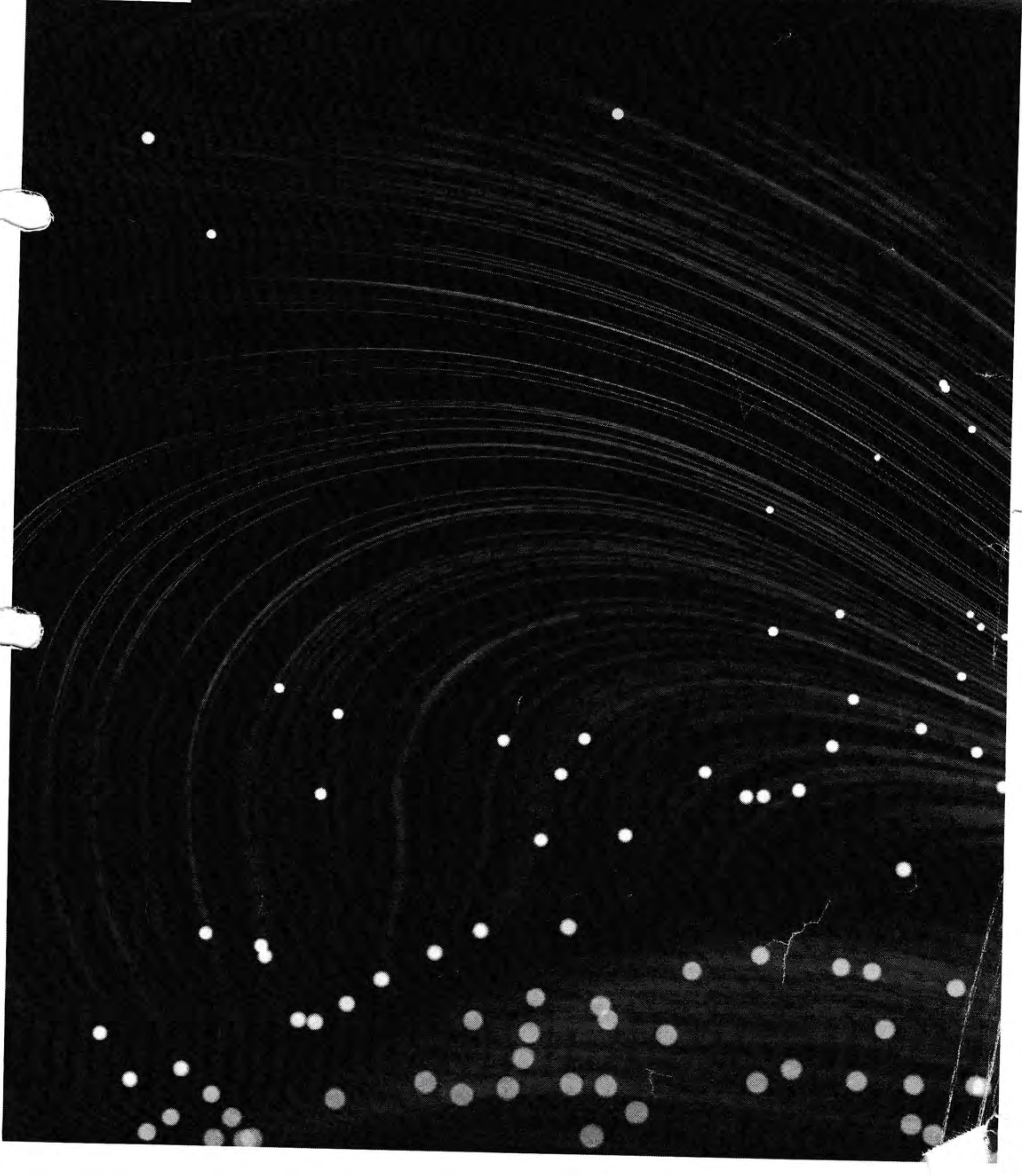
New Zealand Corporate Governance

TRENDS AND INSIGHTS

April 2018

Chapman Tripp, 2018



Contents

NZ Law Firm of the Year

Chambers Asia-Pacific Awards 2018

Most Innovative National Law Firm of the Year (New Zealand)

IFLR Asia Awards 2018

New Zealand Deal Team of the Year

2017, 2016 & 2015 Australasian Law Awards

CHAPMAN TRIPP

This publication looks at recent developments in New Zealand corporate governance and identifies trends for the year ahead.

2018 trends at a glance

Key themes we expect to see in the governance sphere this year:

More effective stakeholder engagement	A regulatory focus on auditor independence	Slow progress on diversity	More transparency from enhanced disclosures

Improved disclosure

Factors at work in improving the quality of disclosure are the bedding in of Key Audit Matters, now in place for a full reporting season, and the first reports under NZX's revised Corporate Governance Code. The Financial Markets Authority (FMA) has refocused its governance handbook on unlisted entities.

