Global Governance Voice

CSIA
Corporate Secretaries
International Association

ISSUE 5 • MARCH 2017

Diligent

Leaders Run Diligent

More than 140,000 leaders across approximately 4,700 organisations in 70 countries use Diligent Boards™, making it the most successful and most popular board portal solution in the world.

Many of the world's leading, most efficient and security-minded organisations run their board meetings on Diligent Boards, the world's No. 1 board communication and collaboration tool.

Join the Leaders. Get Diligent

FIND OUT MORE

▶ +971 4 4214835 ▶ info@diligent.com ▶ diligent.com

Download on the App Store · Get it from Microsoft · AICPA SOC · ISO 27001 CERTIFIED BY BRIGHTLINE

CONTENTS

Full Members

Affiliate Members

Mar 2017

The Global Governance Voice, the magazine of the Corporate Secretaries International Association (CSIA), is published on behalf of the CSIA by Ninehills Media Ltd and is sent to member countries and globally to selected senior executives in the public and private sectors. Views expressed are not necessarily the views of the CSIA or Ninehills Media Ltd.

Production by:
Ninehills Media Limited
Level 12, Infinitus Plaza,
199 Des Voeux Road,
Sheung Wan, Hong Kong
Tel: (852) 3796 3060
Fax: (852) 3020 7442
Email: enquiries@ninehillsmedia.com
Website: www.ninehillsmedia.com

Advertising sales enquiries:
Email: enquiries@ninehillsmedia.com

Artwork & Layout:
Portia Le

Cover images
Sean Pavone

For all enquiries:
The Corporate Secretaries International Association (CSIA)
Paul Davis
Email: paul@ninehillsmedia.com

PO Box No 5647, General Post Office,
Hong Kong
Internet: www.csiaorg.com

PRESIDENT'S MESSAGE

Greeting to you all and belated good wishes for 2017. I hope that you will enjoy this edition of GGV Magazine and that you find the articles published, to your liking.

On 27th and 28th October 2016 the Annual Council Meeting of CSIA was held in Bangkok, Thailand. The meeting was well attended and 10 out of the 11 full council member countries were represented.

The Thai people were in mourning as the Monarch who had ruled the country for 70 years had died recently. He was a much revered person and will be sadly missed by the nation as he was committed to the well being of the people.

Our thanks go to Pensri Suteerasarn, the President of the Thai Listed Company Association- one of our affiliate member countries- and her team for the planning and arrangements which were necessary in ensuring that the meeting ran smoothly and that all our needs were taken care of.

Paul Davis of Ninehills was our link and he worked very closely with TCLA and our thanks go to him as well, for his efforts. We were also able to meet and interact with the other organisations in Thailand involved in Corporate Governance.

A vote of thanks was given to Peter Turnbull of the Governance Institute of Australia for the tireless work that he has done for CSIA, including his time as President of the Association over the years. Peter has stepped down as the Australian representative and has been replaced by Alan Evans.

This edition once again brings together thoughts from around the Globe.

What do we want this magazine to achieve?

It is our desire for this magazine to continue to publish papers based on activities from member countries as well as informing readers of the problems facing the world as regards the implementation of Corporate Governance structures.

Once countries can show that they are determined to get a grip on corruption and take stern measures against the perpetrators they will be able to offer a safe investment platform for Foreign Investors who would be assured that their investment would be safe. Local investors would also be willing to invest their resources at home. The well being of the local people would improve as employment would increase and the country would prosper.

This cannot succeed if countries only offer lip service. This is where CSIA can offer something special. We have the skills amongst our members to help implement structures to enable countries to go that step further and ensure that corporate governance happens.

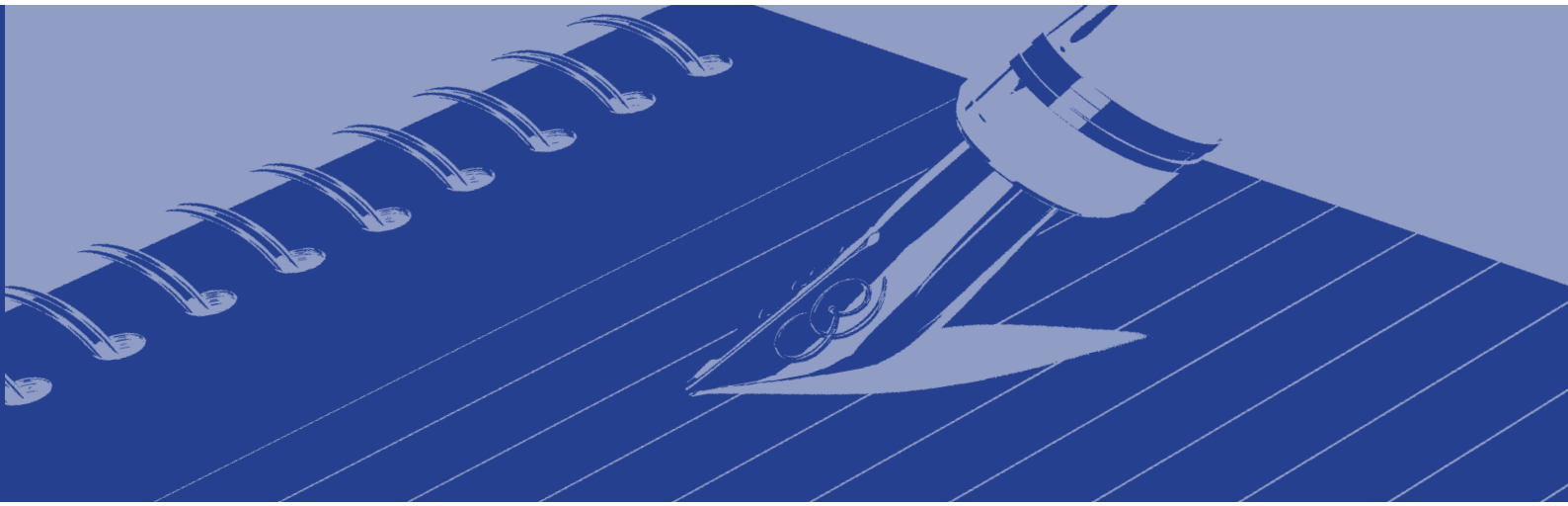
A reminder of our Vision: "To be the Global voice of Corporate Secretaries and Governance professionals."

Our Mission is to "Enhance recognition and visibility of the Corporate Secretary and Governance Professionals by the business world, regulators, governments and NGO's such as WTO, UN, IFC, OCED and similar organisations".

What is our purpose?

Two thoughts:

To promote the professional status of suitably qualified corporate secretaries and governance professionals to the public, government, regulators, the business community and international organisations.



To establish and maintain throughout the world, good relations and exchanges between similar organisations which promote the practice of secretaryship and good governance which will enable and encourage the establishment of common aims and objectives.

We have a unique opportunity at the Council meeting in Johannesburg, South Africa on 15th and 16th March 2017 to firmly put CSIA back in its rightful place as a leader in promoting the role of Corporate Secretaries and Governance Professionals.

I say this because all 11 full members of CSIA and the recently appointed part time CEO are attending. We are looking forward to working with her and I am sure that you will find the write up on her in this edition of interest.

We intend drawing up a comprehensive Strategic Plan which will see us through to the end of 2018.

We need to inject dynamism into this association to enable us to grow.

One of the major challenges faced in identifying new members has been the absence of the corporate secretary profession in many countries. It is therefore difficult to get a country which does not have the corporate secretary profession to become a member. We hope to make inroads in this area.

In closing I wish to thank all those member countries who have contributed articles for the magazine to date and look forward to your continued support going forward.

Rick Summers
President, CSIA

2016 CSIA Annual General Meeting

The CSIA annual general meeting was held on Thursday 27 and Friday 28 October 2016 at the Centara Hotel and the Stock Exchange of Thailand offices in Bangkok, hosted by the Corporate Secretary Club of the Thai Listed Companies Association (TLCA).

With delegates attending from Australia, Hong Kong, India, Kenya, Malaysia, Nigeria, Singapore, Southern Africa, United Kingdom and Zimbabwe, the meeting addressed matters of key importance to corporate secretarial professionals around the world.

CSIA member delegates were keen to air their opinions on all matters with the overriding goal to further build and develop CSIA to help achieve its objectives. The diversity of views was refreshing with members happy to share their own experiences from their diverse range of situations. From jurisdictions with long-established governance practices to those where the profession is relatively nascent – all views and comments were welcomed and appreciated.

A common theme for all attendees was the challenges and opportunities presented by continually evolving nature of corporate governance legislation, practices and the corporate secretarial profession itself.

Such sharing of diverse opinions is one of the cornerstones for CSIA's continued success and growth. Understanding of the different pressures faced within individual countries and the ability to learn from successes and failures of organisations in the same field allowed all members to benefit from other's experiences and so help their own development.

Topics

The meeting took an overview of all matters pertinent to CSIA including the standard yearly progress reports, financial reviews and budgeting discussions. Key topics that generated the most lively debates centred around the CSIA's future including:

- Membership sustainability and growth
- WTO and ILO representation and developments
- Enhancing the use of the Corporate Secretary's Toolkit
- Strategic plan for the coming year and a look to longer-term future goals and initiatives
- How CSIA can help to improve governance leadership in a wider range of countries
- Thought leadership initiatives and development of good practise guides
- Enhancement of the CSIA website to provide users with more updated and useful content

The final topic under discussion related to the re-domiciling of CSIA from Switzerland to Hong Kong scheduled for mid-2017. The timing of this change lead to a deferment of elections for new office bearers and an agreement to hold these during a meeting to be held in Johannesburg, South Africa in March.

All members left the meeting with substantial to-do lists and a reaffirmation to work together through CSIA to promote the best practices in Corporate Secretarial, corporate governance, and compliance services.

Thanks

Rick Summers, the CSIA President, would like to extend his thanks on behalf of all CSIA attendees to Penri Suteerasarn and her team at TLCA for their arrangements in making this a wonderful visit to Bangkok. This thanks is especially heart-felt as the meeting was held at a time of great sadness and national mourning for the people of Thailand following the passing of King Bhumibol Adulyadej.

IOD Event

On Thursday evening, CSIA member attended a dinner presentation hosted by the Thai Institute of Directors. During the event Carina Wessels presented the results and advice provided in the thought leadership paper "Ten Practical Guidelines to Improving Board Communication".

Despite the heavy rain the evening was well received by over 90 attendees with particular praise reserved for the quality of the speakers and the usefulness of the information provided. Thanks especially to Carina for representing CSIA, Siriporn Vaniyananda of the Thai IOD for arranging the event and Diligent Corporation for their support.

Roundtable Meeting

On Thursday afternoon CSIA delegates decamped from the AGM to join a roundtable discussion held at the Thai Securities and Exchange Commission offices. Moderated by Pernsi Suteerasarn, President of TLCA, attendees also included representatives from the Securities and Exchange Commission, Institute of Directors and the Stock Exchange of Thailand.

The roundtable enabled CSIA members to share their experience and knowledge around three main subjects of: corporate governance trends; shareholder communications; and board responsibilities.

Of particular interest for all attendees was the progress made towards the implementation of the new Thai Corporate Governance Code. CSIA members were able to provide valuable insight for the implementation of the new code based on experience of similar governance developments in their respective countries.

Corporate Governance – Board Evaluation

Peter Ling
Partner, Peter Ling & Van Geyzel, Advocates & Solicitors

The heightened focus on corporate governance by the Securities Commission, Bursa Malaysia Securities Berhad, and investors has made periodic evaluation of members of a board of directors increasingly important. A robust program of evaluation of individual board members, as well as that of the whole board of directors and committees of the board, can assist in protecting shareholders against board entrenchment and, when combined with training and continuing education can play a critical role in assisting in the ongoing improvement of performance by individual board members and the entire board.

What does an evaluation process look like in the case of individual board members?

1. What is being measured?

Typically, the evaluation is intended to measure "board competencies." These are the range of characteristics the board members are supposed to possess. Evaluation can happen in the process of selecting a board member or in considering whether or not to re-nominate the board member. Think of the competencies as a checklist for the perfect director.

The sought after "competencies" will vary from company to company but here are some examples:

- Basic knowledge (examples are knowledge of a specific industry, the company, and its executive team; knowledge of risks specific to the company or its industry; knowledge of board responsibilities);
- Technical and analytical skills (examples are financial and accounting expertise, transactional savvy, and demonstrated individual decision making);
- "Soft" inter-personal skills (examples are contributions to group decision making, tolerance of opposing positions, professionalism, and communication skills);
- Professional reputation; and
- Diversity enhancement (adding women).

2. Who is doing the evaluation?

Typically, there is either a specific corporate governance committee or a committee charged with the nomination or re-nomination of board members. This function is sometimes wholly or partially "farmed out" by the responsible committee to independent consultants.

A problem with a large board of directors is that it is difficult to tell in a large setting whether or not a particular director has defective performance. That means the intelligence gathering about a director's performance has to be distributed so that the evaluating committee learns facts from (a) other individual board members, (b) the chair or members of committees on which the board member serves (because in that smaller group, defective performance is more noticeable), or (c) the member himself through self evaluation. (Self evaluation is typically used to identify areas of training that a director identifies as being useful to him.)

Understandably, directors are often reluctant to disclose defective performance of their peers. This no doubt results from among other things the personal relationships of the directors, fear of retaliation and a general desire not to get involved. The company must emphasize that the first duty that it is owed by a director is the duty to the company and not to fellow directors. Perhaps this can be further ameliorated by emphasizing positive aspects of identifying personal development opportunities for directors themselves.

Clearly, in the case of "minor"problems with a given director's performance, counseling among board members may be done without necessarily raising the perceived problem to the level of the committee.

3. Keeping track of evaluations.

A sensitive subject is whether or not and how the committee keeps track of evaluations. There is not one written test that can effectively measure director capability and performance. The hard data points (e.g. attendance at meetings and committee meetings) are few and, as a result, board members often rely on questionnaires that frame possible issues but leave the opportunity for open-ended responses. One fear is that written evaluations might be fodder for lawyers in the event of litigation or dispute. Although the nomination of directors is not protected by the myriad of laws relating to employment discrimination, this boundary can be blurred where a director works for the company.

Another fear is that putting evaluation materials in writing tends to concretize matters which are probably less defined. For example, a committee chair might want to inform a committee member that he was disappointed with his preparation for or contribution to a meeting without necessarily creating a writing which overly emphasizes the problem.

Another issue is the problem of intellectual honesty. Directors must have the courage to stand behind their criticism of other directors, as painful as this may be. Otherwise, the director being criticized may believe that he is being singled out unfairly for personal or other reasons not related to his performance.

