New Zealand Corporate Governance

TRENDS AND INSIGHTS

April 2019

CHAPMAN TRIPP

Contents

Chapman Tripp maintains a data series, based on a detailed analysis of recent annual report disclosures from the top 75 listed issuers by market capitalisation (the "top 75"), with the most recent analysis as at 31 March 2019.

Large Law Firm of the Year *NZ Law Awards 2018*

Deal Team of the Year (>100 lawyers) *NZ Law Awards 2018*

NZ Law Firm of the Year *Chambers Asia Pacific Awards 2018*

Most Innovative National Law Firm (NZ) *IFLR Asia Awards 2018*

CHAPMAN TRIPP

2019 trends at a glance

We begin this year's *New Zealand Corporate Governance Trends and Insights* publication by asking whether the "shareholder primacy" model, which has prevailed in New Zealand and in like jurisdictions for decades, may now be under serious challenge.

Two recent developments which support this view are:

- a significant expansion in the UK Companies Act of the matters to which directors must have regard in their decision-making, and
- the speech by Financial Markets Authority (*FMA*) CEO Rob Everett suggesting that the "Milton Friedman model", where the responsibilities of a listed company board were primarily aimed at the returns to shareholders, is broken and was never valid or sustainable in the first place.

Several of the currents we think will shape 2019 reflect a widening of the expectations of, and on, directors. But as of now, the strict legal obligation is still relatively narrow – to act "in what they believe is the best interests of the company" which "will often, but not necessarily, be what is in the best interests of the existing shareholders".

Key governance trends we expect to occupy boardrooms this year include:

A continuing strong focus on culture from the ripple effects of, and the New Zealand Government's legislative response to, the Hayne Royal Commission and its New Zealand offspring – the FMA/Reserve Bank of New Zealand (*RBNZ*) reviews into the finance and insurance sectors

Increased importance for directors of good Director and Officer (*D&O*) insurance cover, and of boards being able to rely on manageable information flows, including in response to slightly more active litigation funders

Closer scrutiny of directors from shareholders, stakeholders and regulators

Continued development of an iwi strand in Aotearoa's governance culture

More comprehensive disclosure requirements, arising from the new New Zealand Stock Exchange (*NZX*) rules and an increasing shareholder interest in sustainability practices

Shareholder primacy?

Is the "shareholder primacy" model in the crosshairs?

For many years, the orthodox approach to directors' obligations has been founded on the premise that the job of the board is to maximise the wealth of all shareholders as a class and that the "best interests of the company" is generally "whatever will create the most value for shareholders".

But orthodoxy changes over time[1], and is never entirely consistent.

- Although the conventional view in Commonwealth jurisdictions is that directors may not issue shares to thwart a control transaction, some cases have permitted it – and "poison pills" are a relatively accepted feature of the US takeovers landscape.
- The New Zealand Companies Act requires directors to act in what they believe to be the best interests of "the company" – and, in places, expressly distinguishes between "the company" and "all existing shareholders".
- Canadian jurisprudence refers to directors' "tripartite fiduciary duty"[2], encapsulating the duty to act in the "best interests of the corporation, viewed as a good corporate citizen".

The amendments last year to the UK Companies Act present a more significant challenge to the status quo. They require directors to act in what they consider "most likely to promote the success of the company for the benefit of its members (i.e. shareholders) as a whole", and in doing so have regard (among other matters) to:

- the long-term consequences of any decision
- the interests of employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members.

In our view, this is an important shift – which will create work for the legal profession by opening up the opportunities for legal challenge against board decisions, but will throw sand into the machinery of commercial activity.

There has always been a degree of uncertainty and inconsistency as to the extent to which directors *may* have regard to factors beyond shareholder value. But to require that they *must* have regard to these matters is a different thing altogether, for reasons more significant than the observation that it is likely to result in increased legal costs.

One does not need to challenge the perception that "shareholder primacy" gives companies and directors too much latitude to act in socially harmful ways to question whether the UK approach is the best way forward.

What is clear, though, is that it is likely a sign of things to come. For a local example, we need go no further than the recent speech by Rob Everett, FMA CEO.

> *[T]he Milton Friedman model, where the responsibilities of a listed company board are primarily aimed at returns for shareholders... the competitive dynamics of the "market" itself being able to weed out those who do harm, is broken. Actually, it's not broken, because it was never a valid or sustainable model in the first place.*

[1] Readers of Robert Teitelman's excellent "Bloodsport" will be familiar with the transition from "managerialism" to shareholder primacy in the US which accompanied (and spurred) the rise of hostile takeovers.

[2] This tripartite duty comprises (i) an overarching duty to the corporation, which contains (ii) a duty to protect shareholder interests from harm and (iii) a procedural duty of "fair treatment" to relevant stakeholder interests.

Shareholder primacy? *(continued)*

Across the globe, people are asking themselves – what purposes do companies serve, what are the duties of their boards, and who are those owed to...

One flaw in the principle of shareholder primacy is that the shareholder is often no longer the person or entity at the biggest risk from the conduct of the company. Reductions in profit or even bankruptcy at any particular company are not existential threats to global fund managers or other institutional investors running huge, diversified portfolios. Employees have much more at risk.

[S]uppliers likewise often have more at risk than shareholders especially when they become, whether they like it or not, creditors of the company.

Social licence is a phrase that is becoming over-used, but I believe that most market participants now accept that all corporate structures have responsibilities to a broader set of stakeholders than their shareholders...

Boards have to balance serving the shareholders by doing the right thing. And as Hayne pointed out in the Australian Royal Commission, that is a far higher standard than complying with the law, or doing stuff that may not be in the spirit of the law, or does not "affirmatively" and provably breach it.

I think the tide has turned in terms of what the public and the community at large expects from its corporate leaders.

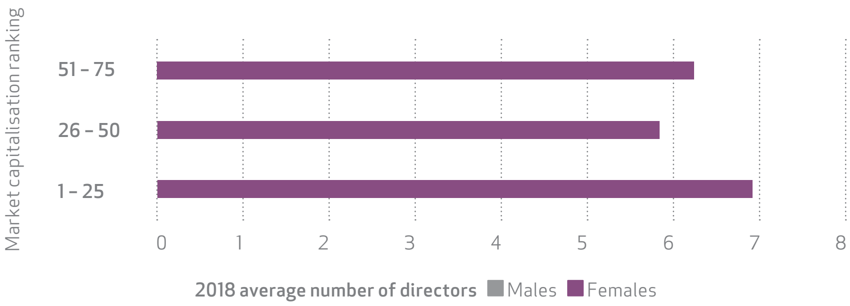
When challenges to governance orthodoxy come from the Chief Executive of the FMA and UK lawmakers, it starts to feel as if change is in the wind.

Diversity reporting

Ten of the top 75 board chairs, or 13%, were women, as were four CEOs (6%) and ten CFOs (15%). In a notable first, Spark will have both a female chair and a female CEO from 1 July, when Jolie Hodson officially takes over from Simon Moutter.

Our analysis continues to show that the top 25 of the top 75 are leading the way on gender diversity.

Director gender by NZX market capitalisation ranking



The ABC of governance – Attitude drives Behaviour drives Culture

The promotion of culture as a key governance responsibility will be an important part of the legacy from the intense regulatory scrutiny of the financial services industry on both sides of the Tasman in the nightmare that was 2018.

A strong theme across all of the various inquiries was that Attitude at the top drives Behaviour through the organisation and sets, for better or for worse, the organisation's Culture. As Hayne put it, culture is "what people do when no-one is watching".[3]

The APRA Report

The Australian Prudential Regulation Authority's (*APRA*) inquiry into the Commonwealth Bank of Australia (*CBA*) drew explicit links between culture and the risk of misconduct (APRA Report).[4]

The report identified four dominant attitudes in CBA – complacency, reactivity, insularity and over-collegiality – and recommended cultural change as a lever to promote improvement.

The Hayne Commission and the FMA/RBNZ reviews

Culture was also a major preoccupation of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Report)[5], so much so that the Hayne Final Report uses the word "culture" 304 times (and the word "competition" scarcely 20 times).

