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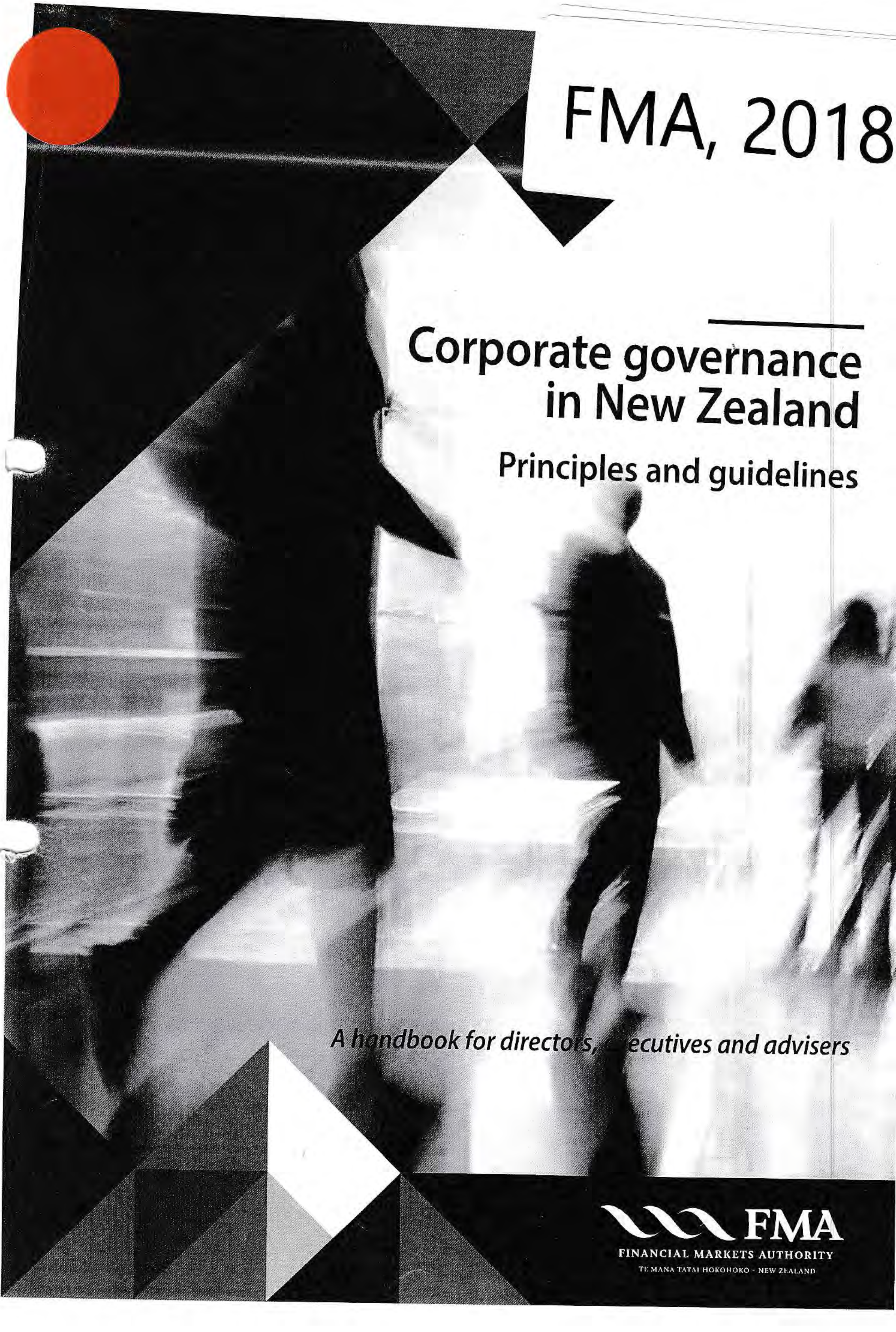
Corporate governance in New Zealand

Principles and guidelines



A handbook for directors, executives and advisers

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

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Principles for corporate governance

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.

2 Board composition and performance

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

3 Board committees

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

4 Reporting and disclosure

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

5 Remuneration

The remuneration of directors and executives should be transparent, fair and reasonable.

6 Risk management

Directors should have a sound understanding of the key risks faced by the business, and should regularly verify there are appropriate processes to identify and manage these.