4. Additional considerations.

One issue about which directors should be educated (which makes the evaluation process easier) is the concept that their service is for the benefit of the company and not themselves. This emphasizes that the directorship is not a lifetime sinecure. Directorship is based on the needs of the company. So, for example, a director may have perfectly fine performance but if the company at that time requires a different skill set, the director may not be re-nominated.

Typically, other techniques are used to "refresh"boards of directors. These include term limits, mandatory retirement at certain ages, changes in job responsibility.

5. The "ecosystem"of training providers and opportunities.

Orientation and continuing education of directors is mandatory under Bursa Malaysia's listing requirements. These factors together with the perceived enhancement of director performance that results has engendered a robust "ecosystem"of training providers for boards and individual directors.

Conclusion

There is no doubt board and board member evaluation and training will continue to play an important role in corporate governance. Lawyers will be helpful advisors to their clients if they can help the company navigate its way through this landscape.etimes different objectives of management and the board.

This article was first published in the October- December 2016 edition of the Corporate Vo!ce, the official journal of The Malaysian Institute of Chartered Secretaries and Administrators (MAICSA). Reprinted with permission.

Culture Truth and Human Bias

Yvonne Willich
Psychologist, Leadership Development, Robyn Worthington,
Partner, KordaMentha

The single most important foundation of positive culture is an organisation's appetite for truth.

However, even in successful organisations with respected leaders, negative information is gradually filtered out as it rises through levels of the hierarchy. This happens without artifice or deceit. It is the result of human bias.

Good intentions

In spite of recent criticism, it is our experience that the great majority of senior people running Australia's financial services organisations genuinely intend to conduct a responsible and ethical business. We have observed they seek advice on how to achieve this and they put processes and policies in place to guide and monitor conduct. Often they are motivated by a commitment to ethical practices. They may also have a desire to continuously evolve and innovate through capturing information about process failures and mistaken judgments as a way to strengthen and improve business performance.

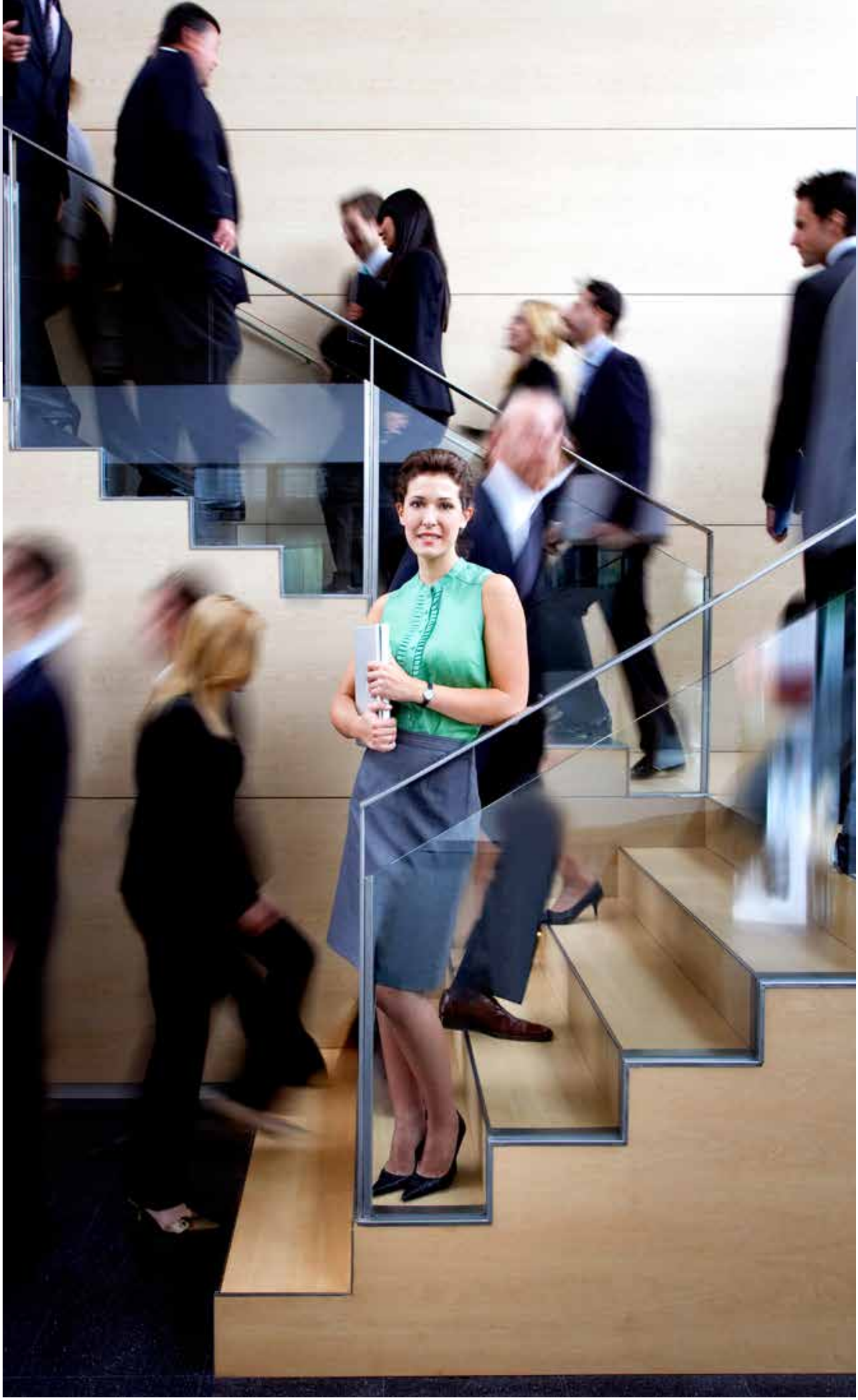
However, even with the best of intentions, the information which leaders are given by their staff and which they use to evaluate the culture and conduct of their business is often incomplete or flawed. The starting point tends to be idealistic — articulating the standard for which the organisation and, by implication, its leaders, wish to be known. This is often defined by best practice. It is exciting and inspiring. The brand value, the commercial benefits and the simple satisfaction of being a good corporate citizen are very attractive elements. It's satisfying to agree processes and measures to monitor culture and conduct as it speaks to a sense of accountability. Leaders become emotionally invested in the vision they have designed and may make public declarations of being held accountable. A corporate launch is considered essential to get team members 'on board' and collateral is produced to ensure everyone understands and commits to the defined culture. Policies and processes are reviewed to support the vision. The means to measure progress is established.

The launch or refresh of a commitment to a responsible and ethical business culture is viewed as a positive and highly visible way to signal what's important to the organisation. The collection of quantitative data to measure progress is seen as evidence of the commitment. It's in the data collection and tracking of progress that information, often unconsciously, is filtered to tell a story of success, of the aspiration for the culture being realised.

Bias to please and confirmation bias

Within the context of these organisational norms and pressures other factors come into play which are more from natural human bias than any attempt to mislead. People display a bias to please — to provide positive information to leaders they want to impress. Where there is an articulated goal to conduct business responsibly, staff provide evidence of the actions which are being taken to do this. Ironically, the more integrity a leader has the more staff will selectively seek validation of the good work which is being achieved.

Quantitative and qualitative data is collected and judgments may need to be made as to relevance and weighting to be given to the various data sets. In the process of making those judgments there is a very human tendency to select data points which evidence the positive. This validates the effort, commitment and resources allocated to the selected strategy. It confirms the capability of leaders and makes the followers feel secure. This is not to say that uniformly positive data is always selected. There is acceptance, even celebration, of some negative data which can be used to verify the 'from' and 'to' elements of the vision. Small amounts of contrary data can be highlighted as a discussion point but overall the tendency is to confirm the desired progress. Factors affecting judgments about which data is relevant include an awareness of the views of leaders and a wish to validate those. Individuals and teams tend to favour that data which confirms their preferred proposition and may selectively ignore opposing data. In these circumstances even ambiguous data may be framed in a positive way. This confirmation bias leads humans to selectively pay more attention to information which confirms the views and attitudes we hold about our world. If we have a positive view of our organisation and its controls and a negative view of external regulators we see events and information in accordance with those constructs. Without consciously manipulating the information available to us, we value confirmatory data as more significant and often fail to give contradictory information sufficient weight or attention.



Another very human aspect of being part of a group which has committed to an ideal and has worked hard to achieve that also comes into play. The employee or team which can present a convincing story supported by selected information may be celebrated and rewarded. Within this environment the bias to self-interest has an opportunity to flourish. What appears to be objective may actually be an individual or group unconsciously editing data sets to promote a sense of progress. The rewards may range from recognition by leaders to monetary benefits. To reside, however briefly, in the glow of your leader's approval can be very compelling. Team based rewards can positively compound those feelings. There is also the implied benefit of longer term rewards such as individual career progression, external awards and even an enhanced public profile.

The JFK effect

Organisational recognition systems acknowledge achievements consistent with the stated cultural values. Rarely do such systems reward the team member who challenges and exposes confronting issues. It goes against the grain to be the person who says 'we are not doing as well as you think we are in this important area.' This has sometimes been termed the JFK effect after the famous American President. History tells us that many bad decisions (such as the Bay of Pigs) were made by well-intentioned, charismatic leaders who were not called out by their senior advisers in spite of their private doubts about the strategy. As a situation progresses it becomes increasingly difficult to be the first person to question something which is viewed as successful by a wonderful boss. The lone voice who challenges with contrary data may be considered a 'naysayer' and sidelined by their colleagues. It takes a courageous and different mindset to deliberately seek evidence of your team's short comings, to share that evidence and to embark on a process of remediation.

In practice the challenge of admitting failure, acknowledging data which does not accord with success and openly sharing details of less than stellar performance is too confronting for many leaders and presents a very real possibility of derailing their careers. The risks involved can be seen as significant, for them and for the teams they lead. Conversely the rewards for aligning behaviour and information with the current corporate perspective and strategy can be significant. Teams naturally form an alliance with the leadership perspective.

The role of internal audit and human resources

Organisations, particularly large organisations and financial institutions, have teams of people whose job it is to provide independent advice and assurance to leadership. Their scope extends across any of the organisations policies, processes and programmes of work. Internal audit and human resources are examples. They should act as the counterpoint to the many human tendencies which find expression in the corporate environment. They are privy to much wider and deeper data than most teams and must take care not to use this information to advantage themselves and their team within the organisational politics. Often they achieve this but sometimes they do not. Whether those teams operate effectively to provide a truly balanced and objective perspective varies greatly.

Human resources (HR), for example, has access to an extensive amount of data, both qualitative and quantitative, which can assist in understanding and managing organisational culture and practices. For this to work effectively the HR function must both be, and be seen to be, objective, balanced and effective. All too often HR is itself a participant in the organisational politics, sometimes for good but sometimes motivated by the imperative to demonstrate its own effectiveness in supporting leadership initiatives. Other ostensibly independent control functions such as internal audit have a core role in seeking out the truth and keeping the organisation on course. In fulfilling this role they can garner information about corporate activities and performance and present it in a damning way without providing context or by simply choosing to take an impractical and extreme perspective. This may occur under the guise of an appetite for truth but prove very damaging in selectively ignoring contextural data. These functions have a critical role in demonstrating the organisations true appetite for truth — whether the rhetoric meets the reality.

Determining a culturally healthy organisation

We know that a key determinant of a healthy organisation is how much confidence the staff have in processes that influence culture and in the leaders and teams responsible for those processes. For example, staff confidence in the integrity and independence of those who deal with complaints provides valuable insights into the operations of teams charged with pursuit of the truth in the organisation.

We find it useful to ask people at every level of the organisation which leaders they trust, and we've done this with companies that have as many as 7,000 employees. We generally get the names of about 20 leaders who are widely perceived to be behaving with integrity, and these are not always the most senior executives.

Under the pressure of external scrutiny bias can shift in ways which are really unhelpful culturally and which have material consequences for an organisation. The bias to selfinterest can quickly shift to one of self-protection when challenged by regulator scrutiny, creating a defensive attitude within the team. They may become suspicious and controlling in sharing information rather than providing full 'warts and all' disclosure. In an uncertain or hostile environment, self-protection overrides higher level thinking. It is likely that the current negative targeting of financial institutions will increase this defensive behaviour rather than increase honest self-examination. We were informed earlier this year of a senior banking official who suggested his team 'vote 5 to stay alive' in response to an internal survey on staff engagement.

What can you do?

So what does this mean for organisations who have an appetite for the truth? Firstly, recognising that bias will play out in a variety of ways — whether it be bias to please, confirmation bias or self-interest. Understanding this human behaviour and routinely looking at data through the lens of challenge and enquiry through questions — What data was not included? Does that data have relevance or support alternative perspectives? Have those perspectives been tested or simply disregarded?

Internal control processes, managed by functions such as risk, human resources, internal audit should be subject to the same level of scrutiny as other operational functions they are charged with judging and assessing.

Acknowledging that organisations, like individuals, have blind spots and committing to an explicit strategy to reveal those blind spots is important. This may involve an examination of culture and conduct which should be undertaken with the goal of increasing awareness rather than as an imperative to meet the demands of an external agent or regulator. The result will be better quality information less likely to be tainted by selfprotection and defensiveness. The criteria and frameworks deployed in assessing culture and conduct should be independently validated and statistically robust. Internal processes of review should be augmented with selective external review to capture that information which is overlooked as a result of the human biases which are ever present.

The appetite for truth which characterises the culture of truly great organisations requires ongoing nurturing, regular challenge from within and a willingness to engage with external perspectives which may reveal unacknowledged and material aspects of organisational behaviour which threaten performance, brand and shareholder value.

- Human biases for delivering and receiving positive reports can result in a skewed selection of data points which can be incomplete or flawed.

- Independent control functions such as internal audit have a core role in seeking out the truth and keeping the organisation on course.

- Internal processes of review should be augmented with selective external review to capture that information which is overlooked as a result of the human biases which are ever present.

The Governance Institute's Latest Guidance Examines the Crucial, yet often Under-valued, Task of Minute Taking

The Policy Team at ICSA: The Governance Institute

Taking minutes of meetings is administrative good practice. It creates a record of what has been agreed, why and by whom; and of what is to be done, by when and by whom.

It is therefore crucial that minutes are of the highest quality. Yet for such a basic aspect of the administration of organisations of all kinds, it is surprising that there is relatively little formal guidance about how the minutes of meetings might be most effectively taken.

Reviewing our guidance

As part of a general update of our guidance for members, ICSA: The Governance Institute has been looking at this area. During our review, we were struck by the changes in practice that have developed over recent years. In particular, the way in which these essentially internal records are increasingly subject to external scrutiny.