And the FMA and RBNZ expressly made "conduct and culture" the single focus of their reviews into the New Zealand retail banks and the insurance industry.[6]

[3] Page 375, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 1 February 2019 (Hayne Final Report)

[4] Prudential Inquiry into the Commonwealth Bank of Australia, April 2018

[5] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, 1 February 2019

[6] Bank Conduct and Culture, Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks, November 2018 and Life Insurer Conduct and Culture, Findings from an FMA and RBNZ review of conduct and culture in New Zealand life insurers, January 2019

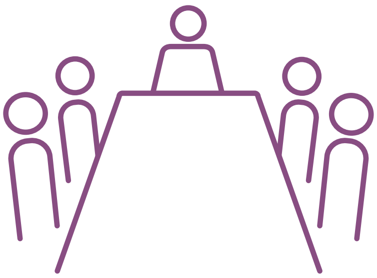
[7] ASX Corporate Governance Council, Corporate Governance Principles and Recommendations, Fourth Edition, page 16

[8] Interim Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 28 September 2018, Volume 1, pages 54 and 55

[9] Page 391 Hayne Report

The role of the board

All four reports highlight the importance of boards taking general ownership of organisational culture, and in particular instilling businesses with sound risk taking cultures that encourage effective risk management and timely assessments, discussions and responses to risk and risk taking activities.



This is consistent with principle 3 of the Australian Securities Exchange (*ASX*) Corporate Governance Council's Corporate Governance Principles and Recommendations Fourth Edition which is that a listed entity should "*instil and continually reinforce a culture of acting lawfully, ethically and responsibly*".[7]

The underlying recommendations to this principle emphasise the importance of organisations adopting values that express the standards and behaviours expected from directors, managers and employees in achieving the business's purpose and aims.

Hayne reinforced this by noting that directors have a duty to pursue the long-term interests of the business (as distinct from short-term gain) and that this requires not only that they obey the law but also that they "do the right thing".[8]

Similarly, the FMA and RBNZ findings highlight the importance of having a culture genuinely focused on improving outcomes, rather than completing box-ticking exercises.

How this might translate into practice

We expect to see boards having a greater focus on:

- assessing their organisation's culture and in particular its risk culture to identify any problematic aspects of that culture and how those issues may be remedied
- "leading from the top" and "walking the talk" by speaking and acting consistently and proactively with the values of the business and reinforcing those values by taking appropriate actions when those values are breached
- ensuring that these behaviours filter through to management and front line employees. As Hayne observes, "tone from above is as important as tone from the top"[9]
- making sure they have the "right" information at the right time to effectively oversee conduct and culture and make informed decisions
- empowering management to use their judgement to instil good cultures but balancing this with the need for boards to be able to hold management accountable
- ensuring the organisation's culture encourages constructive criticism and challenge in a respectful manner, and
- ensuring employee remuneration and incentives are aligned with the true values of the business.

Chapman Tripp comment

These actions will require a commitment of energy but should not substantially lift the compliance burden on business. However, there is a risk that this will happen as a result of the lawmakers' response to the Hayne/RBNZ/FMA findings.

We urge the Government to avoid overreach as the effect of an overly prescriptive approach will be to stifle dynamism, innovation and competition to the disadvantage of consumers.

Do KAMs matter?

As the Key Audit Matter (*KAM*) regime becomes more embedded, we track how it is performing through a detailed analysis of the KAMs reported by the top 75 in 2018 – and draw some comparisons with 2017.

The big audit firms seem to have developed something of a template approach, with set KAMs that they tailor to fit each company. This seems at odds with the purpose of KAM reporting, which is to highlight for the information of shareholders each company's individual financial and risk profile.

Most prevalent Key Audit Matters in 2018 and 2017

- GOODWILL IMPAIRMENT
- REVENUE RECOGNITION
- VALUATION OF INVESTMENTS
- DISCLOSURE AROUND ACQUISITIONS, AND
- INVENTORY.

A KAM is a matter an auditor judged most significant or concerning when conducting the audit. Typically these will involve some complexity and require an element of judgement.

KAM reporting can create conflicts with a range of competing considerations, including continuous disclosure obligations, confidentiality of commercially sensitive information and prejudice to litigation. Chapman Tripp is increasingly asked by audit committees to provide advice on misconceived KAMs, although often this should have been sought earlier to enable full consideration of all relevant factors.

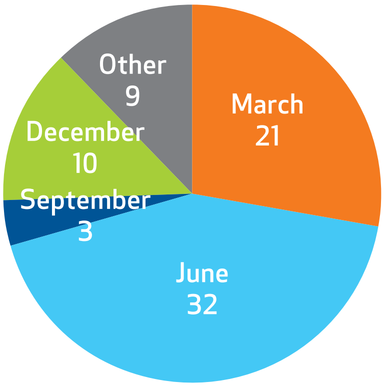
Predictions before the regime's commencement were for an average of three to four KAMs per audit but the average number is around two.

From 1 January 2019, the KAM net has been extended beyond listed issuers to all Financial Markets Conduct (*FMC*) reporting entities, including registered banks, insurance companies and non-bank deposit takers.

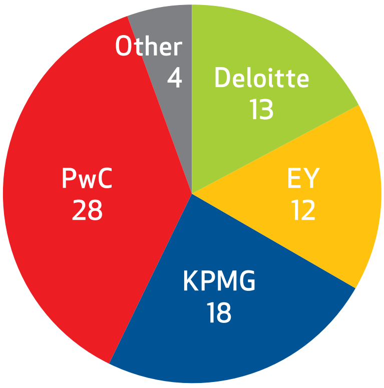
Key observations

- The highest recurring KAM in both 2017 and 2018 was the Goodwill and other intangible assets impairment assessment.
- The average number of KAMs reported by the top 75 NZX listed companies dropped slightly from 1.95 in 2017 to 1.92 in 2018. Across the NZX Main Board, it was around two, with a range of zero to five.
- Many auditors made substantial voluntary additional disclosure about KAMs and the materiality applied to the audit. Auditors generally used plain language, accessible to the average shareholder.
- Companies with the same audit firm (PwC/KPMG/EY/Deloitte) often had the same KAMs and precedent explanations – e.g. Deloitte's audit reports generally included "valuation of investment properties," and PwC's generally included "goodwill and impairment," "going concern" and "revenue recognition."
- Reporting of the more generic KAMs – goodwill, valuation, going concern, tax and capitalisation – increased in 2018 while the incidence of KAMs relating to the specific operations undertaken by companies – acquisitions and demergers, inventory, and revenue – dropped. However, pleasingly, several issuer auditors changed the KAMs looked at, between the two years.
- Going concern reportage trebled in 2018, reflecting the increased volatility of the corporate environment.
- The majority of KAMs seem to be calculation based i.e. valuation of properties, accuracy of revenue, the net realisable value of inventory, acquisitions and impairment assessments. As these are quantifiable, objective measurements, comparisons can more easily be made across time periods.

Most prevalent year-end balance dates



Audit firms for top 75 listed issuers



Board composition – the top 75

as at 31 March 2019

Number of directors
March 2019 ■ Male ■ Female
March 2018 ■ Male ■ Female

The top 75 by market capitalisation ranged from $10.7b for Meridian to $113m for Foley Family Wines. Meridian eased out market darling and 2018 top 75 leader a2 Milk, but only in March. In a year of no IPOs, but several takeovers, Trilogy International dropped out of the top 75, with market heavyweight Trade Me due to follow soon. 35 of the top 75 are also listed by ASX.

Big movers in top 75 rankings were Tilt Renewables (up 18 places on the back of a takeover), Vista up 13, SKY Network Television down 16, and Fonterra Shareholders' Fund and Comvita each down 13 places.

