneration. It is therefore important that issuers have procedures in place to recommend appropriate director remuneration packages to shareholders and to provide disclosure in relation to the actual remuneration paid to directors, including for committee roles and in relation to any other services provided to the issuer. We have suggested within commentary that this could follow the format for disclosure of director remuneration packages.

3 Section 3.5.1 of the Listing Rules
remuneration outlined by the Institute of Directors – this guidance is in the process of being finalised and a link will be provided in due course.

Recommendations in relation to remuneration committees are discussed under principle 3 above.

**Policies for director and senior executive remuneration**

NZX has proposed a recommendation for issuers to publish a remuneration policy in relation to director and senior executives. This is not intended to require detailed disclosure of the actual amounts to be paid to senior executives but instead to describe the general policy for remuneration of these individuals by outlining the relative proportions of remuneration between base salary, short term incentives and long term incentives. This should also include a description of the performance hurdles which must be met in order for relevant incentive payments to be made and/or whether there is discretion to allow payments in other cases. This is intended to ensure greater transparency in terms of the incentives in place for key executives. NZX has not prescribed who should fall within the category of senior executives so this will be up to issuers to determine themselves. However, this may align with the concept of ‘senior manager’ used within the Financial Markets Conduct Act 2013, for example.

The same level of disclosure should be provided for directors, noting however the other separate requirements discussed above which will mean that a more detailed level of disclosure will be required when seeking approval of director remuneration proposals and when disclosing actual director remuneration paid annually.

Initially NZX had proposed a recommendation that senior executive remuneration should include an element that is dependent on entity and individual performance. However this was removed because based on the feedback received NZX considers that this should ultimately be a decision for the board of an issuer. This point is instead suggested in commentary.

Executive and non-executive director remuneration should be clearly differentiated.

Commentary addresses the issue of remuneration consultants. NZX proposes that if remuneration consultants are used by an issuer, they should be independent and should report directly to the board.
CEO remuneration

It is clear from feedback that there is significant interest in CEO remuneration and that this is an important driver for performance of issuers. It is therefore important that there is greater transparency of CEO remuneration.

NZX thinks that the argument for more detailed disclosure is strongest in relation to CEO remuneration. Therefore, in addition to requiring an explanation of the general policy in place for payment of CEO remuneration, NZX has proposed that the actual amounts of CEO remuneration are disclosed i.e. the amounts of base salary, short term incentives and long term incentives. As with the proposals for the general remuneration policy, the disclosure of CEO remuneration should explain the relevant hurdles for performance payments to be made and whether there is discretion for payment of these incentives in other circumstances (which might form part of the general remuneration policy covered in recommendation 5.2). In addition, we have recommended that issuers should disclose actual amounts accrued and paid to CEOs in the relevant periods i.e. the year(s) these are paid or have accrued.

Further specific feedback requested about the proposed outcome

1. Do you agree with the proposals outlined above?

2. Do you agree that it is appropriate to require heightened disclosure in respect of CEO remuneration as proposed?
Principle 6 – Risk management

“Directors should have a sound understanding of the key risks faced by the business. The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.”

“6.1 An issuer should have appropriate policies and procedures in place to identify and manage the key risks facing their businesses and the issuer’s Board should receive and review regular reports on the operation of the risk management framework.”

Summary of feedback

Submitters agreed that this is a significant gap in NZX’s Code which needs to be addressed as part of the current review. However, we received some feedback indicating that the principle should refer only to “material” risks as opposed to “potential and relevant” risks.

There was general support for a recommendation that issuers should identify and manage their key risks. However, views varied in relation to whether there should be a separate specific recommendation relating to internal audit functions. Many submitters noted that this will not be appropriate for all issuers, particularly smaller issuers, and that such disclosure would be of little value to investors.

Submitters generally agreed that there should be a recommendation that issuers should have a staff share dealing policy but views varied on whether this should be covered under risk management or ethical standards. The latter option received the majority support and it has therefore been addressed under principle 1.

A key area of focus related to health and safety risks and ESG reporting, with a number of organisations focusing solely on these two issues.

*Health and Safety Reporting*

Many submitters noted that it is unnecessary for NZX to have specific recommendations in relation to health and safety given that these issues are already addressed by legislation. This was the view expressed by a majority of the issuers and the law firms. Some noted this could be addressed by commentary given it will vary between issuers (for example, NZSA, NZCGF and NZ Super Fund). A number of workplace safety organisations responded specifically on this issue, with one submitter noting that NZX should have a separate principle relating to health
and safety. Respondents focused particularly on ‘lead’ and ‘lag’ indicators, however it was noted that there are difficulties defining appropriate lead indicators.