For example, the recent Treasury Select Committee review of the report into the failure of HBOS plc noted that, 'board and committee minutes were frequently not sufficiently full to provide a definitive record of what happened, and in some cases are missing altogether'.

We sought to understand these changes through questions to a focus group at our annual conference and through a public consultation, issued in May 2016, to support our development of revised guidance.

We have been delighted by the response. More than 100 people attended our conference breakout session and we received 89 responses to our consultation. Working through all the responses to 31 questions has taken us some time and but we feel the results are worth the effort.

No right way

It is an enormous tribute to the importance of good governance that so many people, from so many sectors, were prepared to spend time contributing their views.

The insight that we have gained from them is really helpful, particularly in highlighting the similarities and contrasts between minuting in companies, especially financial services companies, and, for example, NHS entities.

Respondents to our consultation covered an enormous range of subjects and showed a similar range of practices, to which some of them are, clearly, fiercely committed. Some respondents favoured a highly prescriptive style of guidance and asked us to develop standard forms of language, although a number of others wanted to be left to minute as they see fit.

There is no 'right way' to draft minutes and this guidance should always be seen as principles based, offering suggestions that may be tailored to each organisation, rather than as prescriptive.

We do, however, believe that it is important that those who are unfamiliar with the minuting of meetings should have guidance about how issues that they may face could be addressed, what the risks of certain practices are and that they are warned of some of the pitfalls that they may encounter. That is the purpose of this guidance.

Top 20 lessons

Here are some of the highlights – what we regard as the top 20 lessons you have given us:

1. The purpose of minutes is to provide an accurate, impartial and balanced internal record of the business transacted at a meeting.

2. Good minuting is a deceptively difficult and time consuming task which is often under-valued, notably by directors and senior executives who are not board members. More than one respondent to our consultation described it as an art. It is far more than an administrative formality.

3. It can take at least as long, often twice as long, to draft minutes as the meeting itself took.

4. There is no one-size-fits-all approach for minute writing and no 'right way' to draft minutes. Context is always important and each chairman and board will have their own preference for minuting style. It is up to each individual organisation to decide how best its meetings should be recorded.

5. The degree of detail recorded will depend to a large extent on the needs of the organisation, the sector in which it operates, the requirements of any regulator and the working practices of the chairman, the board and the company secretary. As a minimum, however, we would expect minutes to include the key points of discussion, decisions made and, where appropriate, the reasons for them and agreed actions, including a record of any delegated authority to act on behalf of the company. The minutes should be clear, concise and free from any ambiguity as they will serve as a source of contemporaneous evidence in any judicial or regulatory proceedings.

6. Minutes may also be used to demonstrate that the directors have fulfilled their statutory duties, in particular by evidencing appropriate challenge in order to hold the executive to account and by showing that issues of risk and both shareholder and stakeholder impact have been properly considered. Minutes should facilitate regulatory oversight, but this is not their primary purpose. Nonetheless, those drafting minutes should be mindful of regulatory needs. The well-written minutes of an effective board meeting should convey all the assurance that a regulator needs.

7. The company secretary is responsible to the chairman for the preparation and retention of minutes; the chairman and the other members of the board are responsible for confirming their accuracy.

8. Organisations should always employ a properly qualified individual to take minutes of board meetings; one who has the necessary skills. Too often minuting a meeting is left (at short notice) to a junior member of staff without the appropriate experience or training. Key skills of a good minute taker include being able to:
    - Listen to multiple voices at the same time and capture both their arguments and tone
    - Summarise an argument accurately and record decisions taken and action points on which to follow up
    - Identify which parts of the discussion are material and should be recorded
    - Have the confidence to ask for clarification of any point from the chairman or another director during the meeting (and they should always do so if they are not clear what the final decision is)
    - Have the confidence to stand firm when someone asks them to deviate from what they believe to be an accurate record.

9. Wherever possible, the company secretary should be supported at the meeting by a suitably skilled minute taker if one is available.

10. It is generally a good idea for the company secretary to discuss with the chairman before the meeting any relevant procedural issues and, perhaps most importantly, how they can best support the chairman.

11. It may be helpful to develop a minute-taking policy or style guide to set the house style and conventions. This could be approved by the board.

12. Minutes are normally written in 'reported speech' style in a past tense; they should not be a verbatim record of the meeting.

13. Minutes should document the reasons for the decision and include sufficient background information for future reference – or, perhaps, for someone not at the meeting to understand why the board has taken the decision that it has. In simple terms, they should record what was done, not what was said but with sufficient context to give assurance that it was done properly.

14. Individual contributions should not normally be attributed by name, but this will be appropriate in some cases.

15. If board papers are received for noting and no decision is required then, unless there is material discussion that needs to be recorded, minutes should indicate that the relevant report was 'received (or reviewed, if that is what happened) and its contents noted'.

16. Draft minutes should be clearly marked as such and amendments to the draft minutes should be thought of as 'enhancements' rather than 'corrections'.

17. The audio recording of board meetings or the publication of board minutes is not, generally, recommended. Any such recording should be deleted once the minutes have been approved.

18. Great care should be taken with the company secretary's notes of the meeting, both in terms of content and retention. We recommend that they are destroyed once the minutes to which they relate have been approved.

19. Minutes, as a board responsibility, should be included as part of the board evaluation process.

20. The ICSA guidance includes detailed discussion of the usual preliminary information, including quorum and the treatment of conflicts of interest; the style of writing; when it might be appropriate to name individuals; dealing with dissent in the minutes; and the level of detail appropriate in minutes. It also addresses the approval of minutes; the treatment of post-meeting developments; and to whom.

Minute taking can be seen as a necessary yet thankless task, but as one respondent to our consultation asked: how many other people in an organisation get their work in front of the board as frequently and consistently as company secretaries?

Our new guidance, together with a feedback statement detailing the responses to the questions that we asked in our consultation, was published on 19 September and is available on the website.

Beyond the Disconnect

Kieran Colvert
Editor, *CSj*

The theory is relatively simple – the owners of a business appoint directors to manage the undertaking on their behalf and the directors report to the owners regularly based on their stewardship. That, according to Professor Bob Tricker, author of a new HKICS research report on shareholder communications in Hong Kong, was the way things were originally conceived at the time the first limited liability companies opened for business back in the mid-19th century.

Of course, things have become somewhat more complicated over the intervening 160 years. Large corporate groups bear little resemblance to those early limited liability companies, with their management and operations in a single jurisdiction and answering to cohesive and stable group of shareholders. Public listed companies are typically large, complex groups with several layers of subsidiaries and associated companies around the world, and owned by a diverse group of shareholders encompassing a range from long-term investors to short-term speculators – often with conflicting expectations of the dialogue they would like to have with the company.

These trends did and do not favour the maintenance of that close and regular dialogue between companies and shareholders envisaged at the birth of limited liability company. Up until the last decade, companies increasingly lost touch with their shareholders and often lacked a comprehensive knowledge of who those shareholders were, and what concerns they may have about the governance and other aspects of the company.

Was that such a bad thing? In recent years, increasing numbers of market participants are answering that question with a resounding yes. For starters, there are some fairly obvious advantages to having a loyal and long-term

shareholder base – for example, this translates into a lower cost of capital and less share price volatility. On the risk side, in this social media age discontent among shareholders can very rapidly escalate into a reputational apocalypse for the company.

There is, however, another reason which reaches back to the original concept of how the dialogue between companies and their owners would work – well-informed and actively engaged shareholders can provide a constructive challenge to the way companies are run. Shareholders are supposed to be an integral part of the system of independent checks and balances which form the basis of corporate governance. Indeed, they have been written into many disclosure-based regulatory regimes around the world, such as the one in Hong Kong, since such a regime only works if investors read, understand and act on the mandatory disclosures.

The new HKICS report

In recent years, there has been a movement to recapture that original concept of the company/shareholder relationship. Shareholder engagement has risen up the agenda for listed issuers, shareholders and regulators over the last decade, focusing on the need for companies to be responsive to investors' concerns and to facilitate the engagement process, and for investors to take their ownership responsibilities seriously.

In this context, the HKICS has published a new research report: *Shareholder communications for listed issuers – five imperatives to break the monologue*. The report, available on the HKICS website: www.hkics.org.hk, highlights the strategic advantages of better shareholder communications. 'Effective communication leads to satisfied investors, interested potential investors, and enhanced corporate value. But if investor relations are not handled well the market knows, a company's reputation suffers, and corporate value is lost,' the report states.

Highlights

- The new HKICS report will be of interest to all parties hoping to understand the level of importance given to shareholder communications by both listed companies and investors in Hong Kong
- The report finds that shareholder communications tend to be reactively driven by rules and regulation, rather than proactively driven by a choice to communicate and engage with shareholders
- The report argues in favour of a switch of emphasis away from ever increasing disclosure requirements and towards the need for an effective dialogue with investors

The report also highlights the greater opportunities for a close and interactive dialogue with shareholders provided by technology. 'Historically, communication with shareholders has used print. However in recent years, opportunities for communication have, clearly, expanded dramatically. No longer reliant on the printed word alone, companies have access to the internet, using corporate websites, dedicated investor relations websites, the stock exchange website, email, and social media, such as Facebook and Twitter,' the report states.

Given the benefits of good shareholder relations and the greater technological opportunities for an interactive dialogue with shareholders, why does the disconnect between companies and their owners persist? The survey on which the new *Shareholder communications report* is based, for example, found that a third of respondent companies did not know who their shareholders were and did not regularly or routinely monitor their shareholder base. As the report points out – 'if you do not know your audience or what they want, how can you frame your message?'

As mentioned at the beginning of this article, changes in the business environment have resulted in some significant obstacles to a better dialogue – the diversity of shareholder groups with potentially conflicting agendas and the difficulty of identifying beneficial shareholders, for example. The HKICS report points to another reason, however, for the disconnect. The survey results indicate that, for many listed companies, shareholder communications is treated as a matter of compliance rather than a strategic advantage. 'It is reactively driven by rules and regulation, rather than proactively driven by a choice to communicate and engage with shareholders,' the report states.

The report assesses the implications of these results, but also attempts to provide a way forward for improving shareholder communications in Hong Kong. The good news is that the obstacles to better engagement are not insurmountable, and the report makes specific recommendations on the way forward for listed issuers and shareholders – the two parties to the dialogue – but also for regulators whose role can have a significant influence on achieving better outcomes.

Recommendations

For listed issuers

The message for the main audience of the HKICS report – listed companies in Hong Kong – is the need to address 'five imperatives' as a way to improve shareholder communications. These are to:

1. Develop an investor relations strategy within the corporate strategy
2. Know and regularly review your shareholder base
3. Formulate and regularly review shareholder communications policies
4. Formulate and regularly review shareholder engagement policies, and
5. Review the responsibility and accountability for investor relations.

For shareholders

The new HKICS report makes it clear that a shareholder relationship, like any relationship, can only function through the efforts of both sides. 'Thus, shareholders need to express their needs and expectations regarding investor relations to listed companies, to provide feedback, positive and negative, on the information they receive,' the report states. The report also makes the point that investors should have access to a sufficiently senior level in the company. These approaches are consistent with the Securities and Futures Commission's (SFC) voluntary *Principles of Responsible Ownership*.

The *Principles*, published in March 2016, seek to promote greater understanding among investors of their share ownership responsibilities. The growing presence of institutional investors in the Hong Kong market has meant a growing investor lobby with the incentives and resources to monitor their investee companies' performance, decisions and corporate actions. The SFC sees its new investor code as complementary to the existing legal framework for promoting corporate governance, which has historically been focused on corporate and directors' obligations.

For regulators

The new HKICS report has been well received by regulators in Hong Kong. The benefits for the market as a whole of improving shareholder communications has not been lost on both the SFC and the stock exchange. The survey findings on which the report is based will therefore be of interest to all parties hoping to understand the level of importance given to shareholder communications by both listed companies and investors. Moreover, given the apparent shortcomings in the underlying commitment by a sizeable proportion of listed companies to shareholder communications, the report argues in favour of a switch of emphasis away from ever increasing disclosure requirements and towards the need for an effective dialogue with investors.

'[Regulators] might consider less emphasis, perhaps a pause, on regulating the volume and scope of reporting, and place greater weight on quality, requiring listed companies to explain how they realise their commitment to shareholder communications. This would include listed companies specifically reporting on their performance and progress in regards to the five imperatives suggested above,' the report states.

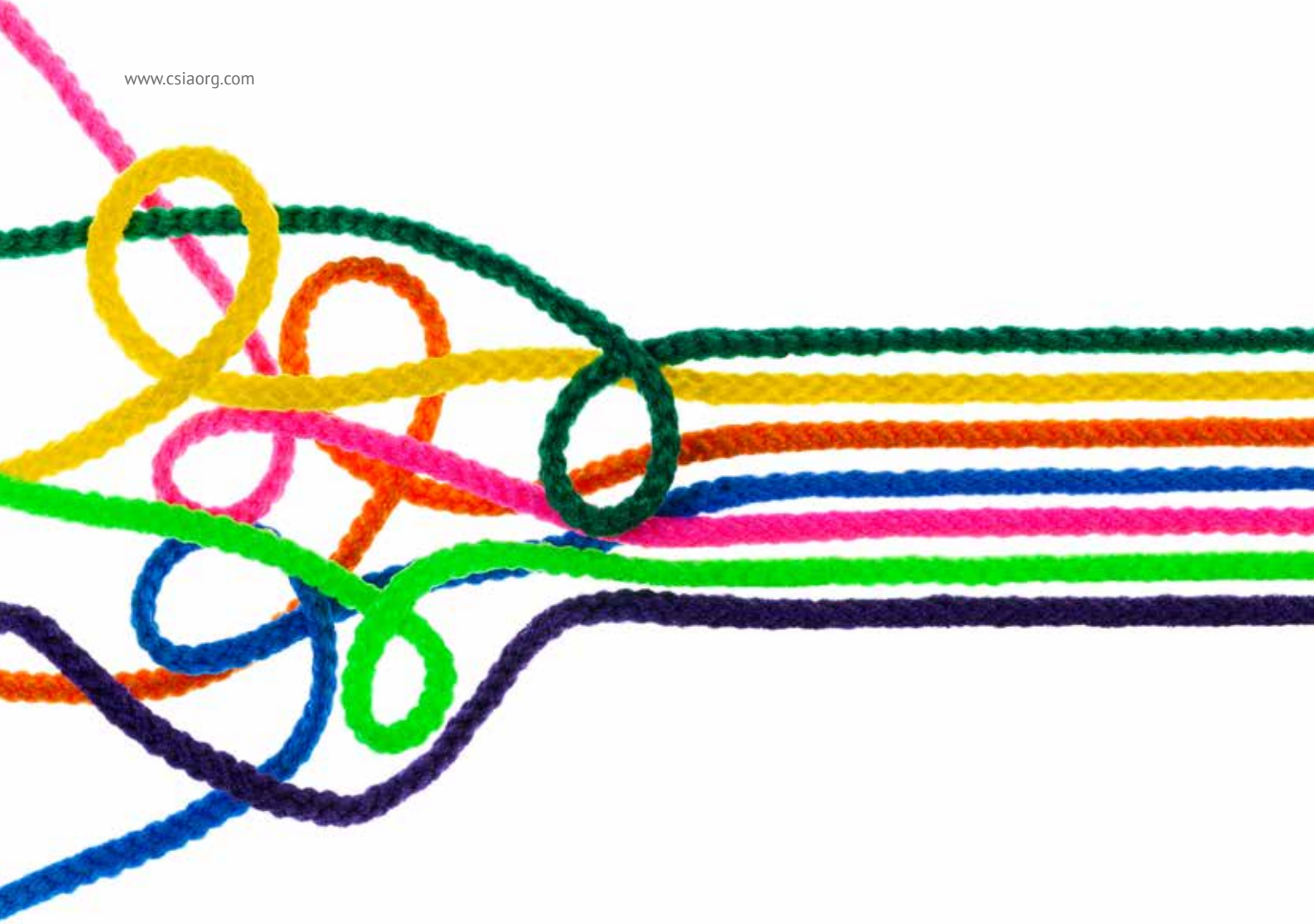
The 'Shareholder communications for listed issuers – five imperatives to break the monologue' report is available on the HKICS website: www.hkics.org.hk.