Average board size

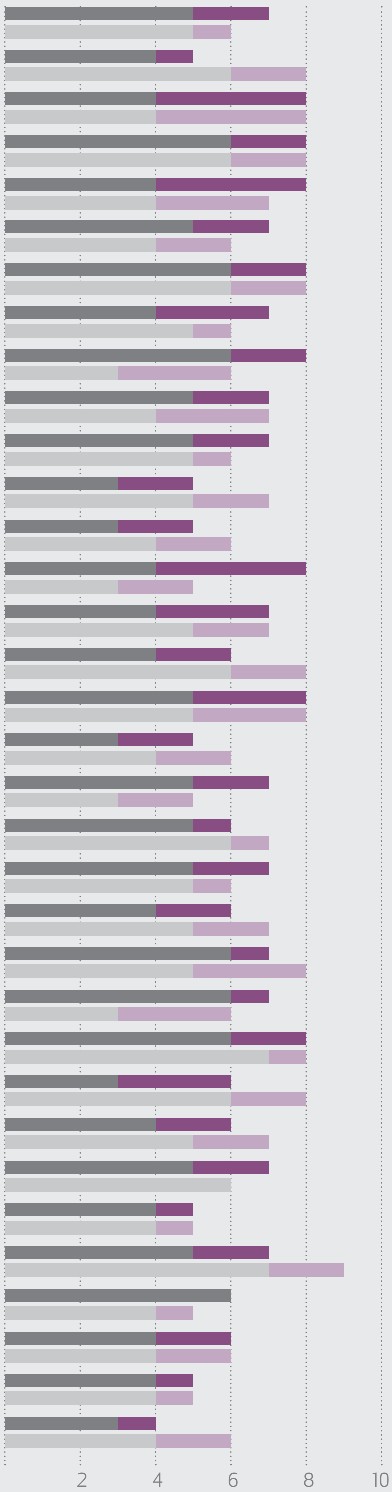
6.35 directors, up from 6.1 in 2018.

Independence

73% of boards had a majority of independent directors, 21% with only independents (against 68% and 19% in 2018).

77% had an independent chair and 38% had the CEO on the board (2018: 29%).

The 1 January 2019 NZX Listing Rules and updated NZX Corporate Governance Code will better define an "independent" director, and require companies to have a majority of independent directors on their boards, or explain why not.



#	Company	Average length of tenure (Yrs)	CEO on board
1	Meridian Energy	7.1	
2	The a2 Milk Company	3.6	●
3	Auckland International Airport	3.3	
4	Fisher & Paykel Healthcare Corporation	5.8	●
5	Spark New Zealand	5.0	●
6	Ryman Healthcare	7.2	
7	Mercury NZ	6.3	
8	Contact Energy	2.8	
9	Fletcher Building	2.2	
10	Port of Tauranga	5.3	
11	Mainfreight	14.3	●
12	Vector	9.0	
13	Ebos Group	13.3	
14	Genesis Energy	3.2	
15	Air New Zealand	5.2	
16	SKYCITY Entertainment Group	4.9	
17	Chorus	4.5	●
18	Trade Me Group	5.3	
19	Z Energy	4.7	
20	Infratil	8.0	●
21	Goodman Property Trust	11.3	●
22	Kiwi Property Group	4.0	
23	Trustpower	6.4	
24	Precinct Properties New Zealand	6.5	
25	Synlait Milk	6.7	●
26	Summerset Group Holdings	5.1	
27	Freightways	4.6	●
28	Tilt Renewables	2.3	
29	Restaurant Brands New Zealand	5.4	
30	Metlifecare	4.6	
31	Argosy Property	3.6	
32	Delegat Group	15.1	●
33	Property For Industry	10.7	●
34	Vital Healthcare Property Trust	8.3	

Length of service

The average length of service across the top 75 remained at 6.2 years, with the highest board average 18.0 years (2018: 19.9).

Multiple board roles

Multiple directorships among the top 75 remain comparatively rare. One director has five roles, three directors have four roles (2018: 6), 11 directors have three (2018: 11), and 52 directors, two (2018: 55).

The top 75 had 474 directors altogether (2018: 473).

NZX Governance Code "Independence" factors

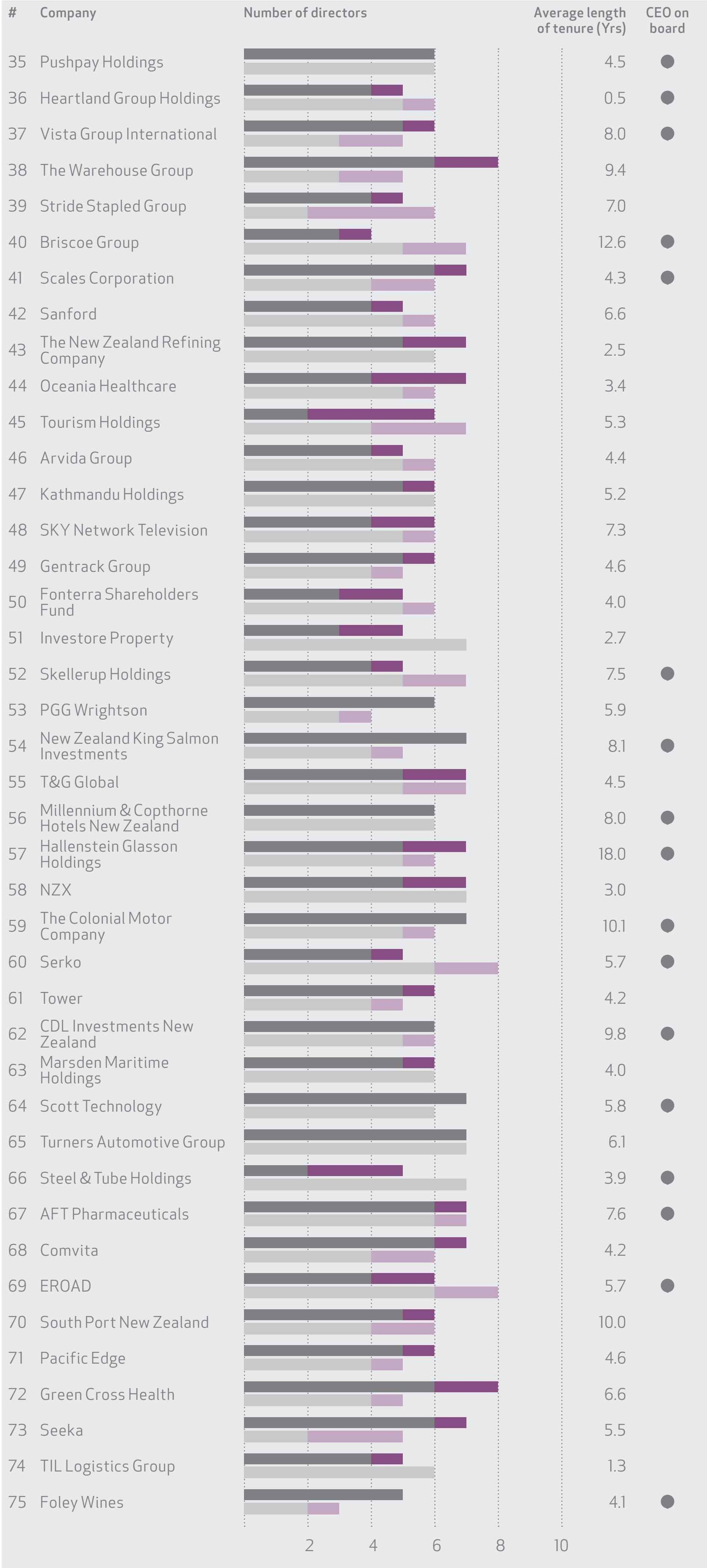
- currently, or within three years, having an executive role
- currently, or within 12 months, holding senior role in material professional services provider
- a current, or within three years, material business relationship (e.g. as a supplier or customer)
- a substantial product holder (*SPH*), or a senior manager or associated person of an SPH
- a current, or within three years, material contractual relationship
- having close family ties with any of the above
- having been a director for a length of time that may compromise independence.

Geographic diversity

212 of the 474 roles in the top 75, or 44.7%, were filled by directors who recorded their place of residence as Auckland.

Other popular locations were Wellington (39), Christchurch (28) and Queenstown/Wanaka (20).

101 roles were filled by directors residing overseas (21.3%).



Iwi and Māori corporate governance

The growth of the Māori economy and of the iwi corporates, three of which are now billion dollar plus concerns, is bringing a distinctive new strand to New Zealand's governance culture – one which has its unique challenges but also has much to offer the mainstream.

A different perspective

Iwi corporates typically work to a 25 to 50-year planning horizon, reflecting the intergenerational nature of their mission, and are guided by Tikanga Māori values such as whanaungatanga (family), manaakitanga (looking after people), and kaitiakitanga (stewardship).

A clear example of this is Te Rūnanga o Ngāi Tahu's tribal philosophy of *Mō tātou, ā, mō kā uri, ā muri ake nei* – for us and our children after us.