**ESG reporting**

Many submitters indicated that it would not be appropriate for NZX to prescribe ESG reporting because it is likely to be less relevant for some issuers; however a number of sustainability groups strongly supported inclusion of a specific recommendation. This issue is also discussed above under principle 4.

**Cyber risk**

Cyber risk is a significant concern for some issuers and is emerging as an area of focus for companies globally, particularly in relation to security of information. To help prevent a cyber breach, a reporting framework could be implemented. NZX welcomes feedback on this issue from stakeholders.

**Development of proposed recommendations**

NZX proposes a recommendation that issuers should have appropriate policies and procedures in place to identify and manage the key risks facing their businesses. This is to help issuers identify and take action about risks in the workplace. The term “key” was chosen because other words such as ‘material’ have a specific meaning in the Listing Rules.

Broadly, NZX proposes that matters regarding specific risks should be included in commentary and not detailed in a recommendation because risks will vary between issuers. Therefore, we have chosen to address specific risks in the commentary of the Code.

Although health and safety is clearly a very significant issue in the New Zealand context given recent changes to legislation, it is likely that this issue will be of more significance to certain issuers (for example, issuers in primary industries) and therefore it may not be appropriate to have its own specific recommendation. It has instead been addressed in commentary and issuers should report on health and safety if it is determined to be a key risk for the issuer. In such cases NZX suggests that issuers report against existing recognised “lag indicators” of ‘lost time injury frequency rates’ and ‘total recorded injury frequency rates’. Certain issuers may also choose to have a separate health and safety committee of the board.

NZX has included specific reference to cyber risk within commentary given that it is likely to be a key risk for many issuers. According to the 2016 PWC CEO Survey, 61% of CEOs consider cyber security a key threat to their business. For New Zealand CEOs that figure is even higher.
at 77%, up from 66% in 2015. The World Economic Forum’s Global Risks Report estimates the cost of cyber crime at $445bn in 2016. NZX considers that these risks are only likely to become even more important to manage in future and wants to be proactive in relation to this emerging issue.

Further specific feedback requested about the proposed outcome

1. Are there any other risk concerns you think should be specifically addressed in commentary?
Principle 7: Auditors

“The board should ensure the quality and independence of the external audit process.”

7.1 The board should establish a formal and transparent framework for the issuer’s relationship with its auditors. This should include procedures:

(a) to establish a formal and transparent procedure for sustaining communication with the issuer’s independent and internal auditors.

(b) to ensure that the ability of the auditors to carry out their statutory audit role is not impaired, or could reasonably be perceived to be impaired;\(^4\)

(c) to address what, if any, services (whether by type or level) other than their statutory audit roles may be provided by the auditors to the issuer; and

(d) to provide for the monitoring and approval by the issuer’s Audit Committee of any service provided by the auditors to the issuer other than in their statutory audit role.

7.2 The external auditor should attend the AGM to answer questions from shareholders in relation to the audit."

Summary of feedback

There was broad support for a recommendation that a company’s auditor attend the Annual Meeting to answer shareholder questions. However, a number of submitters questioned the need to introduce a recommendation for auditors to separately disclose the audit and non-audit fee they receive, given that this is already required to be disclosed in the Annual Report by the FMA.\(^5\)

NZX also sought preliminary views on the existing mandatory auditor rotation requirements with a view to the planned review of the mandatory Listing Rules, which require that the external auditor or lead audit partner is changed at least every five years. Respondents were broadly comfortable with the current five year audit partner rotation requirement, but many noted that extending this to seven years would align with the underlying professional standards

\(^4\) In paragraph 7.2, “statutory audit role” means services required by any law to be provided by the auditors, acting as such.

established by the External Reporting Board (XRB), and the equivalent Australian requirement. A number of submitters highlighted that NZX should not seek to impose requirements in this area given these separate legal requirements. A number of investors noted that NZX should consider incorporating an additional recommendation in the NZX Code that issuers should rotate audit firms every 10 years, but these views were outliers. NZX will consider this issue further when we commence a broader review of the Listing Rules.