Online resources

The Hong Kong Institute of Chartered Secretaries (www.hkics.org.hk)
In addition to the newly published '*Shareholder communications*' research report reviewed in this article, the HKICS published two guidance notes – *Investor Relations Part I and Investor Relations Part II* – in March 2009 and June 2009 respectively. Readers can also consult the '10-point guide to the company secretary's role in shareholder engagement' authored by Philip Armstrong, Senior Advisor, Corporate Governance, International Finance Corporation, published in the June 2015 edition of *CSj* (see pages 18-19).

The Corporate Secretaries International Association (www.csia.org)
In 2015, CSIA published its guidance on international best practice in shareholder engagement for corporate secretaries – *Shareholder Engagement: Practical Steps for Corporate Secretaries*.

The Hong Kong Securities and Futures Commission (www.sfc.org)
The SFC recently published Hong Kong's first investor's stewardship code – *Principles of Responsible Ownership*.



Diversity without Inclusion will not Achieve Positive Results

Tawanda Matembo

Diversity is about differences. The differences may be differences of race, ethnicity, gender, sexual orientation, socio-economic status, age, physical abilities, religious beliefs, political beliefs or ideologies.

In the workplace, diversity means the inclusion of individuals representing more than one national origin, colour, religion and socio-economic stratum.

Diversity in leadership is the inclusion of people of different races, genders, ages, ethnicities and cultures in the various leadership roles and at various levels within an organisation. A diverse workplace is one with a fair mix of race, gender, age, ethnicity, education, socio-economic groups and abilities. Diversity on its own, without inclusion, will not achieve positive results.

Inclusion is involving, valuing, respecting and supporting everyone. It is about focusing on the needs of every individual and ensuring the right conditions are in place for each person to achieve his or her full potential.

Inclusion should be reflected in an organisation's culture, practices and the relationships that are in place to support a diverse workforce.

Verna Myers, an internationally recognised expert on diversity and inclusion, likened diversity to being invited to the party and inclusion as being asked to dance. In simple terms, diversity is the mix; inclusion is getting the mix to work well together.

Diversity in leadership should therefore go beyond merely giving leadership positions to diverse people. Leaders should create welcoming and supportive work environments for everyone.

Without inclusion, diversity will create a hostile environment where minority groups are treated like outsiders who are tolerated but not really welcomed or wanted. Diversity and inclusion should therefore work hand in hand to achieve sustainable results for organisations.

Diversity builds strong teams – a collection of individuals with different experiences, backgrounds and cultures who can view challenges through a wide variety of lenses. The scope and complexity of the global environment, the impact of connectivity technologies and the overarching importance of collaboration in today's society require diversity in leadership.

According to some research, companies with diverse executive boards enjoy significantly higher earnings and returns on equity. There is a general consensus among leading global business leaders that diversity adds value to business growth. Harvard Business Review interviewed 24 chief executives from around the globe who run companies and corporate divisions that have earned reputations for embracing people from all kinds of backgrounds.

These executives represented a wide range of industries and regions, as well as different stages on the journey to creating an inclusive culture. They spoke forcefully about diversity as an advantage.

Paul Block, of the United States sweetener manufacturer Merisant, said: "People with different lifestyles and different backgrounds challenge each other more. Diversity creates dissent and you need that. Without it, you are not going to get any deep inquiry or breakthroughs."

Jonathan Broomberg of the South African insurer Discovery Health said, "Diversity is a source of creativity and innovation."

Brian Moynihan of the Bank of America saw an important link with customer satisfaction. "When internal diversity and inclusion scores are strong and employees feel valued, they will serve customers better and will be better off as an organisation," he said.

A diverse workforce also prevents an organisation from becoming too insular and out of touch with its increasingly heterogeneous customer base. Many of the CEOs asserted that it is crucial for a company's employees to reflect the people they serve. There is an important link between internal diversity, inclusion and customer satisfaction.

A culture of diversity in leadership is founded on inclusivity. An inclusive culture has been defined as one in which employees can contribute to the success of the company as their authentic selves, while the organisation respects and leverages their talents and gives them a sense of connectedness.

In an inclusive culture employees know that, irrespective of gender, race, creed and physical ability, they can fulfil their personal objectives by aligning them with the company's, have a rich career and be valued as an individual. "You are valued for how you contribute to the business," said David Thodey of Telstra, the Australian telecommunications firm.

The essence of diversity in leadership is the creation of a culture of inclusivity. The following practices, identified by leading global business leaders, help to build inclusivity.

- Measure diversity and inclusion. The business leaders agreed that metrics are key, because, as we know, what gets measured gets done.
- Hold managers accountable. Make diversity and inclusion goals part of the managers' performance objectives. Management reports should include things that help promote diversity.
- Recruit and promote from diverse pools of candidates. Workforce diversity begins with the search for talent. Inclusivity should be effected at the recruitment level.
- Provide leadership development. Another key practice is providing leadership development opportunities for women at the lower levels of the organisation, which tend to be more diverse. Recruitment and leadership education of young women is a sure way to build a more robust pipeline of upwardly mobile women.
- Offer quality role models. Diversity at the top promotes diversity throughout an organisation. A varied array of leaders signals an organisational commitment to diversity. It also provides emerging leaders with role models they can identify with.
- Continuous organisational renewal. Always provide graduate trainee programmes.

Our companies have to embrace diversity in leadership. Simply having a diverse leadership team and workforce without their full participation will not add value. Everyone should feel valued, accepted, respected, connected and encouraged to fully participate.

This article is based on a presentation by CBZ Retail Banking Divisional Director Tawanda Matembo at the 2016 ICSAZ Annual Conference.

Reprinted from Issue 4/2016 of "The Chartered Secretary", the official magazine of the Institute of Chartered Secretaries and Administrators in Zimbabwe.

On The Art of Boardroom Decision-making

Victor Prozesky
Managing Director, The Board Practice

Carina Wessels
Group Company, Secretary & Legal of Exxaro Resources Limited and Past President CSIA

The primary role of a board of Directors is to make decisions. Whether it is deciding on or approving strategy, endorsing the validity of financial statements, authorising an investment or signing off on the performance evaluation of the CEO, the board is continuously busy studying, debating and deciding on major organisational issues. It is also in this respect that the board must take full accountability for the sustainability of the organisation, which is largely a result of the combined results of decisions taken over a period.

It is a common misconception that the quality of decisions made by boards is determined by the quality of the debate and the time allocated to the discussion at a particular meeting. Even though these are extremely important and indeed necessary, it is not in itself sufficient. The factors determining whether any specific decision was the best in any particular situation are often influenced much more by actions prior to, and after, the actual debate and decision.

Some of these factors are self-evident, while others are quite surprising and often not explicitly considered by boards:

Board skills set

Not enough boards undergo a formal process of determining what critical skills, and what combination thereof, are required in the board to enable and realise the organisation's strategy. Even fewer boards thereafter ensure that the board composition continuously and proactively adapts as the organisation evolves over time. Director succession is often prompted by other prerogatives such as diversity, or an incumbent stepping off the board, with an aim to replace the departing Director. A better approach for the board is to formally analyse the strategic intent of the organisation and develop a matrix of technical and behavioural competencies required by the board to function effectively and to achieve these strategic goals. The next step is to formally review the displayed competencies of the incumbent members and thus identify the best profile(s) to close the gap between reality and goal as far as possible. A balanced board is one where each critical competence is strongly represented by at least one member, with some backup; not one where essential competencies are only understood at basic level by several members. Generalists may add value to the board, but not all members can be generalists. Very few boards want to increase size to fully achieve a balance: in our view there are only two ways to achieve such within this constraint. The first is to actively source members that can fill identified gaps by selecting new members very carefully when vacancies occur and, the second, to ensure continuous development of the competencies of current members.

A similar argument is valid for the composition of committees. While competencies for some committees are regulated or prescribed, the board should aim to align the demands of the strategic intent closely to other requirements when selecting committee members.

Balancing the work of committees with that of the board

The use of committees to do the bulk of the work of the board is well established world-wide. With the volume of work continuously increasing for the board, committees have become valuable mechanisms at the disposal of the board. The risk the board runs is that committee work may be deemed as the final output from the board, neglecting the legal accountability of the full board for any decisions that may have been taken as a result of a committee recommendation. It is often found that, even though minutes of committee meetings are circulated as part of board documentation and/or verbal feedback is given by chairpersons of committees, Directors who are not on those committees are not well acquainted with the output from committees. While the board cannot redo the work done by the committees, it should establish a satisfactory balance to ensure reasonable discharge of their duties as Directors. The well-known Australian Centro case[1] is an excellent example of the continued role the board is required to play, even in situations where committees have statutory assigned responsibilities.

Quality and timing of information

The 'meeting pack' containing all the information that the board has access to, must be structured appropriately and delivered to the board members well in advance of the actual meeting. Directors often complain that the material contained are too voluminous and can either contain more digested information, or it should be restructured. As an example, the pack may contain a host of financial information through which a Director must work in order to understand the implications. It may be more useful to have a summary of the meaning of that information, while moving the information itself to an annexure. This will mean that the Director receives an analysis of the information, while still having access to the information itself.

Boards should also refrain from accepting late submissions for discussion, as these may compromise due process and adequate consideration. Naturally there are cases where urgent and critical issues need to be decided without delay, but boards should be careful that such items are indeed of such nature.

Options supporting resolutions

The most frequent scenario in which the board makes decisions is where management proposes something to be authorised by the board. To be clear as to the exact request for approval, the proposal is often already articulated in the form of a resolution that can simply be endorsed (or rejected) by the board. It however does not always contain the full thinking behind the proposal. Even less frequently the proposal will contain all the options that management considered and the reasoning behind selecting a particular option, and why others were not pursued. The board not only has the right to such information, but knowing the full rationale behind a particular proposal will allow improved understanding of context and better decision-making by the board.

In addition, surprisingly, proposals from management are often not clearly linked to the strategic dashboard in order to easily establish how well aligned a proposal is to the strategic imperatives. Some boards require management to complete a 'scorecard' on such strategic alignment: if a proposal scores below a certain minimum it is not allowed to be tabled.

[1] Australian Securities and Investments Commission v Healey [2011] FCA 717 (27 June 2011) http://www.austlii.edu.au/au/cases/cth/FCA/2011/717.html

More discussion rather than presentation

While it is important for management to ensure that the board understands the context of the proposals, it is at least as important for the board to allow itself adequate time to debate and discuss the proposal. The full proposal should be in the meeting pack and the proposer should only introduce the issue, with little or no presentation. The board should consider all information as read and understood prior to the meeting, and only allow questions by board members to gain full understanding to, ultimately, be able to decide on the issue. No board can afford a repetition of what is already available in meeting documentation. Some boards have limited presentations by management to less than 4 slides and do not accept the material already in the meeting pack to be repeated in the presentation.

Availability

Linked to the importance of the timing of the distribution of meeting documentation, is attendance by each Director. Most large company board calendars are fixed up to a year in advance, therefore only severe crises should prevent Directors from attending. The same argument is valid for the changing of meeting dates, which may result in some Directors not being available for newly scheduled meetings. Boards are, however, regularly forced to schedule extraordinary meetings resulting in some members not being able to attend. Non-attendees should however do the necessary preparation and either provide input offline prior to the meeting or as part of a video or telephone conference. While telephone and video attendance are satisfactory from a legal perspective, this is not ideal. Much of the chemistry and dynamics of a discussion may be lost, with sub-optimal input and decision-making, therefore this should be limited to exceptional circumstances.

Preparation and processing first level questions prior to meetings

Often too much time spent at meetings are dealing with superficial information such as typographic errors, semantics or non-material information. While it is important that these are taken care of, this does not enhance the debate and takes valuable time available for discussion. One way of getting around this problem is to avoid first level questions or comments at the board meeting. Members should send these questions and comments by email one or two days in advance of the meeting, so that it can be resolved before the meeting. While this may seem unduly bureaucratic, it will not only force Directors to prepare in advance, but allow the debate to focus on substantive issues. This will prevent insufficiently prepared directors to hide behind superficial issues and, to an extent, address the habit of starting to prepare on the way to the meeting.

Leave time between the discussion and decision on major issues

Time for reflection on critical decisions can enhance the outcome significantly. A good example of this is when Sir Adrian Cadbury[2] was Chairman of Cadbury plc. At the time management was proposing a major merger (not with Schweppes) and the board had heard countless arguments and presentations on the matter. When the Chairman asked for final opinions, all members were in favour of the transaction. The Chairman then did the unexpected; because of the unanimity on the board, he postponed the final decision until the next board meeting, scheduled for some days later, given the importance of the decision. At the next meeting one member stated that on reflection he had some reservations and he was joined by others. Ultimately the proposal was rejected and as time passed the board realised that it would have been a mistake if the merger had been approved.

Naturally, lack of time may not allow the postponing of a decision, but the board should allow itself time for reflection on serious matters. The agendas of board meetings are crammed with items and a balance should be sought to allow members to absorb and evaluate the full context and consequences of far-reaching decisions.