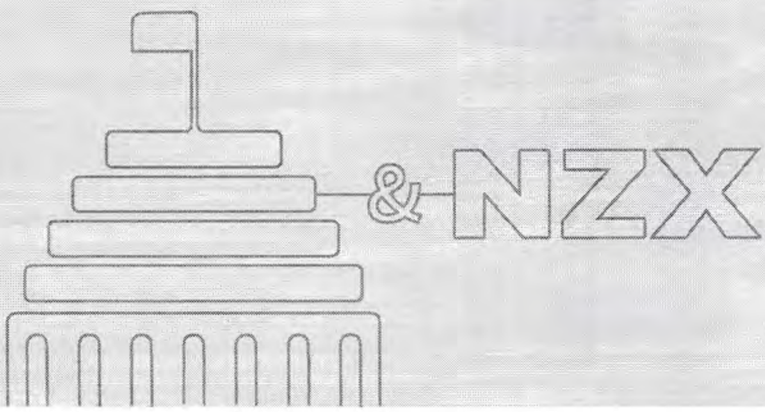
More scrutiny on the horizon

Boards will continue to be subject to high levels of scrutiny, including from the New Zealand Shareholders' Association (NZSA), institutional and retail investors, and the FMA. The Takeovers Panel has recently published updated guidance requiring better quality forecast financial information and reinforcing its expectations that directors will offer their own viewpoint when formulating a recommendation.

Governance comparisons

We have updated our data series on annual report disclosures from the top 75 NZX Main Board issuers by market capitalisation[1], and draw board composition comparisons with the portfolio of Crown commercial entities overseen by the New Zealand Treasury.

The comparison highlights some differences in approach to both board composition and the setting of executive remuneration.



1 Market capitalisation as at 31 March 2018. Overseas listed issuers and NZX Smartshares funds have been excluded.

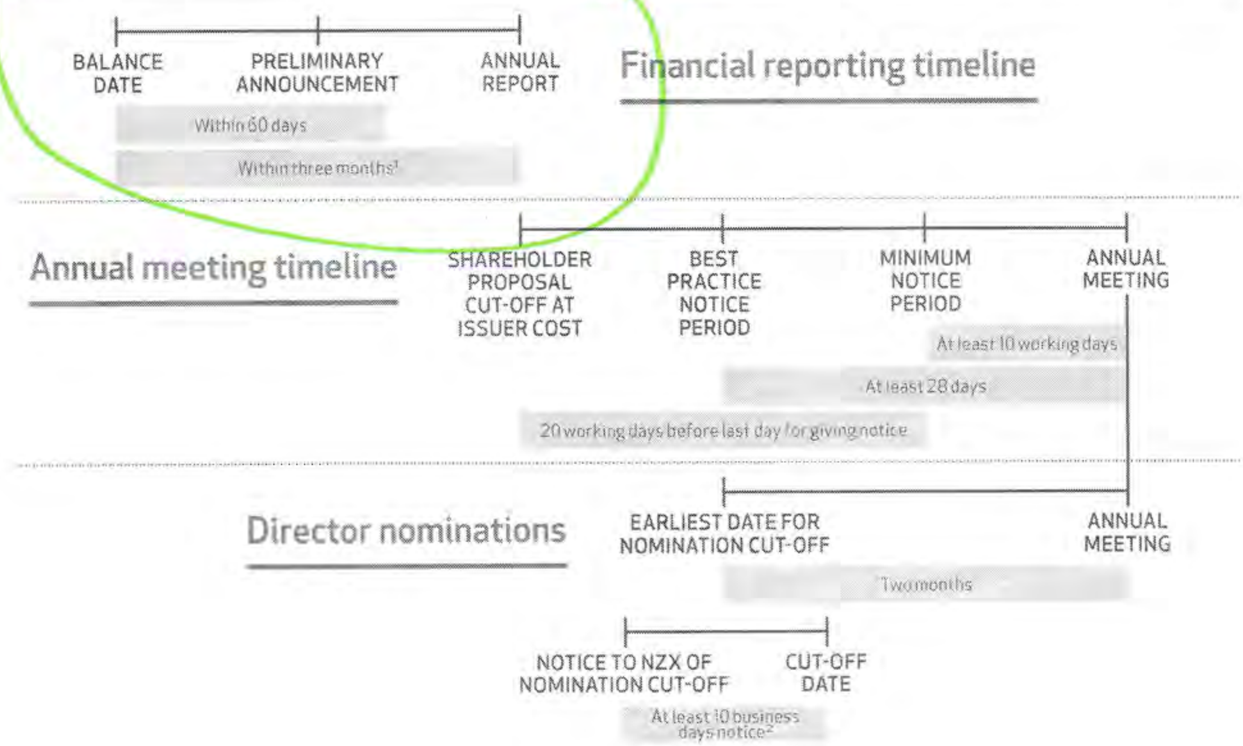
Shareholder engagement

Engagement over activism

In contrast to 2016, which delivered several high profile examples of shareholder activism, 2017 was characterised by more 'behind the scenes' engagement between boards and shareholders. We think this is overall a more constructive approach.

