

**Improving
engagement
between
ASX-listed
companies and
their institutional
investors:**

Principles and Guidelines

July 2014

The Sponsors of this project are

Governance Institute of Australia

The Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our postgraduate education in applied corporate governance and risk management is unrivalled in its breadth and depth of coverage. It sets the standard for entry into the profession. Postgraduate education is also the gateway to membership of the Governance Institute of Australia and the Institute of Chartered Secretaries and Administrators (ICSA) — leading international associations for governance practitioners.

Our Certificates in Governance Practice, Governance and Risk Management and Governance for Not-for-Profits provide skills-based governance and risk management training, and a qualification for a wide range of professionals responsible for corporate accountability functions and processes within an organisation.

Our active membership base of more than 7,000 chartered secretaries, governance advisers and risk managers ensures that the Governance Institute is at the cutting edge of knowledge of issues and support of sound practice in the continuous evolution of governance and risk management.

Sandy Easterbrook

Sandy Easterbrook is well-known on the Australian and international governance scene.

In the mid-1990s he founded Australia's first governance and proxy advisory firm, Corporate Governance International, now called CGI Glass Lewis and part of the international Glass Lewis group headquartered in San Francisco. Over almost two decades as a principal, director and then consultant of CGI/CGI GL, he became familiar with major institutional investors and entities listed on the Australian Securities (formerly Stock) Exchange and many of their principals, directors and senior executives. Prior to that, he was a partner for many years of the major corporate law firm now called King & Wood Mallesons. Internationally, he has a long involvement with the International Corporate Governance Network, the international investor-led organisation of governance professionals, including past service on its board and nominating committee.

Sandy is now an independent adviser in the governance area. He sees the Principles and Guidelines as the natural evolution at this time of his work in the area, which started with the first edition of the *Corporate Governance Principles and Guidelines* of the Australian Investment Managers' Association¹ (known as 'the Blue Book') that he co-authored in 1995.

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Definitions

Unless the context otherwise requires:

ACSI means the Australian Council of Superannuation Investors.

AGM means annual general meeting.

ASIC means Australian Securities and Investments Commission.

ASX means Australian Securities Exchange.

Board means board of directors.

Companies means ASX-listed entities, including listed trusts, and a company means an ASX-listed entity, including a listed trust.

Designated account means the segregation of underlying investors into individual accounts on the share register, for example, Anon Limited <c/- National Nominees Limited>, or INVIA Custodians Pty Limited <Sample Superfund>.

Engagement refers to the ongoing structured and informal interaction — in person at a meeting, or over the phone, or even by email or letter and throughout the year, as well as in the period leading up to, and at, the AGM — of an institutional or retail investor with a company about the company. It can also be such an interaction of a third party, such as a proxy adviser or collective engagement service, used by institutional investors, with a company about the company. The interaction may be initiated by either side.

Engage has a corresponding meaning.

ESG issues means environmental, social and governance issues.

Exposure draft means the exposure draft of the guidelines issued for public consultation.

FSC means the Financial Services Council.

Governance manager, in the case of an institutional investor, means its person or team handling voting, governance and any associated matters in respect of investee companies and separate from its investment team.

Institutional investors means institutional investors that are asset managers or asset owners interested in the sustained long-term performance of their investee companies and institutional investor means such an asset manager or asset owner, as the context requires.

Intermediary means a collective engagement service or proxy advisory service used by an institutional investor.

Management, in the case of a company, means its senior management.

Pooled account means the combination of the assets of multiple clients held through one omnibus account in the name of the custodian or its nominee, for example, Anon Custody Nominees (Australia) Limited or National Nominees Australia Limited.

Regnan means Regnan — Governance Research & Engagement.

Significant institutional investors means not just the institutional investors with the current largest equity interests in the company but also the institutional investors with the longest continuity of significant equity interests in the company. Those investors will often, but may not always, be the same.

Significant investee companies means not just the companies representing the institutional investor's current largest ASX-listed equity interests but also the companies with the longest continuity of significant investment by the investor. Those companies will often, but may not always, be the same.

Smaller companies means companies outside the ASX200.

Sponsors means Governance Institute of Australia and Sandy Easterbrook.

Voting means voting companies' securities on resolutions submitted by companies for shareholder vote.

Vote has a corresponding meaning.

Website means a discrete, public access section of the company's or institutional investor's (as the case may be) website.

Introduction

Engagement is the means whereby companies and investors discuss issues of importance to each of them. It is not an end in itself. The Principles and Guidelines are designed to be used by companies and their long-term institutional investors as a tool for making their engagement with each other more effective.