About The Board Practice

The Board Practice has broad experience in consulting at board and C-suite level, with a focus on board effectiveness evaluation, board renewal and - development programmes. The Board Practice is managed by an experienced team of experts led by Dr Victor Prozesky, one of the most experienced facilitators of board-level consulting globally.
The basic service offering is a software tool enabling clients to develop and manage their own sets of board effectiveness questionnaires online using the questionnaire generator. While questionnaires can be fully customised, the client can also use existing sets of questions and themes that are constantly updated. The tool allows tracking of progress by participants and the compiling of a detailed report on the results. An extension of the online questionnaire service is the addition of support in analysis of the information obtained in the questionnaires and the completion of a report with interpretation and basic recommendations.

The full external board effectiveness programme is focussed on the softer aspects of the effectiveness of the board, such as dynamics, relationships and culture. While compliance issues are checked, the focus is on the role of the board to future-proof the organisation.

Board renewal linked to strategy and CEO succession processes are offered as part of board level consulting services.

[2] Sir Adrian Cadbury, private conversations.

Re-arrange the agenda

Boards often tend to consider the management report and corresponding financials after the initial administrative introduction early in the meeting. It may be convenient to establish the state of the Company as a basis for further discussion, but this is, to a large extent, information that should have been processed as part of thorough preparation. It is easier to deal with historic facts (especially financial performance), whereas strategic issues and the accompanying uncertainties are much more complex and difficult to deal with. The result is often not enough time spent on the future (strategic issues), as these are normally left until other matters, including operational issues, have been dealt with. This means strategic matters are considered close to the end of the meeting, with Directors already starting to calculate the remaining time left to be on time for flights or other meetings. If the agenda is re-arranged to allow long-term issues and strategy to be dealt with early in the meeting it may also add more insight to the alignment between performance and strategy.

Behavioural roles for directors

It is surprising that, when individual members are asked what unique roles different Directors play on the board, it is difficult for them to articulate such roles. Even though it may be deemed as artificial to assign behavioural roles to individuals, it can assist the board in debating issues. Individuals naturally tend to behave in certain ways; some are nit-pickers who like to get into the detail, while others must understand the big picture scenario, etc. There are several behavioural models developed that boards can use to good effect. One in particular developed by Jerry Rhodes[3] on thinking styles has been used at board level successfully.

With their personalities in mind, the Chairman may assign particular roles in a particular situation; this may help the board to look at issues from various angles and they may be able to end up with a deeper understanding of the issues before a decision is made. In the case of individuals who generally do not contribute much, the Chairman may ask for preparation on a specific issue, resulting in an opportunity for valuable input and more even contributions from the board.

It can be beneficial for a board to have one benevolent maverick as member. A maverick will not allow group-think to dominate the decision-making process and tends to ask the unexpected important questions that can shed new light on meaning and context. It is important for such a maverick not to negatively affect the board as team, hence non-conforming behaviour should only be displayed when necessary and, ultimately, such a member should add to the process of moving towards consensus rather than disruption merely for disruption's sake.

Track decisions and decision time-lines

A board should concern itself with the future of the organisation, while taking care of all the governance and performance issues of the present and past. In general boards are struggling to allocate enough time to the future and one way of monitoring this is to establish the time–line of the impact any decision about the future will have on the organisation. For instance, adopting key performance indicators for the CEO for the next year will have a 1-2 year impact. A substantial investment in new technology may have a 5 year impact and a merger proposal may have a 10 year impact on the organisation. Once a board keeps track of the length of the impacts of their decisions, it will quickly learn whether it really is directing the organisation towards the future.

Another aspect which few boards consider, is the real impact of past decisions made by the board. By tracking the outcomes of big decisions, and establishing the success or failure of achieving the intended outcome, based on the assumptions at the time, boards can learn to avoid mistakes in the future.

Conclusion

Board effectiveness and good decision-making are influenced and impacted by a myriad of factors and, as is the case with most things that make a real difference in success, there is no generic silver bullet that will work for all boards. Conscious application of the above factors can, however, assist boards to operate more effectively and efficiently, contributing towards the quality of their decisions and their overall performance. Each board should actively consider the above levers, and although it is argued that all can aid boards to achieve better decision-making, it is up to each board to determine how to optimise its process of decision making.

[3] www.effectiveintelligence.com.

Blockchain Basics, Commercial Impacts and Governance Challenges[1]

Tessa Hoser
Consultant, Norton Rose Fulbright Australia

Even for an era characterised by mass and instantaneous information, there is a veritable tsunami of information about blockchain and similar technologies. For boards, advisers and governance professionals it is challenging to know whether blockchain is a technology looking for an application or is really the information superhighway of the 21st century. It certainly would not seem prudent to ignore it, either in strategy setting or risk evaluation. For some businesses, blockchain could be a fundamental threat to profitability, market position or even the existence of the business itself. For others, it is a oncein- a-generation opportunity.

Very much like the internet, blockchain technology may well be the next frontier in a huge number of sectors of our economy and society.[2] It may produce profound changes in the way in which data, assets and financial value is or are held, analysed or transacted. The technology has the potential to streamline internal processes and speed up institutional and peer-to-peer transactions. The author's long-held belief[3] is that blockchain applications, if applied and regulated in a pragmatic and principles-based way, is more likely to reduce, rather than increase, risk for participants in blockchain innovation.

[1] The author wishes to acknowledge the assistance of Felicity Young, Paralegal, in the preparation of this article and the Norton Rose Fulbright global blockchain team, whose publications *Blockchain Technologies: Legal and Regulatory Guide* www.nortonrosefulbright.com/knowledge/ publications/141573/ unlocking-theblockchain- a-global-legal-and-regulatoryguide-ch1 and Smart Contracts: coding the fine print www. nortonrosefulbright.com/knowledge/ publications/137955/smartcontracts-coding-the-fine-print are partially reflected in this article. Nothing contained in this article should be taken to be or relied upon as legal advice in any jurisdiction. This is a fast-changing and highly complex area in relation to which specific advice should be sought. All errors or omission remain the responsibility of the author.

[2] Blockchain technologies 'can be applied to a wide range of industries and services, such as financial services, real estate, healthcare and identity management… Furthermore, their underlying philosophy of distributed consensus, open source, transparency and community could be highly disruptive to many of these industries'. UK Government Chief Scientific Adviser, Government Office for Science, Distributed ledger technology: Beyond block chain, 2016, p 14, www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf.

[3] The author's comments at GDCA's Forum, G20, Brisbane, 2014, including that existing regulation could be adapted to produce a workable governance framework for the digital currency community.

What is a 'blockchain'?

A blockchain is a method for storing large amounts of information relating to transactions/interactions and their history. Messages containing data, generally related to the transactions, are submitted to a network of computers for processing. The messages are submitted with the object of having the messages authenticated and verified by cryptography and consensus reached by that network on that authentication and verification.

The messages are grouped together by the software into a block of information and given a title known as the 'block header'. Block headers may be entirely public, such that all of the contents of a block can be viewed by any network or 'ledger' participant, or semi-public, being restricted so that the block container and its label can be seen (but not the contents of the block).

Software allows for the block header to be simplified or 'hashed'. Hashing is the process by which a grouping of digital data is converted into a single number. The number is like a unique digital fingerprint. The block header for a new block contains a reference to the hash for the previous block in the chain. When a later block is added, it too will include a reference to the hash for the immediate preceding block. In this way, there is a continuous chain of blocks, know as the blockchain, tracking back in time. There is also a time stamp that is applied each time a new block is created.

This process results in trust in the system itself rather than in a central authority or party that controls or verifies the information.

How does blockchain technology operate?

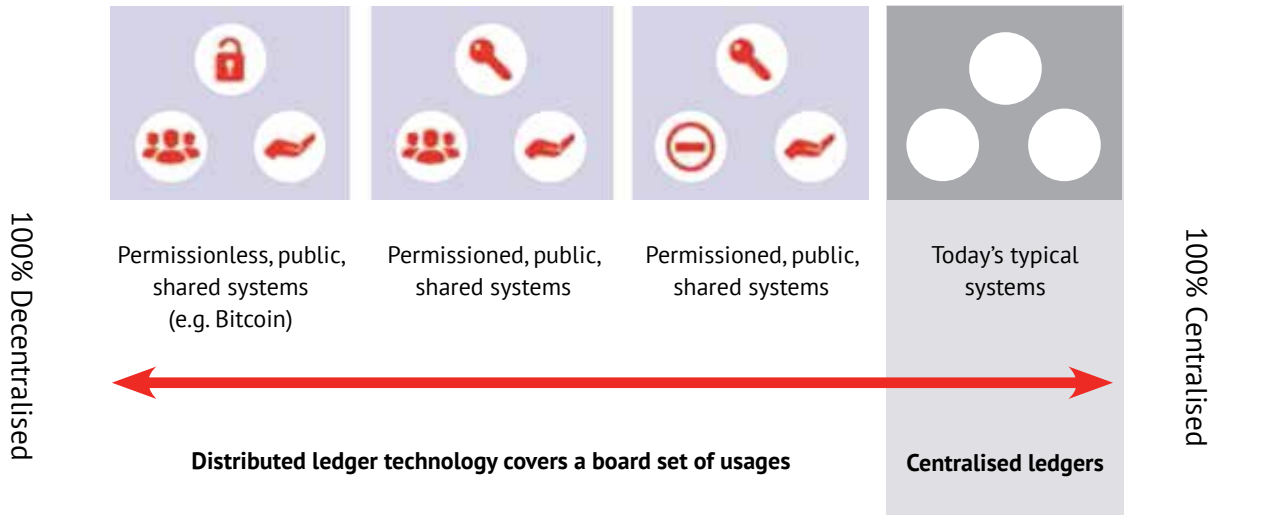
'Blockchain technology' is a term to describe software applications that utilise a blockchain. A blockchain has five key features:

1. **It is digital**: it is made up of software (coding including algorithms) and data. The software allows the data to be transmitted, processed, stored and represented in human readable form.
2. **It is a ledger**: it is a record in the form of a database representing transactions.
3. **It is distributed**: identical copies of the ledger are held across a network of computers (also known as nodes) which can be spread across a site, an organisation, a country, multiple countries, or the entire world. For this reason a blockchain is sometimes called a distributed ledger.[4]
4. **It uses a consensus model**: a computer program sets rules for how each participant in a blockchain should process transactions, and how those transactions should accept or reject the processing done by other participants. Consensus generally occurs where fifty percent or more of the nodes conclude that a message is authenticated and verified so that the message can be added as a block to a blockchain.
5. **It uses cryptography**: blockchains deploy public key infrastructure to verify that a message comes from the purported sender and to authenticate the contents of the message.

How does a typical transaction operate?

Blockchain technologies can either be permissioned or permissionless (see Figure 1). A permissionless blockchain is

Figure 1: Different ledger technologies vary in their 'degrees of centralisation'



Source: UK Government Chief Scientific Adviser, Government Office for Science, Distributed Ledger Technology: Beyond Block Chain', 2016.[5]

[4] Note that there are permissionless and permissioned distributed ledger groups.

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_datafile/492972/gs-16-1-distributed-ledger-technology.pdf.

a public ledger where anyone can download the software, submit messages for processing, and be involved in the process of authentication, verification and consensus. A permissioned (private) blockchain requires participants to be pre-selected or subject to gated entry. To verify information, a permissioned blockchain may use either a consensus model, a subgroup of participants, or an administrator.

If a person (the initiator) wanted to initiate a transaction on a public permissionless blockchain the initiator would use a unique alphanumeric number allocated to the initiator by the software. This is known as a public key. The initiator would then publish the key on the system and initiate the transaction by using the initiator's address to send an initiating message to other participants in the relevant network, encrypted with the initiator's private key. This message would be picked up by the nodes on the network. Participants on the network would verify that the transaction was initiated by the initiator and authenticate the message. When sufficient nodes reached the same conclusion, generally more than 50 per cent, the network would determine that the message should be written into a block and added to the blockchain.

Key characteristics of blockchain technology

A number of performance characteristics of blockchain technology are relevant to the analysis of the legal and regulatory treatment of blockchain transactions.

A blockchain is transparent, with each participant having a complete and traceable record of all transactions on the blockchain. There may be varying degrees of transparency and that will influence the extent of regulatory acceptability of some blockchain applications. The time stamping associated with each transaction created on a blockchain will be useful in proving the precise transaction history.

It is generally considered that it is almost impossible to alter existing data held on a blockchain. This immutability renders blockchain-held data safe relative to the data security position of current non-blockchain systems. The lack of a single point of failure on a blockchain is helpful in evaluating use of blockchain technology in data recovery and business continuity planning. The irrevocable and programmable nature of the blockchain can be both a strength and a weakness of the technology. Both of these aspects are discussed further below in relation to smart contracts.

Governance and regulatory considerations

As blockchain technologies develop, so too is the regulatory framework developing. The challenge for the industry and for regulators is that many blockchain applications are currently being developed in silos, albeit with some collaboration within those silos. Regulators are therefore largely considering the impact of this technology on the products, services or participants that fall within each regulator's mandate.

For example, the Reserve Bank of Australia, ASIC and the Commonwealth Treasury share supervisory power over clearing and settlement facilities (C&S) in Australia. The ASX, the main C&S facility provider in Australia has invested significant capital in developing blockchain technology. However, as matters currently stand it is unclear how a blockchain-backed securities settlement facility would fit within existing C&S regulations.

Amongst the various governance and regulatory issues are identity and data privacy and anti-money laundering and counter-terrorism financing (AML/CTF).

Identity and data privacy issues

Blockchains collect, store and process a large amount of data in relation to parties and their transactions. Blockchains may have the effect of 'passporting' identity information, enabling documents that satisfy the standard '100 points check' to be made available to a range of suitable authorised parties. However, the Privacy Act 1988 currently imposes obligations on persons who collect, store and transmit personal information without those obligations reflecting potential use of blockchain technology in those processes.

Anti-money laundering and counterterrorism financing (AML/CTF)

There are a number of potential issues that arise in relation to the use of blockchain technology and existing AML/CTF requirements. For example, the current definition of 'e-currency' under the AML/CTF legislation does not cover crypto or digital currencies. However, recent review of the Anti-Money Laundering and Counter—Terrorism Financing Act 2006 completed by the Attorney— General's department recommended that digital currencies be regulated under the AML/CTF Act. The report recommends that AUSTRAC, as the relevant regulator, should monitor the AML/CTF risks associated with new types of payments.

What are smart contracts and how do they operate?

To date, one of the key commercial applications of blockchain technology has been in relation to cryptocurrencies such as Bitcoin. However, a more far-reaching application of blockchain technology is so-called 'smart contracts'. A smart contract is in essence a set of transaction terms specified in a digital form (see Figure 2). The code can provide for a certain action to be performed on the occurrence of a specified event. These contracts simultaneously link the transaction terms to the action itself.