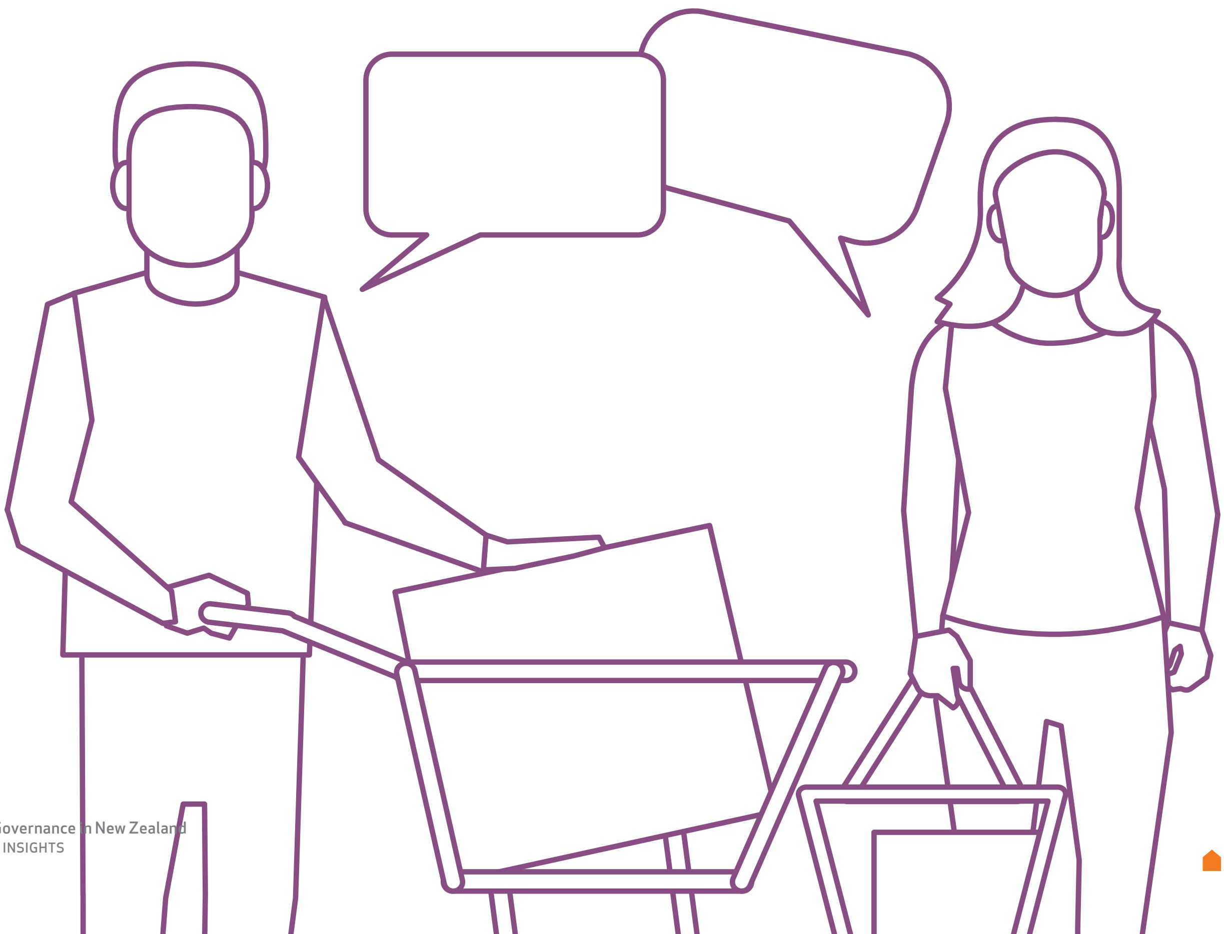
These characteristics tend to promote a focus on sustainability – in contrast to the Companies Act focus on the best interests of the company, meaning the shareholders as a whole, which can drive short-term profit taking.

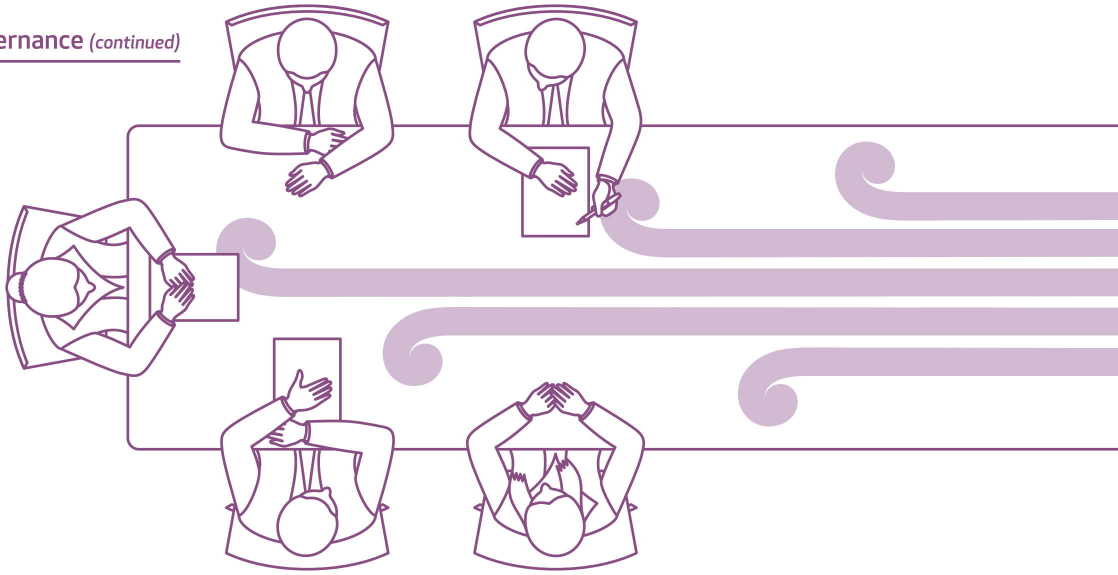
Relationships between governors and iwi members

Iwi boards have clear and reinforced responsibility for the collectively owned assets of thousands of individual iwi members.

They are also likely to be related to, or live in the same community as, at least some of these people – running into their whānau in the supermarket, or being questioned at the monthly marae hui on decisions made around the board table.

The accountability is direct and personal.





Challenges today

Iwi boards have a distinct perspective which can make them strong in areas where the traditional board can be weak – taking a long-term view, managing assets to produce income streams over many generations, selecting investments which are relatively protected from technologically induced disruptive change.

But they also face particular challenges, in part because board members are necessarily drawn from small populations.

Measuring success

Iwi have to find an appropriate balance between investing in cultural revival and the present day wellbeing of iwi members, against the need to reinvest a proportion of the profits to support future generations. Success is therefore about 'the whole package' rather than simple bottom line returns.

It is common for iwi corporates to use an annual profit announcement as the starting point for discussions on how they are re-investing in their people. We are seeing the expansion and normalisation of impact or socially responsible investing within te ao Māori and believe this will become more prominent in the future.

Capability around the table

A long-standing challenge for iwi and Māori organisations has been to get the 'right people' around the table. This is a particular issue for parent trusts, where trustees are elected by iwi members – a political process that in this day of social media campaigns, often rewards popularity ahead of mana, integrity or skill.

For the more directly commercial subsidiary asset holding companies, directorships are by appointment. If there is a skills shortage, experienced independent directors can be recruited to fill the gaps and to share their expertise with whānau directors in exchange for the opportunity to bring a new cultural dimension to their own leadership and governance skills.

Ngāti Awa and Ngāi Tahu have instituted associate director roles on their corporate boards for whānau members to gain governance experience. Ngāi Tahu has also introduced Manawa Tītī – a programme which seeks to harness the skills of formal and informal leaders through three wānanga, each running over two days.

We expect iwi corporates to continue to invest in these and similar programmes to bring the young Māori population coming through into the boardroom. This will introduce new ideas and strategies to iwi boards and, through them, to Aotearoa corporate governance.