Effective engagement between companies and those investors is important because it builds alignment between them. That enables them to work together to help the company perform well over the long term and to counter short-term pressures in the market inimical to sustained long-term performance.

The Principles and Guidelines have been developed for the Australian market in consultation with representatives from ASX-listed companies, asset owners, asset managers and intermediaries, each with direct presence in this market and offering valuable insights and expertise on shareholder engagement from their perspective. They also take into account input from the public consultation on the exposure draft.

While the Sponsors have conducted the research and consultation process and are the authors, the Principles and Guidelines represent the most consistent themes evidenced and expressed by the stakeholders at this time on improving engagement in the Australian market between companies and their long-term institutional investors.

The Principles and Guidelines address engagement between ASX-listed companies and institutional investors, but they also have application to engagement between companies listed on other exchanges in Australia and institutional investors.

It should also be mentioned that hedge funds and some other institutional investors are not necessarily long-term investors and that some institutional investors' business model or investment style does not include engagement.

The Sponsors will continue to monitor the development of engagement between companies and institutional investors, including their response to the Principles and Guidelines, and will welcome further feedback from time to time from interested stakeholders.

In light of that experience, the Sponsors may review the Principles and Guidelines at an appropriate time in conjunction with key stakeholders.

Process of development

The Principles and Guidelines are the outcome of an extended process comprising:

- Stage 1 Roundtable convened under the Chatham House Rule by the Sponsors in June 2013 between invited principals of companies and institutional investors to look at practical ways to improve engagement, and thereby the overall relationship, between companies and institutional investors

- Stage 2 confidential, one-on-one interviews by the Sponsors between July and October 2013 of Roundtable participants, their peers and other key stakeholders with a significant involvement in or knowledge relevant to engagement between companies and institutional investors
- Stage 3 circulation by the Sponsors in November 2013 to all Stage 2 participants of a draft Background Paper and Guidelines for review and comment
- Stage 4 release by the Sponsors in February 2014 for public review and comment of an exposure draft Guidelines and accompanying Background Paper reflecting the most consistent themes evidenced and expressed by the prior stage participants.

Submissions on the exposure draft can be found at governanceinstitute.com.au/shareholderengagement.

Acknowledgments

The Principles and Guidelines have benefited from the invaluable contributions made by many representatives from ASX-listed companies, asset owners, asset managers, intermediaries and other stakeholders. The Sponsors are most grateful for their input. A list of all those who participated in the development of the Principles and Guidelines can be found at governanceinstitute.com.au/shareholderengagement.

Purpose and application

The purpose of the Principles and Guidelines

The Principles and Guidelines aim to improve the efficacy of engagement between companies and their institutional investors.

They do so by promoting better explanation and disclosure by each side — and corresponding understanding by the other side — of basic information that enables effective engagement between them (Principles 1, 2 and 3); a regular engagement program on each side, including on ESG, to foster a good ongoing relationship (Principles 4 and 5); and the use of technology to facilitate disclosure and engagement (Principle 6).

A number of leading companies, institutional investors and intermediaries have for some time been conducting their activities substantially in this manner. The Principles and Guidelines are designed to help the broader spectrum of the market, especially companies and institutional investors without large and well-resourced investor relations and corporate access functions.

The application of the Principles and Guidelines

The Principles and Guidelines are intended primarily for companies that are in, or gain entry to, the ASX200 and for institutional investors in respect of their ASX200 investee companies. Those companies and institutional investors should be familiar with the Principles and Guidelines.

Precisely how each such company and institutional investor applies the Principles and Guidelines will

depend on its circumstances, size and the particular issue. The Principles and Guidelines represent sound engagement practice, but it is recognised that there is no 'one-size-fits-all' approach to engagement and not all aspects will be applicable in all situations.

Smaller companies

Engagement by and with the smaller companies is complex. The problem is one of resources on both sides. Except where an institutional investor is a substantial shareholder (that is, holding a five per cent or greater equity interest) in a smaller company, the limited engagement resources of each understandably tend to be prioritised to the core and different commitments of each.² That leaves little or no capacity for engagement with a wider set of institutional investors, in the case of the smaller companies, and with a wider set of smaller companies, in the case of institutional investors.

There are, however, clear signs of progress. Proxy advisers and a number of institutional investors (both asset managers and asset owners) have taken steps to arrange group visits to, or one-on-one meetings with, smaller companies on their home ground.³ Those prearranged exchanges have enabled institutional investors to introduce themselves and explain their guidelines and perspectives and smaller companies to explain their own challenges and perspectives. The feedback from such meetings has been positive on both sides.