Our experience with institutional investors is that some do not fully appreciate the rights they have under the Companies Act and the listing rules or the timelines that apply for changes to board composition. The diagram below distils the key timeframes for annual financial reporting to shareholders and the nomination periods for director changes at the annual meeting.

Key timeframes



Notes
1 Many of the larger companies choose to release annual reports with a preliminary announcement.
2 Although a minimum of 10 business days notice of director nomination cut-off is required, most Issuers give more.

"RULES OF ENGAGEMENT" BETWEEN SHAREHOLDERS

- Hold discussions in confidence
- Do not commit to any particular course of action as a group. Any indication of approach should reserve your right to change position
- Do not trade or tip if you have any inside information (including others' intentions)

DIRECTOR REQUIREMENTS

- At least two, or one third, independent
- At least one third rotate each year
- Rotation exception for MD (for five years) and board/ shareholder appointees
- Board appointees don't count for rotation calculation

Hybrid meetings

Five of the top ten issuers and eight of the top 75 held hybrid shareholder meetings – combining a traditional physical meeting with real-time online participation. This was slightly higher than last year, indicating a developing trend.

Timing of meetings

There continues to be a significant lag between the publication of preliminary financial results and the annual report and the holding of the annual meeting of shareholders. The average gap was 118 days after balance date. This is a slight improvement of 127 days from our analysis last year.

46% of the top 75 complied with NZX Corporate Governance Code recommendation 8.5 that shareholders should be notified of the meeting at least 28 days in advance via publication on the company website.

Proxy advisory firms

The role of proxy advisory firms continued to attract some attention. The Australasian Investor Relations Association published a *Code for engagement between listed companies and proxy advisers*, structured around five key principles:

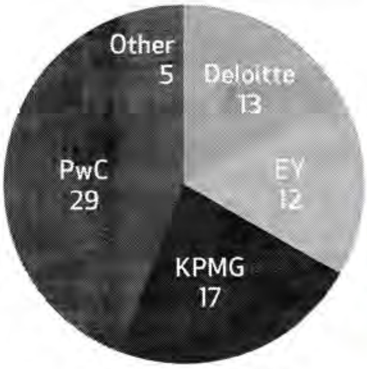
- proxy research should be factually accurate
- proxy advisory firms should be adequately resourced
- proxy advisory firms should be provided with adequate feedback
- proxy advisory firms should have a system for managing conflicts of interest, and
- proxy advisory firms should report on a regular basis.

Associated recommendations include offering the issuer a small window to review draft voting recommendations and to correct factually incorrect information.

Key audit matters and audit independence

Most prevalent year-end balance dates

Audit firms for top 75 listed issuers



KAMs – expectation gap remains

A stocktake by FMA and the External Reporting Board (*XRB*) on the first year of key audit matter (*KAM*) reporting showed a mixed response from investors about the usefulness of the initial KAM disclosure.

The average number of KAMs identified was around two, which is fewer than the three to four predicted before the regime commenced. The range was zero to five.

The purpose of KAM reporting is to alert the investor to those items the auditor judged most significant when conducting the audit.

Practice has varied on the level and particularity of the disclosure.

There is a tension between providing enough information to convey the significance of the KAM without the reader reading too much into the outcome, given the judgements that need to be applied to complex decisions.

On a more constructive note, many auditors made fulsome voluntary additional disclosure about the materiality applied to the audit and sought to use plain language focused on the needs of the user.

It will be interesting to see whether or how KAM disclosure evolves this year.

Audit independence

The FMA wants directors to play a more active role in auditor independence, particularly around selection of the firm and assessing the impact of non-audit services provided, rather than leaving that to management.

This was the key message in the FMA handbook for directors, published in December, on audit quality.

FMA's recent Corporate Governance update also has a new guideline that the chair of an audit committee should not have a longstanding association with the external audit firm, with the guidance that any employment relationship should have ceased at least three years before the appointment as chair.

> "The FMA wants directors to actively assess non-audit services provided, rather than leaving that to management."

Our thanks to Lynette Humphrey for helping with research, and Patricia Herbert for helping to write this publication.

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Every effort has been made to ensure accuracy in this publication. However, the items are necessarily generalised and readers are urged to seek specific advice on particular matters and not rely solely on this text.

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