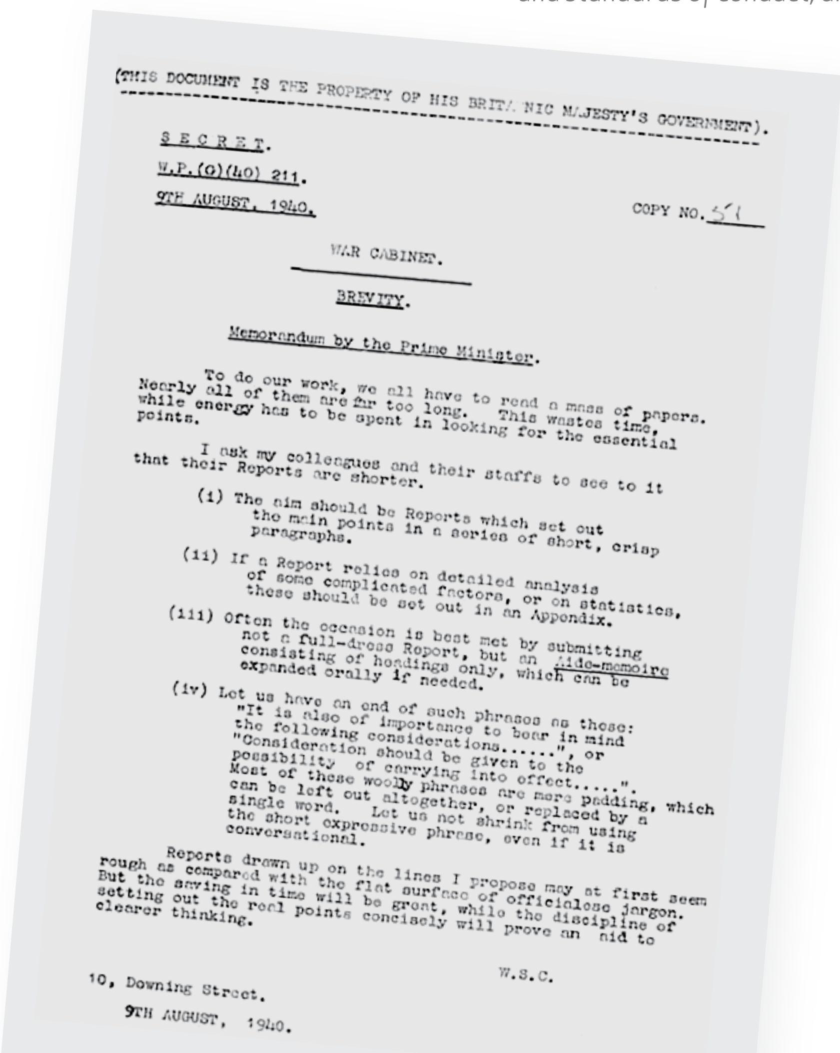
We will fight them on the pages

A common complaint we hear from directors is the huge volume of information they are expected to wade through, particularly for businesses in regulated sectors. The problem may be exacerbated by the ease of modern communication technologies, but it is scarcely new.

In 1940, at the height of the Battle of Britain, Sir Winston Churchill called for brevity in cabinet "board papers".

His message is as relevant today as it was then, and was echoed (although less cogently) by Commissioner Hayne in the Final Report of the *Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*[10]:

> *"Boards must have the right information in order to discharge their functions. In particular, boards must have the right information in order to challenge management on important issues, including issues about breaches of law and standards of conduct, and issues that may give rise to poor outcomes for customers. Without the right information a board cannot discharge its functions effectively.*
>
> *When I refer to boards having the right information, I am not referring to boards having more information. As I noted earlier, it is the quality, not the quantity, of information that must increase. Often, improving the quality of information given to boards will require giving directors less material and more information."*



(THIS DOCUMENT IS THE PROPERTY OF HIS BRITANNIC MAJESTY'S GOVERNMENT).

SECRET.

W.P.(G)(40) 211.

9TH AUGUST, 1940.

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WAR CABINET.

BREVITY.

Memorandum by the Prime Minister.

To do our work, we all have to read a mass of papers. Nearly all of them are far too long. This wastes time, while energy has to be spent in looking for the essential points.

I ask my colleagues and their staffs to see to it that their Reports are shorter.

(i) The aim should be Reports which set out the main points in a series of short, crisp paragraphs.

(ii) If a Report relies on detailed analysis of some complicated factors, or on statistics, these should be set out in an Appendix.

(iii) Often the occasion is best met by submitting not a full-dress Report, but an Aide-memoire consisting of headings only, which can be expanded orally if needed.

(iv) Let us have an end of such phrases as these: "It is also of importance to bear in mind the following considerations.....", or "Consideration should be given to the possibility of carrying into effect.....". Most of these woolly phrases are mere padding, which can be left out altogether, or replaced by a single word. Let us not shrink from using the short expressive phrase, even if it is conversational.

Reports drawn up on the lines I propose may at first seem rough as compared with the flat surface of officialese jargon. But the saving in time will be great, while the discipline of setting out the real points concisely will prove an aid to clearer thinking.

W.S.C.

10, Downing Street.

9TH AUGUST, 1940.

Commissioner Hayne's observations echo those in the *Centro* litigation[11]:

> *"The papers provided to the Board each month were voluminous. However, it is to be recalled that this is a matter that is within the power of the Board to control. It is the Board's responsibility to determine the information it requires or does not require."*

The challenge for management and boards is to ensure they have the knowledge they need to perform their governance duties without being drowned in unnecessary detail.

Sir Churchill's four point advice is a very good place to start.

[10] https://financialservices.royalcommission.gov.au/Pages/default.aspx

[11] Australian Securities and Investments Commission v Healey [2011] FCA 717

Corporate governance codes

The pre-eminence of the NZX Corporate Governance Code first promulgated in October 2017, and updated 1 January 2019, has removed an old bugbear of ours – the plethora of governance codes available to issuers in New Zealand.

All of the top 75 were required to report against the 1 October 2017 edition of the NZX Corporate Governance Code in 2018.

Listing Rule Review

The Code has been recently refreshed to capture the changes arising from the new NZX Listing Rules which came into effect on 1 January this year with a six month transition.

As at 15 April, 23 of the top 75 issuers (30.6%) had already migrated to the new Listing Rules.

Key governance related changes include:

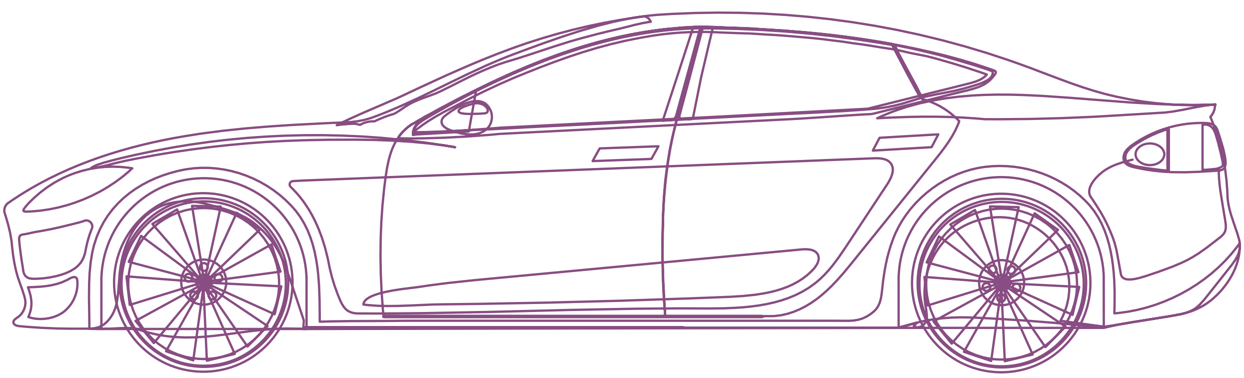
- a more detailed and sensible definition of "independent director" factors
- a recommendation to have a majority of independent directors on the board
- replacement of the requirement that a third of directors resign or seek re-election each year with a three year maximum term provision (which is less disruptive to manage for smaller companies and boards)
- removal of the exemption to the rotation rule which had been available to executive directors, and
- stronger disclosure requirements around business strategy and non-financial assets.

The Hilux, the Tesla and the Volvo

We had previously unkindly characterised the 2002 NZX Corporate Governance Best Practice code as a 'Hilux', compared to the ASX "Volvo".

In our view, with the 1 January NZX Corporate Governance Code edition, the NZX "Hilux" has morphed into a sleek Tesla.

The ASX Corporate Governance Council has moved in the opposite direction with its "Volvo", adding some clunky features which have compromised its aerodynamics and the elegance of its design.