There was also some feedback in relation to introducing a recommendation for issuers to seek CEO/CFO declarations for financial statements. However, care needs to be taken here because it is not required under New Zealand legislation as is the case in Australia.

**Development of proposed recommendations**

As discussed at page 20-21 of the discussion document, NZX’s current requirements in this area are reasonably comprehensive. NZX proposes to adopt an additional recommendation that the external auditor should attend the Annual Meeting to answer questions from shareholders in relation to the audit.

**Further specific feedback requested about the proposed outcome**

1. Are there any other concerns you think should be specifically addressed in commentary about audit requirements?
Principle 8: Shareholder rights and relations

“The board should respect the rights of shareholders and foster constructive relationships with shareholders that encourage them to engage with the entity.”

“8.1 An issuer should have a website where investors and interested stakeholders can access information and key corporate governance information about the issuer.

“8.2 An issuer should allow investors the ability to easily communicate with the issuer, including providing the option to receive communications from the issuer electronically”

Summary of feedback

This was a particular area of focus for investors. A key piece of feedback was that the FMA principle should be amended to focus on shareholder rights, not just relations. This feedback was also supported by a number of other submitters, including some issuers and law firms.

Many of these submitters noted that it may be appropriate to adopt the ASX Code’s principle 6, “Respect the rights of security holders”. NZX agrees with feedback that a principle in this area should focus primarily on shareholder rights. This will allow for proposed coverage in relation to shareholder relations but will also recognise that boards and management are ultimately in place to protect the interests of security holders. As a result, NZX amended this principle to “Shareholder rights and relations”.

Development of proposed recommendations

NZX considers that shareholder rights and shareholder relations should be merged into a single principle given that they are closely interlinked. This means that an issuer can comply with the code by ensuring that a single principle is fulfilled rather than two separate overlapping principles.

Shareholder rights and relations are important because each issuer should seek to ensure that investors and other stakeholders are able to gain a greater understanding of the entity’s business, governance, financial performance and prospects. In particular, shareholders should be given an opportunity to express their views to the issuer on important issues.

Electronic communication is now commonplace and often more convenient for investors. An issuer should ensure that it has a modern communication framework in place so investors can receive communications in a manner that best suits them. This also reduces an issuer’s environmental footprint.
An issuer should have an investor relations programme, and should proactively encourage shareholder input.

**Further specific feedback requested about the proposed outcome**

1. Do you have any concerns about principle 8 and 9 being merged into a single recommendation regarding shareholder interests?

2. Are there any other concerns you think should be specifically addressed in relation to shareholder rights and relations?
Transition and implementation arrangements

NZX welcomes feedback on any additional matters submitters may consider have not been adequately covered above.

In particular, NZX would like feedback in relation to a proposed time frame for implementation of an updated NZX Code. NZX expects to be in a position to seek approval of proposed rule amendments by the FMA to give effect to an updated NZX Code in Q4 2016. NZX considers that it may be appropriate for such amendments to come into effect in Q1 2017 (i.e. for issuers to report against the updated NZX Code for reporting periods ending in 2017 and onwards) so that issuers have time to transition to the updated reporting requirements. Given that the majority of balance dates end either 31 December or 30 June it would mean that issuers would need to commence reporting under the new regime for periods ending 30 June 2017 and onwards.

NZX also welcomes feedback on any additional steps which might be taken to make compliance easier for issuers. We have attempted to identify where existing guidance might already be available or where precedent policies or reporting frameworks may be available to use. For example, NZX will give more thought to whether a reporting template might be suitable for other matters addressed by the proposed updated NZX Code.

In addition, NZX notes the feedback requesting that NZX convene a corporate governance council similar to ASX. We do not propose to take this step at this stage because we consider the current review process sufficient to ensure delivery of a quality updated regime. However, NZX will consider options in future for an external advisory group to provide input into updating commentary for the new regime in future. We would first like to see how the new regime operates in practice before considering this point further. We think it makes sense to allow at least two years of reporting in order to make this assessment and therefore assuming an updated code comes into effect in Q1 2017 we would anticipate considering this matter further in Q1 2019 - although NZX will of course assess how the regime is operating in the interim.

Amendments to the Listing Rules will be required to give effect to an updated NZX Code. The proposed draft amendments are attached as appendix 2.