7 Auditors

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

8 Shareholder relations and stakeholder interests

The board should respect the rights of shareholders, and foster constructive relationships with shareholders and stakeholders. Shareholders should be encouraged to engage with the entity.

Introduction

This handbook assists directors, executives and advisers of non-listed and public-sector companies, and other entities, to apply corporate governance principles to their particular entity.

Corporate governance comprises the principles, practices and processes that determine how a company or other entity is directed and controlled. Good corporate governance supports investor confidence. It contributes to our role of regulating capital and financial markets in New Zealand. It is also critical to our overall purpose of promoting and facilitating fair, efficient and transparent financial markets.

How an entity approaches corporate governance will depend on the nature and purpose of the entity's business, operating environment and stakeholders. We recognise that a 'one-size-fits-all' approach is not appropriate for every type of entity. This handbook is intended to assist those in governance roles for New Zealand non-listed and public-sector companies and other entities ('companies and entities') to think about, apply and report on corporate governance.

Good corporate governance allows directors and executives to focus on growth, value creation and long-term sustainability.

Who should read this handbook?

Broadly, the principles can be useful to all companies and other types of entities. We are most keen to see the principles considered by entities with an involvement in New Zealand's financial markets. This may include:

- companies wanting to raise capital and/or list on the NZX in the future
- companies providing financial services
- issuers of unlisted securities
- state-owned enterprises
- community trusts
- public-sector entities
- Māori and iwi-owned entities
- large non-government organisations
- not-for-profit organisations and charities
- other companies.

Refining our focus

We last published this handbook in 2014. That version provided advice for listed and unlisted companies.

In 2017, the NZX published an updated corporate governance code (the NZX Code) for companies listed on their licensed markets. This was based on our 2014 handbook.

We now view the updated NZX Code as the primary guidance on corporate governance practices for NZX-listed companies. Therefore we have refocused our handbook on non-listed companies and entities, many of which have a significant impact on New Zealand's financial markets.

We want to provide their directors and executives with a practical guide to applying corporate governance principles.

We will continue to engage with the NZX and listed companies to ensure corporate governance standards continue to rise. We will also continue to take appropriate action where we find examples of poor governance.

Additional governance obligations apply to the boards of issuers of debt securities, managers of managed investment schemes and their supervisors under the Financial Markets Conduct Act ('FMC Act'). This handbook may be useful to these groups as they review their governance frameworks against their FMC Act obligations.

Our approach

Principles

The principles do not impose any new legal obligations, and reporting against them is voluntary. However, the principles do set out standards for corporate governance that we believe directors and executives should apply, and report on, to their investors, shareholders and stakeholders.

The principles are in no particular order of priority. Principles 1 to 7 deal with how directors should govern. Principle 8 deals with the board's relationship with shareholders and other stakeholders. The handbook focuses on principles rather than checklists or rules.

Not all principles will wholly apply to all entities. Directors and executives should consider the nature and needs of their businesses when they consider the relevance of each principle and how to apply it.

For instance, public-sector organisations do not have shareholders in the traditional sense and are subject to specific board appointment processes. However, they are accountable to one or more responsible ministers, their stakeholders and the New Zealand public. These entities should apply the principles to the fullest possible extent, except where they are subject to competing statutory or public policy requirements.

As these principles are broad and high level, we suggest boards explain to investors and stakeholders how they have applied each principle. The 'comply or explain' approach of the NZX Code is appropriate for listed companies. The 'explain' approach of this handbook is intended to cater for reporting by the broad range of entities that may use this handbook

Guidelines and commentary

This handbook also provides guidelines and commentary for each principle, as the NZX Code does.

Guidelines assist directors and executives by providing examples, and detail, of the types of rules, practices and processes that may help them explain how they apply the principles.

Our commentary provides context and other information to assist directors and executives in understanding why it is important to apply a particular principle.

Other useful publications

The Institute of Directors' Code of Practice for Directors, and The Four Pillars of Governance Best Practice contain high-level principles of governance best practice, plus practical guidance on day-to-day directorship.

The NZX Corporate Governance Code provides guidance for listed companies.