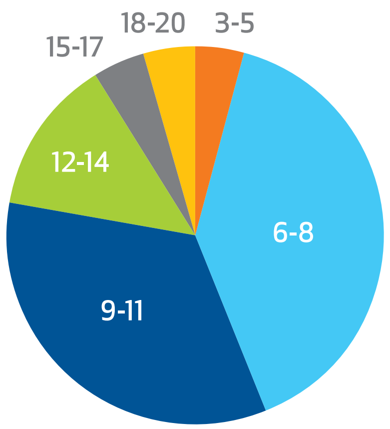
Board and committee meetings

Board meetings

67 of the top 75 disclosed in their annual report and/or on their website director profile and meeting attendance information, as recommended in the NZX Corporate Governance Code.

The number of regular meetings varied, 40% held between six and eight; 33% between nine and 11; and 4.5% fewer than six.

2018 Board meeting frequency



Committees

Principle 3 of the NZX Code says board committees should be used in key areas where this will enhance the board's effectiveness.

But veteran Australian director David Murray warned in a hard hitting speech last August that excessive use of committees can promote too much focus on management, risk and external audit issues – distracting the board from taking a broader strategic view, and making it less effective.

Since the GFC, most larger ASX listed issuers have split the audit and risk roles into two distinct committees, as recommended by the Third Edition of the ASX Corporate Governance Council best practice code, published in 2013.

In New Zealand, with smaller boards, it is common to still combine them. Only three of the top 75 had a separate risk committee. It is also commonplace for issuers (36 of the top 75) to combine remuneration and nominations in a single committee. The average number of board committees was three. Foley Family Wines had no committees (the audit function was undertaken by the full board), and NZX and Vector had six. 22 issuers had a dedicated health and safety committee, and eight a due diligence committee.

Committees contemplated by the NZX Listing Rules and Governance Code

Audit committee

Under the Listing Rules, NZX Main Board issuers must have an audit committee.

The audit committee must be comprised solely of directors, have a minimum of three directors, have a majority of independent directors, and have at least one member with an accounting or financial background.

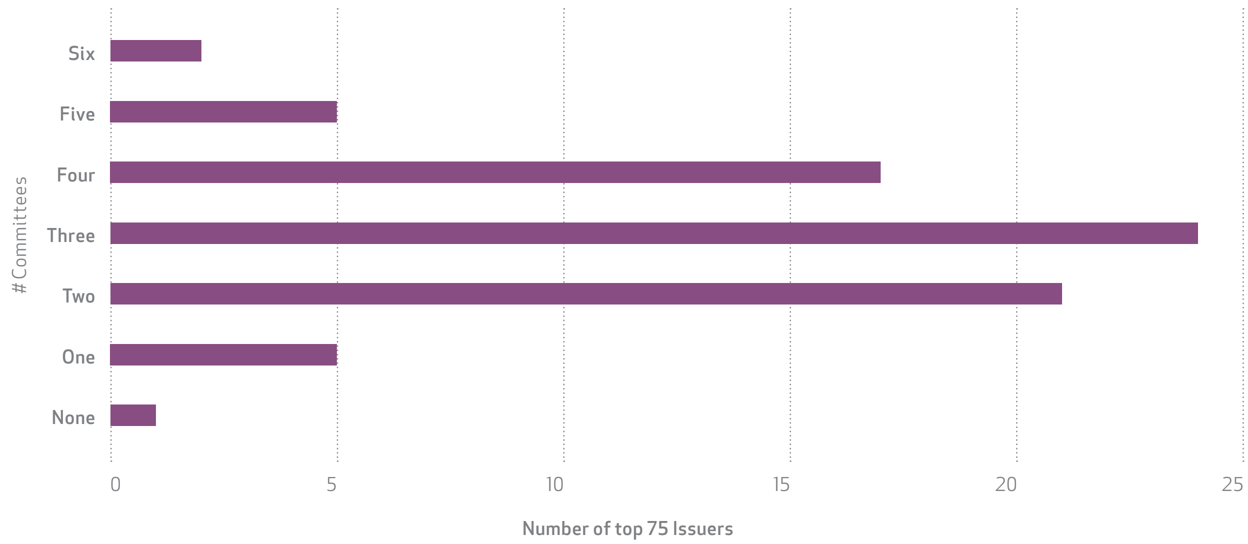
The NZX Corporate Governance Code recommends that the audit committee should comprise solely non-executive directors, and that the chair of the audit committee should be an independent director and not also be the chair of the board.

Other committees

The NZX Corporate Governance Code recommends that issuers have:

- a **remuneration committee** which should operate under a written charter, with a majority of independent directors, and that management should only attend by invitation
- a **nomination committee** to recommend director appointments, which should operate under a written charter, with a majority of independent directors. The nomination committee can be combined with the remuneration committee, and
- **other board committees** as the board considers appropriate, depending on the nature of the businesses.

Number of board committees



Shareholder engagement – 2018 research

Solid progress is being made in the quality of shareholder engagement, as measured by the timeliness of annual shareholder meetings. This builds on an improvement in 2017.

Timeliness

We updated our top 75 database in 2017 to include the publication dates for preliminary financial results and annual reports, and the date that annual shareholder meetings (*ASM*) were held.

Our analysis this year shows:

- a continuing trend among larger NZX companies to publish their full annual report well within the 60-day deadline set for their preliminary results, rather than the three months allowed by NZX
- an average time after balance date before publishing the annual report of 65 days compared to 60 days in our 2016 analysis, and 57 days for the top 20, and
- a slight increase from 118 days in the 2016 analysis to 119 days in the time gap between balance date and the ASM.

The delays are disappointing. Shareholders are not being well-served if they are presented with outdated financial information at the ASM because it means that they are looking in the rear vision mirror.

In response to investor feedback, the 1 January 2019 edition of the NZX Corporate Governance Code recommends that a board should ensure notices of annual or special meetings of shareholders are posted on the company's website at least 20 working days before the meeting – the Companies Act 1993 bare minimum legal requirement is for at least 10 working days' notice.

Hybrid meetings

The number of top 75 issuers undertaking hybrid meetings (online and a physical presence) increased slightly to 14 of the top 75 (2018: eight), although seven of them are in the top 10 by market capitalisation.

Meeting participation

A recent report from share registry Computershare highlights the relatively low participation rates at issuer meetings.

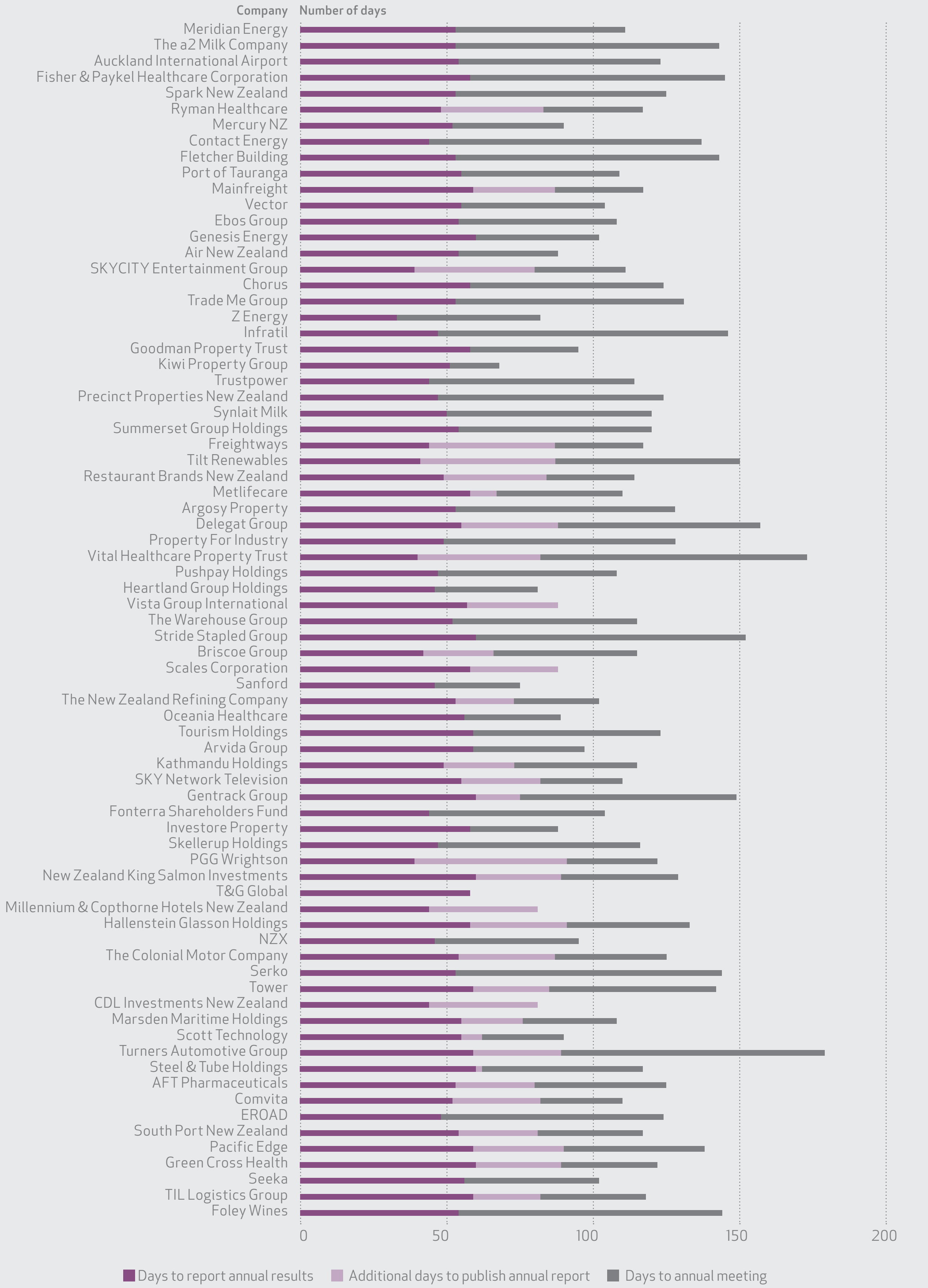
Only 1.7% on average by number of shareholders attended Computershare client meetings in the 2018 season. More concerning was that only 46.4% of issued capital was voted. Of those voting, 60.6% did so online, a 41.3% increase over the last five years.