In most cases, the terms of an underlying contractual clause will be embedded as code in hardware or software. However, in other cases the code itself can constitute the terms of the agreement.

Like any new technology, there are a number of legal and regulatory issues that need to be considered before widespread implementation. In the case of smart contract, these issues include:

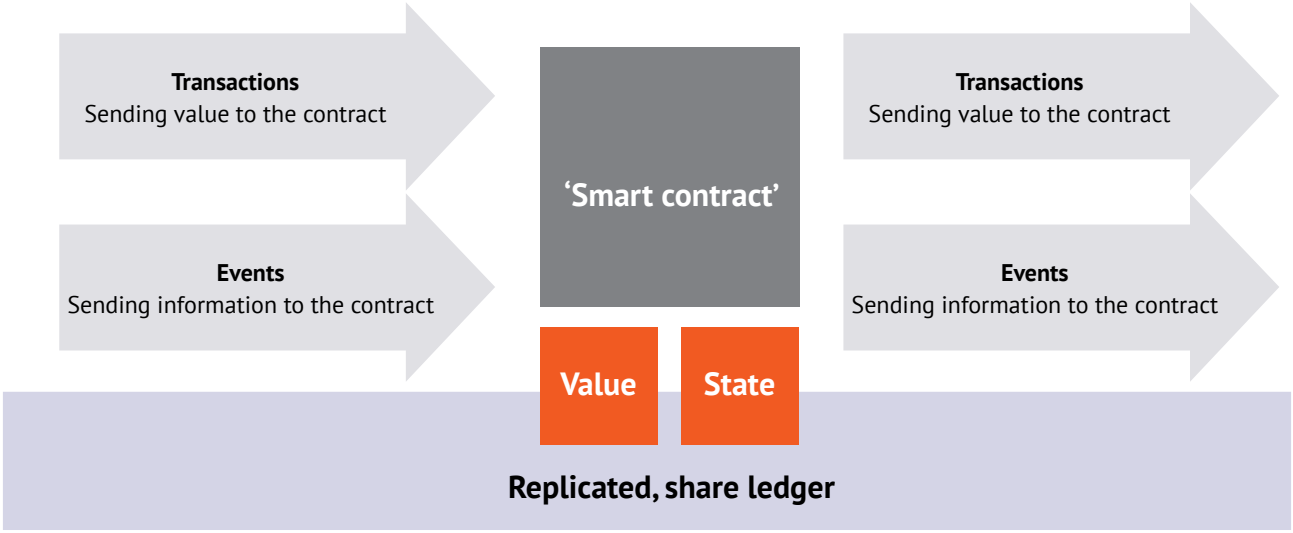
1. Whether a smart contract is legally binding?
2. How can complex terms be encoded?
3. Can legal formalities be accommodated?
4. Can smart contracts be amended?

1. Are smart contracts legally binding?

The *Electronic Transactions Act 1999* (ETA) confirms that a contract is not invalid merely because it was made by means of electronic communication. This is the case even if no natural person was involved in the contracting process. An 'automated message system', which likely includes a blockchain backed smart contract is capable of binding parties without input from a natural person. However, whether a smart contract is legally binding still involves consideration of the four essential elements required to constitute a contract: offer and acceptance, consideration; intention to create legal relations and certainty of terms.

If a smart contract is initiated at the instance of only one party, it may raise issues as to whether there has been an offer and acceptance. The ETA provides that a proposal to form a contract made electronically which is not addressed to specific persons is generally an 'invitation to treat' and not itself an offer. This means that a contract is not formed until such time as the initiating party has accepted the price offered by counterparty. However, if a smart contract is directed at one party, it will be characterised as an offer and open for acceptance by that party.

Figure 2: Model of a 'smart contract'



Source: Richard Gendal Brown, A Simple Model for Smart Contracts, 10 February 2015.[6]

[6] https://gendal.me/2015/02/10/a-simplemodel-for-smart-contracts/

The codes that underlie smart contracts are often short — 500 lines or less. This brevity increases the risk that there may not be sufficient certainty for there to be a contract in the legal sense. There may also be issues regarding the electronic execution of a smart contract and the effectiveness of that form of execution by an Australian company for the purposes of certain third-party protections under the Corporations Act 2001.[7]

2. Can complex contracts be encoded?
Business contracts are complex and sophisticated and often include a number of legal phrases, the meaning of which is open to legal analysis. Terms such as 'reasonable notice', 'material adverse change' and 'best endeavours' have a number of possible interpretations which depend on the circumstances. The variety of interpretations means that they are difficult to code for a particular 'event'.

These concerns may be alleviated by building into the code a mechanism to halt performance of the contract temporarily while input from the participant, or a third party empowered to verify a state of affairs is sought. Consider a smart contract for the delivery of goods. The code could provide for release of payment if the goods comply with a specification. The code could allow for temporary halt to allow for the certification of compliance.

While building in a temporary halt increases dependency and appears to undermine a key benefit of blockchain technology, smart contracts could still deliver value to business by coordinating the various stages of a transaction by process automation.

3. Can legal formalities be accommodated?
A number of legal formalities are imposed on parties to transactions by statutes, regulations and common law courts around the world. These include obligations in relation to the form of the document, proof of signatures, the legal persona of the parties and evidence of the contract.

Many jurisdictions require that certain information must be in writing and signed by one or more parties for it to be legally valid. Assignments of some intellectual property, guarantees, contract for the sale of land and the transfer of certified shares are often required to be in writing and physically signed. Public/private key cryptographic technology could possibly solve this problem, as the unique keys are individualised in the same way that a signature is. In blockchain technology, public/private key cryptographic technology is typically used as the basis for initiating a smart contract. In addition, it can also show the chronology by using time stamping.

The acceptance of this method is likely to require a change in the applicable regulations. The ETA and various state electronic signature laws are helpful in enabling electronic signatures to be recognised. The Australian courts have also confirmed that a customer is taken to have signed a contract electronically by completing the online process and clicking on the relevant buttons agreeing to the terms and conditions. Relevant legislation may require some amendment to enable Australian companies that enter into smart contracts to be considered to have executed those contracts in a way that allows third parties to rely on certain assumptions regarding validity.

Similarly, many jurisdictions require that a contract must be entered into by a legal person (either a human being or other legal entity) who has capacity to do so. There is also common law authority to the effect that, for a contract to arise there needs to be sufficient certainty regarding the identity of the contracting parties. Blockchain technologies are often anonymous. However, the transactions can be linked to a person by identifying features such as the public key. Concerns about adequacy of linkage may be allayed by the use of closed community or permissioned blockchains where all of the members are all identified. This could also reduce concerns about anti-money laundering regulatory compliance ('know-yourcustomer' checks).

Often, the strongest evidence that a contract exists is a written paper version of the agreement. Issues arise when there are discrepancies between a smart contract and an underlying written contract; or when the contract exists purely on the code. Offshore courts have already had to call

- Blockchain technology could present a revolution for many sectors in the economy in the way data, assets and financial value are held, analysed or transacted.

- Governance and regulatory issues that arise include identity and data privacy and anti-money laundering and counter-terrorism financing.

- A far-reaching application of blockchain technology is the 'smart contract' in which some transaction terms are specified in a digital form and those contracts are concluded automatically.

[7] Ss 127-129, *Corporations Act 2001*.

for expert evidence as to the meaning of some code. In order to avoid a dispute as to interpretation, underlying contracts could include an English or other language priority clause similar to that already commonly used in international commercial contracts.

4. Can smart contracts be amended?

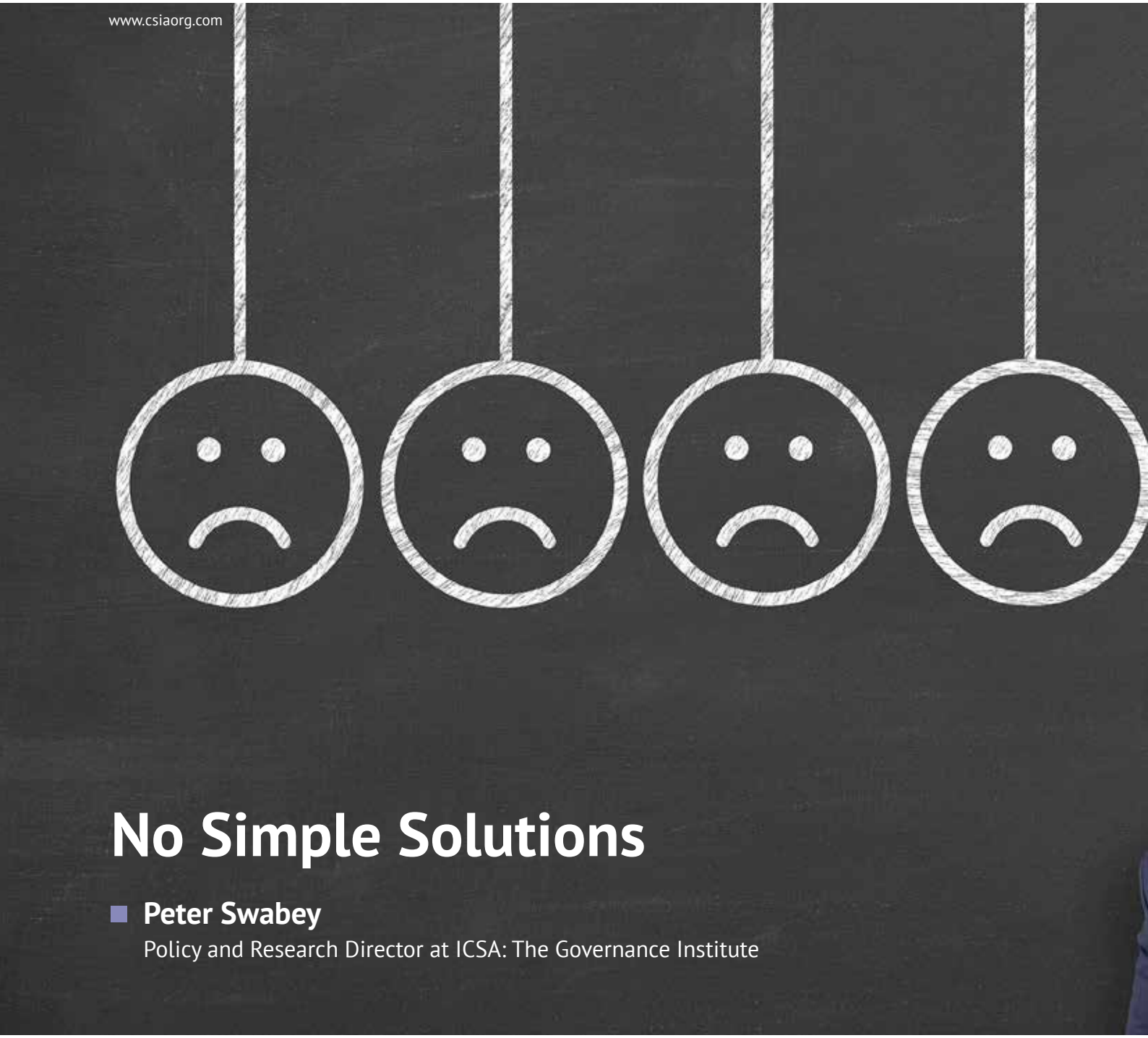
One of the main concerns with internet based technologies is cyber-security, the potential susceptibility to attack and unauthorised amendment. A key feature of blockchain technology is the irrevocability of transactions once initiated. The difficulty in forging ownership and amending previous transactions makes it a safe model for asset transfers. This design feature means, in the context of smart contracts, that once a contract is initiated, automatic performance cannot be stopped.

From a legal perspective, irrevocability of transactions can give rise to a number of different issues. Many contracts need to be brought to an end, changed or amended to reflect changes in the underlying agreement. In a smart contract, as performance is encoded as part of the functionality of the code, there is no ability to change or replace a block transaction once it has been set in motion. Technical solutions will no doubt be proposed to meet these concerns. These might include setting codes to respond to an update requirement sent by an administrator, or including provisions that contractually require a party to transfer back what has already be transferred.

For consumer contracts, compliance with disclosure, customer identification and 'cooling-off' period requirements, may prove difficult where smart contracts are used. However, standardised contracts between business participants or wholesale investors present significant opportunities for the use of smart contracts. Derivatives transactions, securities trades and settlements, supply chain and trade finance, leasing and the agri-sector are some of the potential applications of smart contracts. They could result in more transparent and streamlined recordkeeping and reporting for regulatory and risk management purposes.

Conclusion

Analysing the risks and opportunities involved in using blockchain technology is complex, not least of all because the technology and jargon are difficult to grasp. However, as terminology becomes more standardised and a greater number of commercial blockchain applications come to market, the assessment and risk mitigation challenges will become more manageable. Market participants, industry bodies and regulators will assist in this transition. What does seem to be clear, is that blockchain or other forms of distributed ledger technology are not a passing fad but will be integral to the next phase of Australian and global social and economic development.



No Simple Solutions

Peter Swabey
Policy and Research Director at ICSA: The Governance Institute

On 16 September, the Business, Energy and Industrial Strategy Committee (BEIS Committee, formerly known as the BIS Committee) announced an inquiry on corporate governance. It focuses on directors' duties, executive pay and the composition of boardrooms, including worker representation and gender balance in executive positions.

As befits ICSA: The Governance Institute, we have been giving a great deal of thought to these issues already. This article is intended to give a flavour of the response we have developed, the full text of which is available on our website.

It is easy to see the lens through which the Committee is approaching this issue – its recent inquiry into the failure of BHS – but we believe that, although there have been some high-profile failures in private companies, there is little evidence that the existing governance model for private companies is not working in the majority of cases.

Directors' duties

We believe that the statutory directors' duties, set out in sections 171-177 of the Companies Act 2006, are clear and unambiguous. These were considered in some detail when the decision was taken to codify them under the Act.

We believe that they continue to strike an appropriate balance between the rights of shareowners and the rights of other stakeholders. It is important that directors, with the proactive support of their company secretaries, are clear as to whom they owe their duties.

There may be a case for strengthening the statutory duties to have greater regard to the long term and for including a specific duty to have regard to members of defined benefit pension schemes. There may also be a case for reviewing the enforcement of directors' duties – perhaps creating a role for Government.

One important point that we have made to the Committee is that in a unitary board, all directors should have the same responsibilities. There is no legal difference between an executive director and a non-executive director, and we do not believe that there should be. Nor do we believe that a case for moving away from the unitary board model has been made.

One of the strengths of the law as currently drafted is that it is akin to the principles-based regulation that we see elsewhere in corporate governance, where it is not enough merely to comply with a set of rules; directors must also comply with their spirit.