The proposed draft amendment builds on existing Listing Rule 10.4(5)(i). It provides greater clarity about what NZX expects of issuers who do not follow the recommendations and explains what “comply or explain” looks like in practice. This requires Issuers to identify the recommendation that the issuer has not followed and, if alternative arrangements are in place,
what these are, when they are applied and whether the board has approved such measures. NZX are only going to amend 10.4.5(i) at this stage.

We welcome further feedback on whether other rule amendments are required, with a view to our planned broader review of the Listing Rules.

Finally, NZX also notes that the final version of the updated NZX Code will include some additional introductory and explanatory commentary. This commentary will seek to explain the key aspects of the proposed regime, including:

- that the regime seeks to outline recommendations for good practice but does not seek to dictate how issuers should address corporate governance in every situation i.e. it is intended to be flexible and adaptable; and
- issuers should be seeking to continually improve and refine their corporate governance practices. Even if certain recommendations may not be appropriate for an issuer to adopt immediately, issuers should consider in future whether it is appropriate to do so; and
- the proposed updated NZX Code should not be viewed as a set of minimum standards. Issuers are of course encouraged to go above and beyond the specific recommendations outlined in the NZX Code where this will be of value.

This commentary will also include an explanation of how the regime is intended to operate in practice.

**Further specific feedback requested**

1. Do submitters agree with the proposed time frame for implementation of an updated regime of Q1 2017 i.e. for balance dates falling in 2017?

2. Do you consider NZX should take any other steps to assist issuers to comply with the new regime? Will any of the proposals create particularly problems in terms of compliance costs?
Appendix 1 – List of non confidential respondents to November 2015 discussion paper

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<th>Respondent</th>
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<tr>
<td>Accounting &amp; auditing</td>
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<td>(1) Chartered Accountants Australia and New Zealand</td>
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<td>(2) The Institute of Internal Auditors New Zealand</td>
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<td>(3) PwC</td>
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<td>(4) XRB</td>
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<td>Gender Diversity/Diversity</td>
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<td>(5) Global Women</td>
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<td>(6) Ministry for Women</td>
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<td>(7) Human Rights Commission</td>
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<td>Governance Groups</td>
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<td>(8) Governance New Zealand</td>
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<td>(9) Institute of Directors</td>
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<td>(10) Institutional Shareholder Services Australia Pty Ltd</td>
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<td>Health and Safety</td>
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<td>(11) Business Leaders’ Health and Safety Forum</td>
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<td>(12) Concordia NZ Ltd</td>
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<td>(13) New Zealand Council of Trade Unions</td>
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<td>(14) Sitesafe 1</td>
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<td>(16) Worksafe</td>
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<td>Investors</td>
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<td>(17) Guardians of the New Zealand Superannuation</td>
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<td>(18) New Zealand Corporate Governance Forum</td>
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<td>(19) New Zealand Shareholder Association</td>
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<td>(20) Devon Funds Management</td>
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<td>Issuers</td>
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<td>(21) Auckland Airport</td>
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<td>(22) Chorus Limited</td>
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<td>(23) Fonterra Co-operative Group Limited</td>
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<td>(26) Kingfish Limited</td>
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<td>(27) Kiwi Property Group Limited</td>
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<td>(28) Listed Companies Association</td>
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<td>(29) Marlin Global Limited</td>
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<td>(32) SKYCITY Entertainment Group Limited</td>
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<td>(33) Spark New Zealand Limited</td>
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<td>(34) TradeMe Group Limited</td>
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(35) Z Energy Limited

**Law Firms**

(36) Bell Gully  
(37) Chapman Tripp  
(38) Russell McVeagh  
(39) Simpson Grierson

**Sustainability**

(40) Envirostate  
(41) GRI  
(42) Sustainability Matters  
(43) Sustainable Business Council
APPENDIX 2

(Listing Rule 10.4.5 (i))

(i) a statement (or URL link to the statement on an Issuer’s website) on whether, and if so the extent to which the Issuer has followed the recommendations set by the NZX Corporate Governance Best Practice Code during the reporting period. If the Issuer has not followed a recommendation for any part of the reporting period, the Issuer should also separately state:

(a) which recommendation, or recommendations, have not been followed; and

(b) the period during which it was not followed; and

(c) the Issuer’s reasons for not following the recommendation; and

(d) what, if any, alternative governance practices it adopted in lieu of the recommendation during that period; and

(e) the date at which the alternative governance practice is current (which must be the Issuer’s balance date or a later date specified by the entity); and

(f) that the alternative governance practice has been approved by the board of the Issuer.