Standing Proxies

In an effort to increase the voting at issuer meetings, Chapman Tripp has recently assisted the New Zealand Shareholders Inc. (*NZSA*) to implement a *Standing Proxy* service.

A *Standing Proxy* means a shareholder appoints the NZSA once under section 6(3) of Schedule 1 of the Companies Act 1993 to vote at any future company meetings as may be specified by the shareholder (e.g. all meetings for shareholdings of a shareholder), rather than having to make appointments meeting by meeting.

Most recent time of issuer reporting financial results and Annual Meeting of Shareholders



Notes: 32 of 70 of the top 75 gave at least 28 days notice of ASM (five have not scheduled their latest meeting yet)

Recent reporting against NZX Code

Diversity

Recommendation 2.5

An issuer should have a written diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving diversity (which, at a minimum, should address gender diversity) and to assess annually both the objectives and the entity's progress in achieving them. The issuer should disclose the policy or a summary of it.

Almost all issuers reporting had adopted a diversity policy with measureable objectives, although the quality of reporting progress was mixed.

The 2019 review shows little tangible change in diversity outcomes – the percentage of 24.8% of female directors in the top 75 has increased only marginally since 2018 (23.6%) and 2017 (20%). The NZX also now provides for gender-diverse disclosure, and in the case of NZX itself had one gender-diverse employee as at its balance date of 31 December 2018.

Australia might be about to steal a lead on us here as the ASX Corporate Governance Council's fourth edition, released in February, includes in the Principles a hard-coded target of 30% female directors for the ASX 300.

ESG and strategy reporting

Recommendation 4.3 (as amended in 1 January 2019 code)

Financial reporting should be balanced, clear and objective. An Issuer should provide non-financial disclosure at least annually and include consideration of the issuer's material exposure to environmental, economic and social sustainability risks and other key risks. It should explain how operational or non-financial targets are measured. Non-financial reporting should be informative, include forward looking assessments and align with key strategies and metrics monitored by the board.

47 issuers had a section in the annual report devoted to Environmental, Social and Governance Disclosure, or reported on it separately.

CEO Remuneration

Recommendation 5.3

An issuer should disclose the remuneration arrangements in place for the CEO in its annual report. 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.

All issuers disclosed their CEO base pay, and the basis for determining short term and long term incentives in 2019, as in 2018. The level of detail varied significantly but was generally improved from last year.

As with 2018, two issuers also voluntarily disclosed the base, and the short-term and long-term incentives for their CFO.

Takeover protocols

Recommendation 3.6

The board should establish appropriate protocols that set out the procedure to be followed if there is a takeover offer for the issuer, including any communication between insiders and the bidder.

The board should disclose the scope of independent advisory reports to shareholders. These protocols should include the option of establishing an independent takeover committee, and the likely composition and implementation of an independent takeover committee.

54 issuers had formal protocols in place for dealing with a takeover at the reporting date. This was a big increase on 2018 when only nine did. Eight issuers including all of the Mixed Ownership Model companies noted that they had not adopted a takeover protocol because their majority ownership positions meant a takeover would not be possible.

Board remuneration

2018 chair and base director fees

Our review of remuneration disclosure among the top 75 identified a wide variance in director and chair base fees. This may reflect a tendency among New Zealand boards to allow three to four year intervals before going back to shareholders for a non-executive director remuneration adjustment.

The problem with that approach is that the size of the increase sought can look large and, if the company has had a flat year, may meet shareholder resistance.

A better model, more aligned to normal commercial practice, would be to seek an adjustment every year, or to set a cap which allows for small adjustments as appropriate over a few years.

Two trends identified in our data are:

- a movement toward paying separate board committee fees, particularly to the chair of the audit committee, and
- a formal policy requiring directors to apply a set amount of their fees to buying shares in the issuer on the stock exchange.

#	Company	Chair (at 31 March 2019)	2018 Chair base fee	2018 Director base fee	Extra Committee fees	Base fee notes
1	Meridian Energy	Christopher Moller	$200,000	$110,000	Yes	
2	The a2 Milk Company	David Hearn	$120,000	$120,000	Yes	
3	Auckland International Airport	Patrick Strange	$250,000	$118,320	Yes	
4	Fisher & Paykel Healthcare Corporation	Tony Carter	$218,350	$96,065	Yes	
5	Spark New Zealand	Justine Smyth	$357,099	$140,675	Yes	
6	Ryman Healthcare	Dr David Kerr	$207,000	$103,000	Yes	
7	Mercury NZ	Joan Withers	$180,000	$98,000	Yes	
8	Contact Energy	Rob McDonald	$300,000	$133,000	Yes	
9	Fletcher Building	Bruce Hassall	$352,000	$132,800	Yes	
10	Port of Tauranga	David Pilkington	$162,000	$85,000	Yes	
11	Mainfreight	Bruce Plested	$0	$113,000	Yes	
12	Vector	Alison Paterson	$201,300	$100,650		
13	Ebos Group	Mark Waller	$296,875	$149,084		Averaged
14	Genesis Energy	Barbara Chapman	$177,000	$90,000	Yes	
15	Air New Zealand	Tony Carter	$270,000	$97,500	Yes	
16	SKYCITY Entertainment Group	Robert Campbell	$275,000	$126,000	Yes	
17	Chorus	Patrick Strange	$223,650	$111,850	Yes	
18	Trade Me Group	David Kirk	$215,000	$95,000	Yes	
19	Z Energy	Peter Griffiths	$185,000	$97,500	Yes	
20	Infratil	Mark Tume	$200,000	$100,000	Yes	
21	Goodman Property Trust	Keith Smith	$155,000	$90,000	Yes	
22	Kiwi Property Group	Mark Ford	$165,000	$92,000	Yes	
23	Trustpower	Paul Ridley-Smith	$176,500	$86,000	Yes	
24	Precinct Properties New Zealand	Craig Stobo	$162,080	$91,170	Yes	
25	Synlait Milk	Graeme Milne	$136,667	$73,333	Yes	
26	Summerset Group Holdings	Robert Campbell	$165,000	$80,000	Yes	
27	Freightways	Mark Verbiest	$160,000	$85,000	Yes	
28	Tilt Renewables	Bruce Harker	$190,000	$85,000	Yes	
29	Restaurant Brands New Zealand	Ted van Arkel	$125,000	$65,000		
30	Metlifecare	Kim Ellis	$165,000	$96,250	Yes	
31	Argosy Property	Mike Smith	$160,000	$85,000	Yes	
32	Delegat Group	Jim Delegat	$0	$70,000		Averaged
33	Property For Industry	Anthony Beverley	$32,000	$70,000	Yes	
34	Vital Healthcare Property Trust	Claire Higgins	Not disclosed	Not disclosed		
35	Pushpay Holdings	Bruce Gordon	$60,000	$45,000	Yes	

Board remuneration *(continued)*

Implementation of this requirement can bring with it a risk of insider trading allegations. Mechanisms to manage this are:

- 'fixed trading' plans which put the share purchase decision in the hands of a third party. Issuers using this mechanism include Abano Healthcare, Auckland International Airport, Serco and Tilt Renewables, and
- paying a proportion of directors' cash fees in the form of new shares. Generally these arrangements are timed for when there is a minimal insider trading risk – e.g. immediately after a product disclosure statement is registered or a results release.