The Committee went on to ask – again BHS may not have been far from their minds – whether there should be greater alignment between the rules governing public and private companies. We believe that there should be, but that such alignment should be proportionate. The rules applicable to companies, including those relating to the degree of scrutiny and challenge to which their boards should be open, should be dependent on their size and societal impact, rather than their choice of ownership structure.

In the majority of UK companies, managed by the owner, the need for scrutiny and challenge is fundamentally external – the need for those affected by the company's decisions to be able to challenge them. Shareholders in UK companies have more power over directors than those in many other countries, but it is a power that must be used with discretion.

Shareholders can best be assured that executive directors are subject to appropriate independent challenge by electing non-executive directors in whom they have confidence to provide supportive and constructive challenge. If shareholders do not trust those elected to the board, then they have the ability to vote against their appointment.

A sensible approach would seem to be an obligation on those unlisted or private companies and LLPs with greater societal impact to comply (or explain non-compliance) with an appropriate corporate governance code and to appoint a company secretary to support the board. In both cases, these requirements should be subject to a threshold – for example, that the company is of sufficient size to qualify for external audit or that it must comply with the new regulations regarding publication of information on the gender pay gap. In either event, we would recommend that those private companies which are subsidiaries of others, particularly of quoted companies, be exempt.

For the largest companies, especially those that are publicly quoted, there are additional significant transparency requirements that allow the directors, not only to be held to account by the owners, but, increasingly, in the court of public opinion through the activities of the press and special interest pressure groups. These parties can, and often do, challenge the activities of the company.

Executive pay

We are pleased that the Committee has, in our view, rightly focused on understanding the reasons why executive pay is excessive in some companies before seeking to recommend action. We consider there to be four principal issues driving executive pay:

- The increasing internationalisation of senior executive recruitment, creating a competitive environment which is not usually replicated at more junior levels
- Complexity of senior executive pay structures, often driven by a desire to align executive pay more closely with company performance and investor experience in the long term
- Impact of consultants, who are rarely incentivised to develop lower and simpler pay packages
- The level of disclosure which, especially with the requirement for publication of a single figure, places executives in a stronger position to compare their pay with that of their peers and, therefore, in a stronger position to demand comparability.

All that said, the central question about high pay is: who defines 'too high' and against what criteria? There is clear evidence of a public perception that there is a level of pay that is too high, regardless of performance, but it is not clear what this level is and how it is defined. In our view, there are three separate elements to this public perception and the issues surrounding them, and the steps that may be taken to address them, differ. These elements are:

- Pay is disassociated from performance – although this is closely monitored by investors who have the power to reject pay policies of which they disapprove and to indicate to boards that they do not agree with the manner in which a policy has been implemented
- There is income inequality in our society
- Some people are simply paid too much.

Both of these latter points are undoubtedly true, but are not really corporate governance issues and will not be addressed solely by a focus on executive pay in public companies. The pay of senior executives in quoted companies is visible to all, but the same cannot be said of the income of those in equivalent positions in private companies, professional firms or private equity and other investment firms, to say nothing of entertainment or sports stars or those who receive income from inherited investment.

There is a whole range of fiscal and other remedies available to Parliament and the Government to address these issues of inequality.

Given that we are still in the first cycle of pay policy implementation following the changes introduced in 2013, and there has been insufficient time to assess its impact, we are not convinced that it is yet necessary to take further action in this area.

Board composition

Finally, on board composition, we firmly believe that as talent is diverse, boards that have taken advantage of that diversity are likely to perform more effectively and so all elements of diversity should be embraced in our society. Companies' approach to the training and development of staff is crucial and companies must comply with the spirit, as well as the letter, of anti-discrimination laws.

Our report in May this year, undertaken jointly with EY, on the role of the nomination committee provided strong evidence that many of the better nomination committees are making considerable progress in this direction.

As mentioned above, we believe that the unitary board system is effective, but boards cannot function properly when each member is representing a particular constituency. For this reason, we do not support the development of a new 'class' of 'worker director', although this is not to say that employees should necessarily be excluded from board membership.

We believe that a better approach, and one more likely to address the underlying issues, might be to look at ways in which boards can get a better understanding of the views of stakeholders, in order to have greater regard to their interests.

This might include a further review of the nomination committee process to broaden the range of candidates, including employees; adding 'advisory' members to the nomination and remuneration committees; or requiring specific board members to be the primary point of liaison with particular stakeholder groups.

We think that Lord Davies' initiative to increase women on boards was effective but the momentum now needs to be maintained to increase the number of women in executive positions. We await the outcome of the Hampton-Alexander review, to which we have contributed.

However, it is crucial that the 'pipeline' issues are addressed, together with lifestyle policies to facilitate women's continued participation in the workplace. In our response to the Government Equalities Office consultation on the gender pay gap last year, we suggested what some of these policies might be:

- Encouragement for young women and those from non-traditional backgrounds to consider the broadest range of careers.
- More initiatives to support parental leave and childcare, which we believe to be at the heart of addressing the imbalance between men and women at senior levels in business.
- More support for carers, in order that older working women and those from certain cultures are able to fulfil their career potential.

These are all important issues which deserve a proper examination. They are not susceptible to simple or knee-jerk solutions and we look forward to working with the Select Committee and responding to the anticipated Government consultation on similar issues over the coming months.

This article was originally published in the November 2016 edition of Governance and Compliance magazine, www.govcompmag.com – the magazine of ICSA: The Governance Institute.

The New Malaysian Code on Take-overs and Mergers and Rules on Take-overs, Mergers and Compulsory Acquisitions — Some Selected Thoughts

Wong Tat Chung
Partner, Wong Beh & Toh

Introduction

The Code was prescribed by the Minister on 11 August 2016, superseding the Malaysian Code on Take-overs and Mergers 2010 ("the 2010 Code"). Also issued by the Securities Commission of Malaysia ("SC") shortly after this, on 15 August 2016, were the Rules.

The Code, unlike its predecessors, is relatively brief. The main provisions governing take-overs and mergers are instead found in the Rules. This approach enables easier modifications to provisions on take-overs and mergers as changes to the Code require prescription by the Minister under section 217 of the Capital Markets and Services Act 2007 ("CMSA") while only the SC has to agree to changes to the Rules under section 377 of the CMSA.

The Code, also, for the first time since the Malaysian Code on Take-overs and Mergers 1987, introduces a set of general principles to be observed and complied by persons engaged in a take-over or merger transaction. It means that the Code and the Rules should also be read taking them into account.

The Code and the Rules introduce some important changes to Malaysian regulation of take-overs and mergers. This article discusses a selection of these changes.

Scope of the Code and Rules

The Code and the Rules do not apply to all unlisted public companies, unlike under the 2010 Code. Only those with more than 50 shareholders and net assets of RM15,000,000 or more are subject to the new provisions.[1] Business trusts listed in Malaysia are also made subject to them.[2] The provisions also apply to other entities as under the 2010 Code.

Relaxation in criteria for Schemes

Schemes of arrangement, compromise, amalgamations and selective capital reductions subject to the 2010 Code could only be implemented if the offeror and persons acting in concert collectively held more than 50% of the voting shares or voting rights of the offeree[3]. An offeror and persons acting in concert holding less than this could not use a scheme of arrangement, compromise, amalgamation or selective capital reduction to effect a takeover offer. The Rules now allow use of these and similar methods without the threshold having to be satisfied.

Options and derivatives

The 2010 Code did not provide for options and derivatives amounting to an acquisition of the underlying securities. So indeed, a share would not ordinarily be considered to be an acquisition of control under the 2010 Code until an option in respect of the share was exercised or arrangements were effected in such a way that title to the shares or entitlement to exercise or control the exercise the shares was acquired. It was possible for a party to obscure or circumvent the application of the 2010 Code by way of options and derivatives.[4]

1 Rule 1.08, the Rules.

2 *Ibid*, Note 1.

3 Practice Note 44 of the 2010 Code.

4 See also, in the U.K. context, Decision of the U.K. Takeover Panel in Swiss Bank Corporation, Trafalgar House Public Limited Company, Northern Electric PLC (3 March1995) and Report by Richard Fletcher in The Telegraph- Entrepreneurs are using a controversial derivative to acquire a stake in the companies they are stalking (25 May 2003). There were some subsequent regulatory responses.

The Rules now expressly say that acquiring or writing any option or derivative which causes a long term economic exposure, whether absolute or conditional to changes in the price of securities would be treated as an acquisition of those securities.[5] The SC requires a consultation where a person would acquire control or trigger the creeping threshold as a result of acquiring these options or derivatives.[6] Securities convertible into new shares are, however, excluded from this[7].

Holders of options and derivatives not convertible into new shares would have to be particularly careful. They could trigger a mandatory offer when this might not have been the case under the 2010 Code.

Acquisition of a company through an upstream entity

The 2010 Code had imposed a mandatory offer requirement on a person who intended to obtain or had obtained control in an upstream entity which held or which was entitled to exercise or control the exercise of more than 33% of the voting shares or voting rights of a downstream company and the upstream company had a significant degree of influence in the downstream company[8]. It had often been thought that the intention to obtain or the obtaining of control in an upstream entity referred to "control" as defined in section 216 of the CMSA, which meant a 33% threshold[9]. In practice, however, "control" had been applied, at least in more recent times, as the acquisition of more than 50%.[10] This created difficulties as it was possible for a person to creep within the thresholds permitted by Section 9(1)(b) of the 2010 Code such that he acquired more than 50% in an upstream entity without triggering a mandatory offer in the upstream company but trigger, however, a mandatory offer requirement in a downstream company.

The Rules now codify the threshold as the acquisition of more than 50%.[11] It however, also provides that in the case of a listed upstream company, where the major shareholder has a holding which entitles him to obtain statutory control without having to extend a mandatory offer in the upstream company, a mandatory offer in a downstream would not be required.[12] It allows for the possibility that a person may now creep within the permitted thresholds[13] in an upstream company to attain more than 50% without triggering a mandatory offer downstream.

Conclusion

The above and other changes introduced by the Code and the Rules are important developments in ensuring a more effective and business friendly regulation of takeovers and mergers in Malaysia, well in line with other improvements to Malaysian capital market regulation. We look forward to more.

This article was first published in the October- December 2016 edition of the Corporate Vo!ce, the official journal of The Malaysian Institute of Chartered Secretaries and Administrators (MAICSA). Reprinted with permission.

5 Note 11 to Paragraph 4.01 of the Rules.

6 *Ibid*, Note 5.

7 *Ibid*, Note 5, Note 10 to Paragraph 4.01 of the Rules.

8 Paragraphs 4.1 to 4.4 of Practice Note 9 of the 2010 Code.

9 Sections 2(1) and 21 of the Interpretation Acts 1948 and 1967 apply the definitions used in an Act to its subsidiary legislation.

10 See too, e.g., Note 7 to Rule 14.1 Singapore Code on Take-overs and Mergers, Note 8 to Rule 26.1 of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases for similar approaches.

11 Note 3 to Paragraph 4.01 of the Rules.

12 *Ibid*, Note 11.

13 Paragraph 4.01(b) of the Rules.

18th Annual Corporate and Regulatory Update to be held on 2 June 2017

The HKICS 18th Annual Corporate and Regulatory Update (ACRU 2017) which brings together prominent speakers from the regulatory bodies in Hong Kong: the Companies Registry, Hong Kong Exchanges and Clearing Limited, Hong Kong Monetary Authority, Privacy Commissioner for Personal Data, and the Securities and Futures Commission will be held at the Hong Kong Convention and Exhibition Centre on Friday, 2 June 2017. This annual signature event will provide first-hand knowledge of the latest corporate and regulatory developments as well as emerging trends from leading regulatory bodies in Hong Kong. Details will be announced soon on the HKICS's website: www.hkics.org.hk.

HKICS Beijing Representative Office (BRO) 20th Anniversary Dinner

2016 marked the 20th anniversary of the establishment of the Institute's Representative Office in Beijing (BRO) in 1996. To celebrate two decades of close collaboration with our Mainland peers, a dinner was held on 18 November 2016 at The Westin Beijing Financial Street Hotel, Beijing. The dinner was attended by representatives from regulatory and professional bodies, board secretaries of H-share listed companies, as well as President Ivan Tam FCIS FCS, Council members, members, students and Affiliated Persons of the Institute. Edwin Ing FCIS FCS, Institute Past President who officiated the opening of the BRO in 1996 also attended the dinner.

HKICS Annual Dinner 2017

The Institute held its 2017 Annual Dinner on 19 January 2017 at the JW Marriott Hotel Hong Kong and achieved a record-breaking attendance of about 600. Under the theme of 'Eye on the Future', Institute President Ivan Tam FCIS FCS addressed the occasion with a review of the Institute's major achievements in 2016, and how the HKICS, as a governance institute, envisioned its development in the near future, in particular reaching out to the young generation, focusing on corporate social responsibility and international thought leadership projects.

Guest of Honour, Carlson Tong SBS JP, Chairman of the Securities and Futures Commission (SFC), delivered his keynote speech in a video clip. Mr Tong indicated that 'the job of the company secretary has become ever more demanding and each of you [company secretaries] deserves recognition for playing a critical role in making sure the boards of listed companies function properly'. Michael Duignan, Senior Director, Corporate Finance of the SFC then spoke about corporate regulation and how the SFC encourages better corporate disclosure.

Member Update

Securing the Future: ICSA Offshore Jurisdiction Events 2017

The regulation of financial services is now stricter than it's ever been and political uncertainty in the UK and Europe is creating greater instability in the market.

ICSA's offshore jurisdiction events are designed specifically for company secretaries and governance leaders. This year's conferences take on the theme of 'Securing the Future' and considers the important role that GRC professionals have to play in steadying the ship during times of great risk and uncertainty. The conferences aim to provide delegates with the tools to approach the coming year with confidence and an opportunity to reflect upon the value of governance.

Delegates will benefit from expert input on topics including: leadership, minute taking, Brexit, interactive workshops and personal development.

There are three events in this series:

Guernsey, 26 April 2017:
https://www.icsa.org.uk/events/conferences-and-summits/conferences2017/guernsey

Jersey, 27 April 2017:
https://www.icsa.org.uk/events/conferences-and-summits/conferences2017/jersey

Isle of Man, 10 May 2017:
https://www.icsa.org.uk/events/conferences-and-summits/conferences2017/isle-of-man

Reservations and further information can be obtained from:
Phone: 020 7612 7032
Email: events@icsa.org.uk

60 years of Reporting Awards

Chartered Secretaries Southern Africa (CSSA) hosted the 60th anniversary of the Integrated Reporting Awards in Johannesburg on Wednesday 16 November 2016. The Annual Report Awards were renamed in 2013 to bring them into line with the new focus on integrated reporting. Almost 100 companies entered and 420 guests attended the gala dinner. Hosted by CSSA in partnership with the Johannesburg Stock Exchange (JSE) Limited, the Integrated Reporting Awards have been rewarding excellence in corporate reporting since 1956. The ceremony recognised the importance of good governance and reporting in the face of a rapidly changing business world and was attended by companies from various sectors across the Southern African region.