Directors and executives of companies and entities thinking of listing on the NZX in future can refer to our publication Going public, a director's guide to IPOs. This guide helps directors and executives assess whether going public is appropriate for their entity. It also outlines the process of becoming a public company.

Entities which have market services licences under the Financial Markets Conduct Act 2013 ('FMC Act') may wish to refer to our Guide to the FMA's view of conduct for further commentary on governance.

Public sector entities may wish to refer to guidance provided by the State Services Commission.

Throughout this handbook we use the term 'entity' to refer broadly to any type of company or organisation the principles apply to.

Principle 8

Shareholder relations and stakeholder interests

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

Guidelines

We encourage entities to:

8.1 Publish clear policies for shareholder relations to the extent relevant to their shareholding structure. Policies should clearly communicate the goals, strategies and performance of the entity. Such policies should include a regular review of practices.

8.2 Publish up-to-date information, online or in another easy-to-access format, providing:

- a comprehensive description of its business and structure
- commentary on its goals, strategies and performance
- key corporate governance documents
- separate information that shows how it has followed the principles in this handbook (if not in the annual report).

8.3 Encourage shareholders to take part in annual and special meetings. Shareholders will be more inclined to attend meetings if they are easy for them to get to and held at a convenient time. Information about the meetings' agendas should be clear and meaningful to shareholders.

8.4 Recognise it is in shareholders' interests to take account of the interests of other stakeholders, (eg customers, employees, the public, the government, and anyone else affected by the business).

8.5 Take account of stakeholder interests by, for example:

- having clear policies for the entity's relationships with significant stakeholders, bearing in mind distinctions between public, private and Crown ownership
- regularly assess compliance with these policies to ensure conduct towards stakeholders complies with its code of ethics and the law
- check conduct towards stakeholders aligns with current accepted social, environmental, and ethical norms.

FMA commentary

Shareholders are the ultimate owners of companies. In general, company shareholders have a right to vote on certain issues which affect the control and direction of their company. In this handbook we use the term 'shareholders' broadly to include people with an ownership interest in non-company entities where they have similar voting rights. The rationale for good shareholder relations applies equally, whatever the legal form of the entity.

The role of shareholders in corporate governance

As owners, shareholders have important rights and functions in corporate governance. Certain matters are reserved for shareholder approval and boards can facilitate appropriate shareholder involvement. If relations with shareholders are cooperative, entities will be better placed to attract the capital and support they need, and to demonstrate real accountability.

Good governance requires effective communication between an entity and its shareholders. A policy for communicating with shareholders and encouraging shareholder participation can assist. This can include:

- being responsive to shareholders' questions and ways to make information more accessible to shareholders and others
- giving shareholders sufficient time and detail to participate in decisions
- clearly setting out resolutions for shareholder decisions, and encouraging informed use of proxies
- providing ready access to auditors for shareholder questions at annual and special meetings
- allocating time and resources to providing clear, plain-language explanations of performance, strategies and goals, and identified material risks in their annual report and (if applicable) half-year reports
- actively maintaining websites with:
  - comprehensive, up-to-date information about operations and structures
  - key corporate governance documents
  - shareholder reports
  - current and past announcements
  - performance data.

Institutional shareholders play a vital role in monitoring company performance. Those with voting power in an entity need to make use of their rights to question and challenge the board's performance and corporate governance practices. Boards can increase accountability by encouraging all shareholders to vote on resolutions.

Stakeholder interests in corporate governance

An entity's business activities can impact a wide range of stakeholders. This could include: employees, customers, creditors, suppliers, and the wider community. Legal obligations and relevant social, ethical, and environmental factors need to be taken into account when considering the interests of stakeholders.

Good corporate governance and benefits to stakeholders

Company law requires directors to act in the best interests of the company (subject to certain exceptions). Advancing the interests of other stakeholders, such as employees and customers, will often further the interests of an entity and its shareholders.

Good corporate governance practices will benefit stakeholders and shareholders. Relationships with significant stakeholders can be improved if addressed in specific policies that are disclosed and reported to stakeholders. Managing stakeholder interests should be viewed as good business and can have positive long-term impacts on society and the environment. It ensures entities maintain their social licence to operate.

Stakeholder interests in public-sector entities

Stakeholder interests are particularly significant for public-sector entities. As they receive government funding, they need to pay careful attention to their public stakeholders.

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