19 of the top 75 sought shareholder approval to increase the shareholder cap on total non-executive director remuneration during the 2018 meeting season.

52 of the top 75 paid committee chairs, and/or directors serving on committees, additional fees above a base fee (subject to the overall total shareholder approved fee cap).

#	Company	Chair (at 31 March 2019)	2018 Chair base fee	2018 Director base fee	Extra Committee fees	Base fee notes
36	Heartland Group Holdings	Geoffrey Ricketts	$150,000	$100,000	Yes	
37	Vista Group International	Kirk Senior	$441,464	$85,833		
38	The Warehouse Group	Joan Withers	$166,000	$78,525	Yes	
39	Stride Stapled Group	Tim Storey	$288,750	$87,916		
40	Briscoe Group	Dame Rosanne Meo	$107,000	$75,333		Averaged
41	Scales Corporation	Tim Goodacre	$131,000	$65,000	Yes	
42	Sanford	Paul Norling	$150,000	$85,000	Yes	
43	The New Zealand Refining Company	Simon Allen	$180,000	$75,000	Yes	
44	Oceania Healthcare	Elizabeth Coutts	$180,000	$90,000	Yes	
45	Tourism Holdings	Robert Campbell	$150,000	$75,000		
46	Arvida Group	Peter Wilson	$150,000	$82,000	Yes	
47	Kathmandu Holdings	David Kirk	$241,302	$126,236		
48	SKY Network Television	Peter Macourt	$170,000	$100,000	Yes	
49	Gentrack Group	John Clifford	$103,000	$62,000	Yes	
50	Fonterra Shareholders Fund	John Shewan	$80,000	$53,000		
51	Investore Property	Mike Allen	$70,000	$45,000		
52	Skellerup Holdings	Elizabeth Coutts	$165,000	$82,500	Yes	
53	PGG Wrightson	Joo Hai Lee	$210,000	$80,000	Yes	
54	New Zealand King Salmon Investments	John Ryder	$99,750	$56,375	Yes	
55	T&G Global	Klaus Josef Lutz	$45,000	$47,429		Averaged
56	Millennium & Copthorne Hotels New Zealand	BK Chiu	$0	$35,000	Yes	
57	Hallenstein Glasson Holdings	Warren Bell	$120,000	$83,000		Averaged
58	NZX	James Miller	$100,000	$50,000	Yes	
59	The Colonial Motor Company	James Gibbons	$89,500	$54,500		
60	Serko	Simon Botherway	$80,000	$63,626	Yes	
61	Tower	Michael Stiassny	$130,000	$87,570	Yes	
62	CDL Investments New Zealand	Roy Austin	$35,000	$33,125		Averaged
63	Marsden Maritime Holdings	John Goulter	$61,875	$33,917		Averaged
64	Scott Technology	Stuart McLauchlan	$125,000	$51,250		Annualised
65	Turners Automotive Group	Grant Baker	$110,000	$55,000	Yes	
66	Steel & Tube Holdings	Susan Paterson	$145,000	$75,000	Yes	
67	AFT Pharmaceuticals	David Flacks	$95,000	$49,989		
68	Comvita	Neil Craig	$115,000	$58,000	Yes	Averaged
69	EROAD	Graham Stuart	$110,000	$55,000	Yes	
70	South Port New Zealand	Rex Chapman	$70,000	$40,000		
71	Pacific Edge	Chris Gallaher	$75,000	$40,000		US Director paid more
72	Green Cross Health	Peter Merton	$85,000	$60,000		Non exec $35k
73	Seeka	Fred Hutchings	$100,000	$56,500	Yes	
74	TIL Logistics Group	Trevor Janes	$75,833	$40,833	Yes	
75	Foley Wines	Bill Foley	$100,000	$35,000		
	Average		$153,284	$80,279		

How good is your D&O insurance?

Recent litigation, including the *Mainzeal* decision, has highlighted the need for directors to look carefully at their D&O insurance arrangements.

We set out below the questions you should ask. As you run through this exercise, note that the two cases we quote were both funded by commercial class action funders. Litigation funders have become more active and may over time increase the risks of legal challenge.

1. Does the policy provide separate cover for liability and defence costs?

If a plaintiff wins a claim against directors, the D&O policy must first pay out on that claim. Only after that can it be used to pay the director's defence costs, putting the director's coverage potentially at risk.

To avoid that problem, policies now routinely provide for two separate amounts of cover:

- one for liability, which money would be available to a successful plaintiff, and
- the other for defence costs, which would be off-bounds to any third party claims.

2. Is the level of coverage sufficient?

In *Mainzeal*, the court set the damages by calculating approximately one third of the amount owed to creditors in the actual liquidation. Every case will turn on its facts, but directors should be thinking about what that number might look like should their company be liquidated.

Are you covered for a meaningful proportion of such a sum? Remembering that it may also need to cover interest awarded by the court (which could run for several years), and an adverse costs award?

The recent award against Strathboss Kiwifruit Ltd of $2.6m in costs and disbursements, although not in a governance context, is an indication of how big these numbers can get.

3. Is the limit of liability in the defence costs part of your policy sufficient?

A claim against directors of a substantial business, covering corporate governance issues, could require a lengthy trial with considerable input from expert witnesses. Such processes can be very expensive.

4. Will there be competing claims on the insurance money?

In *Mainzeal*, for example, various directors were separately represented, requiring separate sets of defence costs. In other scenarios, the relevant policy may be eroded by other substantive claims. Where "side C" cover is obtained to protect the entity itself, the possibility of erosion through other claims can be particularly important.

Chapman Tripp's Corporate Governance team

Promoting investor confidence through the application of good governance principles

We advise a number of New Zealand's largest listed issuers and government owned companies and agencies on governance and strategic advice, relevant NZX and FMA guidance, and market practice and trends.

Our work includes advising on:

- directors' duties and liabilities, delegations and conflict of interest management
- best practice corporate governance policies and procedures
- market disclosure, insider trading and appropriate procedures and systems
- director and senior executive remuneration structuring and disclosure, including employee share plans and incentive arrangements, and director contracts
- board and sub-committees composition, including charters and best practice, and
- annual reports and preparation for meetings of shareholders.

A number of our partners and consultants are independent directors of NZX-listed companies, crown agencies, and other large business entities. Our partners regularly provide media commentary on topical governance issues, and are active contributors to governance law and policy reform initiatives of government, NZX, the FMA and the Takeovers Panel.

We have worked with a number of directors and boards on a range of complex issues including:

- advice on appropriate decision-making processes, management of conflict of interests, and resolution of deadlocks
- acting as a sounding-board for difficult, or strategic, decision-making
- advice on delegation, reasonable reliance on others and required ongoing monitoring and oversight of delegates
- providing external, independent advice to the chair or individual directors including advising on issues of board composition and refreshment
- advice on market disclosure of listed issuers, financial reporting and assurance requirements, and other statutory disclosure obligations
- advice on director and senior manager remuneration policies, appropriate short-term and long-term incentives, and other benefits
- advice on director and officer insurance and indemnification
- preparing corporate governance policies, and charters that meet best practice and the requirements of the Listing Rules, Companies Act and other legislation
- assisting with reporting against corporate governance policies in annual reports, or via websites, and comparison with the NZX, FMA and other third party best practice governance codes and recommendations, and
- attending meetings of shareholders and advising on meeting practice and procedure.

We advise a number of New Zealand's largest companies and government agencies on governance and strategic advice.

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