The key note speaker for the evening was Corli Le Roux from the JSE Ltd who gave a thought provoking speech. The JSE Ltd is currently ranked the 19th largest stock exchange in the world by market capitalisation and the largest exchange on the African continent.

Prof. Mervyn King who is a regular presenter, handed out the award to the overall winner. Prof. King is often referred to as the doyen of corporate governance in South Africa. He convened the first King Committee in 1994 and has been leading the corporate governance process in South Africa ever since, with the release of King IV on 1 November 2016. Prof. King is also the chairman of the International Integrated Reporting Committee, which has spearheaded integrated reporting around the world.

Mervyn King (right) presents the overall winner award to Sandi Linford, Vodacom Group Ltd.

CSSA President, Karyn Southgate gave a speech.

CSSA Directors, Robert Likhang, Sandile Mbhamali and Brian Dialwa enjoy the evening.

Mervyn King and Stephen Sadie, CEO, CSSA.

Member Update

An Overview of Key Developments in King IV

Natasha Bouwman

Non-executive director, CSSA

Chartered Secretaries Southern Africa (CSSA) has been represented on the King Committee since 1994 when King I was released to coincide with the dawn of democracy in South Africa. King IV was released on 1 November 2016 and replaces King III. King III contained 75 principles and King IV contains 17 principles, 1 of which applies to institutional investors only. King IV assumes 16 of these principles can be applied by all organisations and all are required to validate a statement that good governance is being practised.

So what's different in King IV?

Outcomes-based approach to corporate governance

King IV follows an outcomes-based approach and requires entities to demonstrate qualitative application of good corporate governance. Lessons learnt in the past have shown that reporting on quantity does not necessarily translate into quality of corporate governance. Entities that mindfully implement practices to give effect to King IV's principles will benefit from achieving four governance outcomes, namely an ethical culture, good performance, effective control and legitimacy.

Increased transparency

King IV has a clear focus on transparency and recommends specific disclosures, amongst others in relation to executive remuneration, risk governance, ethics governance, information and technology, compliance and stakeholder governance.

Apply and Explain

King IV follows an "apply and explain" approach (as opposed to King III's "apply or explain" approach). King IV assumes application of 16 principles and strives to instil a qualitative approach and to avoid mindless compliance and a quantitative approach. Organisations should explain the practices that have been implemented to give effect to each principle and to realise the specific governance outcomes, namely ethical culture, good performance, effective control and legitimacy. Explaining application of King IV will allow stakeholders to make an informed assessment as to whether an organisation is indeed achieving the four governance outcomes.

Other highlights include:

- King IV contains recommendations in relation to the governance of information, as well as technology.
- Greater focus on governance in relation to remuneration, including increased shareholder approval of remuneration policy and implementation report, as well as shareholder engagement requirements.
- The social and ethics committee's role is expanded to oversight of organisational ethics, responsible corporate citizenship, sustainable development and stakeholder relationships.
- Tax should be considered from a responsible corporate citizenship perspective and reputational repercussions should be taken into account.
- Risk governance entails governing opportunities as well as risks.
- Governance of stakeholder relationships is critical in the governance process
- Classification of directors as independent follows a more practical approach. The important thing to note is that all members of the board have a legal duty to act with independence of mind in the best interests of the company. Although important, independence in appearance is only one consideration in achieving balance in the composition of the board. Indicators are given by King IV that should be considered holistically to assessing independence for classification purposes.
- Group governance recommendations require specific disclosures from the holding company and subsidiary companies.
- King IV does not prescribe the design of the assurance model and recommends that it should go beyond the technical definitions of assurance.
- Emphasis on the concept of integrated thinking, as integrated reporting is an outcome of integrated thinking.

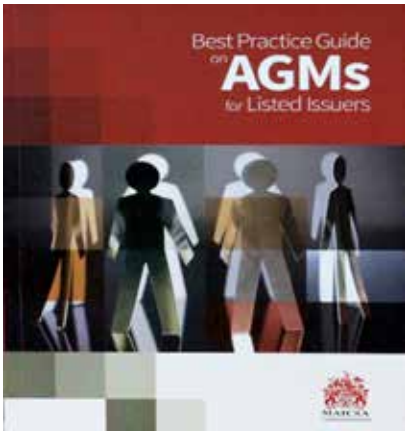
Natasha Bouwman

Member Update

Best Practice Guide on Annual General Meetings for Listed Issuers

The Malaysian Institute of Chartered Secretaries and Administrators (MAICSA), in collaboration with Bursa Malaysia Berhad (Kuala Lumpur Stock Exchange), has published a "Best Practice Guide on Annual General Meetings for Listed Issuers". The Guide is tailored for Chairmen and Directors of public listed companies and provides practical guidance for the conduct of AGMs, including the principles and procedures required to prepare, convene and conduct an efficient and effective AGM.

The Guide was officially launched by the Chairman of Bursa Malaysia Berhad, Tan Sri Amirsham Aziz in association with the MAICSA President, Dato Heng Ji Keng on 21 November 2016. The launch was followed by a talk on "How to leverage on AGMs for better engagement with shareholders" by Mr Peter Turnbull, ICSA International Vice President and Chairman of Calix Limited Australia and a panel discussion on the topic with panelists comprising Mr Peter Turnbull, Ms Chua Siew Chuan and Tan Sri Asmat Kamaluddin with Datuk Suseela Menon as Moderator. More than 150 Directors of public listed companies attended the event.



Best Practice Guide on AGMs for Listed Issuers.


Mr Peter Turnbull delivering his talk.


Launch of the AGM Guide.


Panel Discussion

CSIA Appoints a CEO

CSIA is delighted to announce that they have appointed a new part-time CEO, Zahra Cassim, who is based in South Africa.

Zahra has been employed in the professional body sector since 1999, when she joined the Institute for Public Finance and Auditing (IPFA) as the Professional Development Director. At IPFA she spearheaded the growth of the Institute's qualifications with stakeholders in the South African government as well as international stakeholders such as the World Bank. In 2005 she was appointed Chief Executive Officer of the Institute.

Zahra was appointed Head of CIMA South Africa on 2 July 2012 and during her tenure at CIMA, student numbers and market share grew substantially as well as the recognition of management accounting amongst stakeholders in the corporate, government and tertiary sectors of the South African market. In addition to driving the long term country strategy for South Africa, Zahra was also responsible for overseeing growth in Botswana and Namibia and aligning the country growth targets at both regional and international level. Zahra has had experience of promoting the King Code of governance in South Africa.

In her role as CEO of CSIA, Zahra is responsible for coordinating the execution of the strategic goals and plans of the CSIA and driving both growth and strategy across the globe. Her role will be instrumental in ensuring that the unique skills set of corporate secretaries and governance professionals across the world are showcased.

Zahra Cassim

Zahra brings a wealth of knowledge in strategy and business management and an understanding of the role of the professional body in developing people and promoting the recognition of specialist skills. She intends to apply her skills and experience to drive growth in the membership, recognition of the role of the corporate secretary and governance professional and better co-operation amongst the national associations of corporate secretaries.

CSIA e-Magazine Advertising & Technical Specs

"Global Governance Voice" is the quarterly e-Magazine published by Corporate Secretaries International Association (CSIA). With a readership of 70,000 legal, governance, risk, Senior Management and corporate secretary professionals across 70 countries, it is the first international e-Magazine of its type and aims to bring governance topics to the fore, highlighting the challenges faced by governance professionals across the globe. Contributions by in-country experts bring local flavour to global issues, and enable sharing of best practices. Don't miss your opportunity to advertise your organisation or services, and reach more than other publications in this sector!

Readership: 70,000 governance professionals across at least 70 countries

Company Name:		Contact Name:	
Company Address: (for Invoice)		Contact Number:	
		Email Address:	

I would like to book the following advert in the CSIA e-Magazine (Please tick as appropriate)

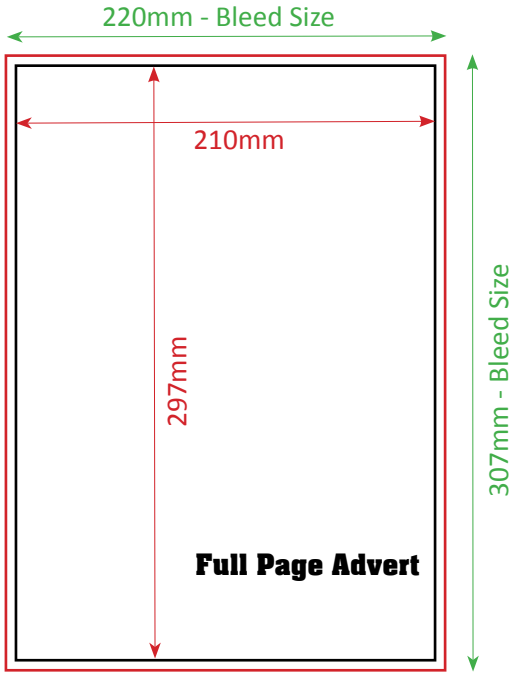
- 1st Full Page – US$2,420 ☐
- 2nd Full Page – US$2,200 ☐
- 3rd Full Page – US$2,200 ☐
- Other Full Page – US$1,815 ☐
- Half Page – US$1,045 ☐

Note: CSIA country member organisations should contact paul@ninehillsmedia.com for special member association rates.

Technical Information:

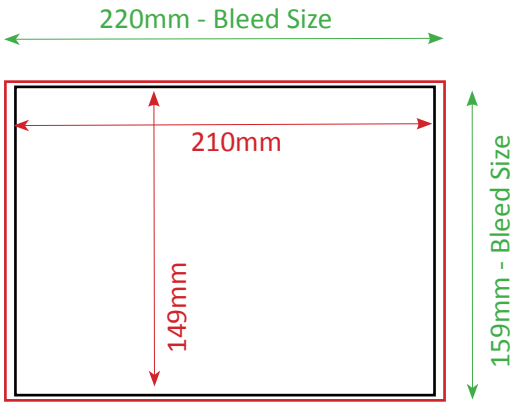
Please provide all art work at 300dpi, PDF, JPG or EPS file. Please ensure that the advert has a 5mm bleed around the whole piece.

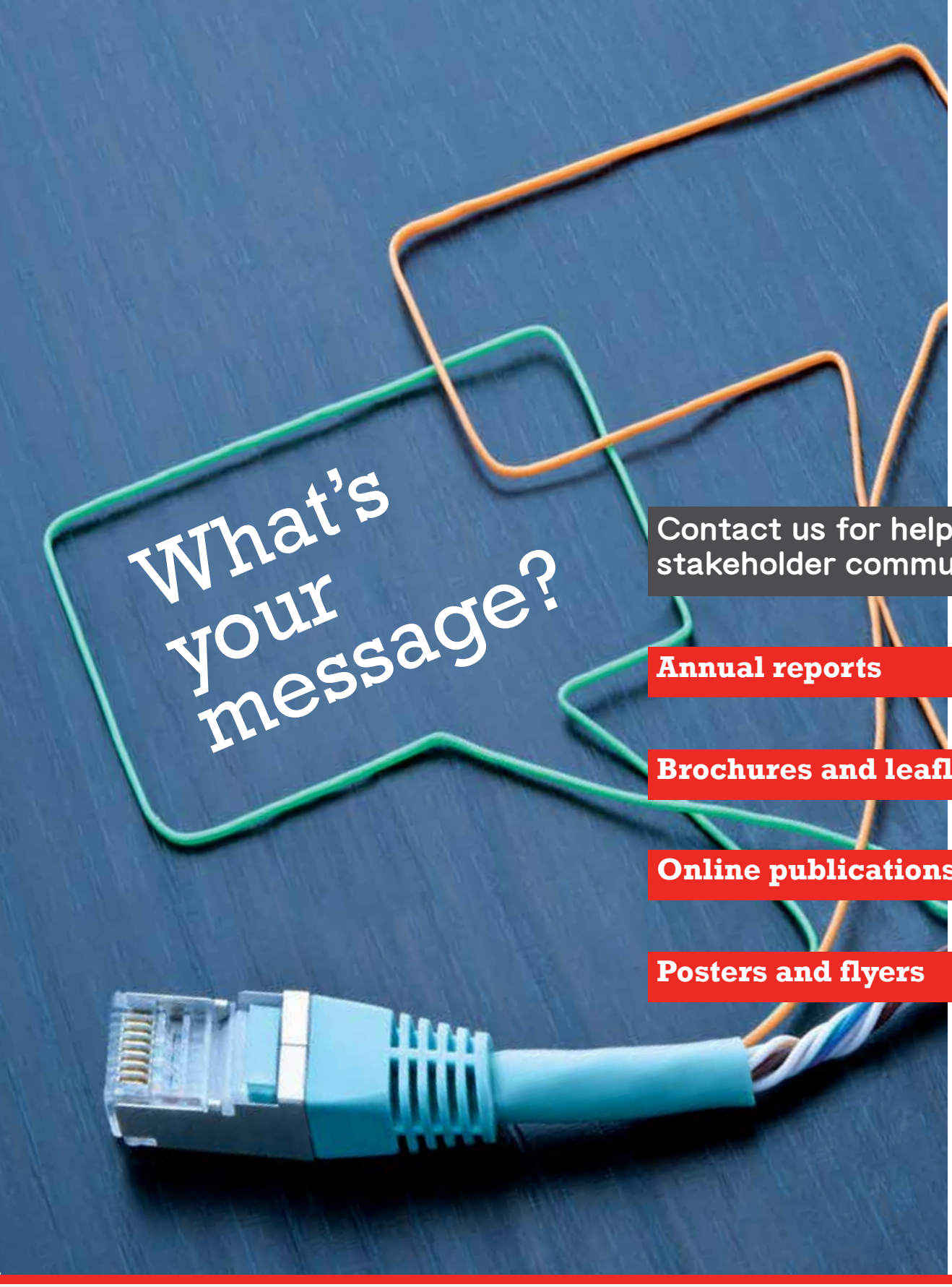
Advert sizes:



TO BOOK AN ADVERT, PLEASE COMPLETE THIS FORM, SCAN AND EMAIL TO: paul@ninehillsmedia.com

1/2 Page Advert





Contact us for help with your stakeholder communications

Annual reports

Brochures and leaflets

Online publications

Posters and flyers

ninehills media

t +852 3796 3060

e enquiries@ninehillsmedia.com

w www.ninehillsmedia.com