Smaller companies also are naturally aspirational to move up the index, develop, raise capital

and expand their shareholder base. They recognise that, as they do so, they need to be in an increasingly better position to satisfy institutional investor scrutiny, in general, and, in nearly all cases being Australian-incorporated companies, to avoid a first strike on their remuneration report, in particular.

In addition, smaller companies are already required to consider and disclose their corporate governance practices under the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, which have force under the ASX Listing Rules. It makes sense, therefore, for smaller companies — as early as possible — to become familiar with expectations in relation to governance and learn to cope with institutional investor scrutiny. One of the keys to coping is to understand how to engage effectively with institutional investors and the consequent need to devote some resources to that.

In turn, where a smaller company demonstrates that it has done its homework on that front and seeks engagement with an institutional investor, it is reasonable for the investor to recognise that and reciprocate.

It is, therefore, good governance for smaller companies to endeavour to implement the Principles and Guidelines and for institutional investors to endeavour to engage with smaller companies that do so.

Retail investors

Retail investors also are frequently long-term investors and it is important to encourage good engagement between companies

and their retail investors. This includes engagement between companies and the Australian Shareholders' Association, which acts collectively on behalf of many retail shareholders.

The Principles and Guidelines concentrate on the participation of institutional investors, in part so that retail investors will thereby gain a better understanding of key aspects of the relationship between companies and institutional investors, including consensus on improving engagement between them. That should correct any misconceptions of how those aspects of the market work in practice and help to improve the relationship, including engagement, between companies and investors generally.

More pluralistic approaches to engagement could arise as engagement evolves, including the possible coming together of both retail and institutional investors on particular engagements.

Continuous disclosure

Adherence to the principles of continuous disclosure by listed companies and institutional investors is integral to the integrity and proper functioning of our equity markets. It ensures that market-sensitive information is released to all investors simultaneously. Reducing the risk of leaks or insider trading promotes and preserves market integrity.

The Corporations Act prohibits a person with market-sensitive information from trading or procuring trading by someone else or communicating the information to someone likely to trade or procure trading. The board and senior executives of companies

and institutional investors need to understand clearly their obligations to ensure that market-sensitive information is neither released nor sought during the engagement process.

ASX Listing Rule 3.1 requires immediate disclosure of market-sensitive information by listed companies. This obligation relates only to information that is market-sensitive, and not to all information held by a company.

Companies need to take care when organising and participating in one-on-one meetings to ensure that they do not breach their continuous disclosure obligations through selective disclosure.

Principles of engagement

Structure of the Principles and Guidelines

The Principles and Guidelines comprise:

1. six Principles of engagement
2. a set of practical Guidelines on how to implement the Principle, and
3. commentary providing further context and explanation to assist users.

The Background Paper issued with the exposure draft Guidelines will also be of assistance in understanding the context and logic of the Principles and Guidelines and is available at governanceinstitute.com.au/shareholderengagement.⁴

Principles of engagement

Principle 1: It is good practice for institutional investors to explain how they vote and engage with companies; for companies to explain how they engage with institutional investors; and for each of them to keep abreast of this information.

Principle 2: It is good practice for institutional investors and proxy advisers to explain their voting and other governance guidelines; how they apply them to voting; when they can engage; and for companies to keep abreast of this information.

Principle 3: It is good practice for companies to know their significant institutional investors; for institutional investors to know their significant investee companies; and for companies to know and engage with intermediaries.

Principle 4: It is good practice for companies and institutional investors to have a regular, efficient and meaningful engagement program.

Principle 5: It is good practice for companies and institutional investors to incorporate ESG issues in engagement.

Principle 6: It is good practice for companies and institutional investors to take advantage of technology to facilitate disclosure and engagement.

Principle 1: It is good practice for institutional investors to explain how they vote and engage with companies; for companies to explain how they engage with institutional investors; and for each of them to keep abreast of this information

Guidelines to Principle 1

1.1: Institutional investors explain how you vote

Institutional investors should clearly explain to companies the activities and processes the institutional investor carries out in respect of voting.⁵

The explanation should cover:

- the institutional investor's process for deciding or recommending how votes should be cast, and
- the other steps that the institutional investor takes to reach, execute and report upon that decision or recommendation.

The explanation should include:

- the information disclosed by the company (for example, notice of meeting booklet, annual report including remuneration report etc) that the institutional investor reviews in connection with voting
- whether the institutional investor uses one or more proxy advisory services and, if so, how many services and in respect of which constituency of companies (for example, the ASX200) and how the institutional investor uses the service(s) in connection with voting
- any other information or service the institutional investor reviews or uses in connection with voting
- in the case of institutional investors that are asset managers, the steps they take to reach and execute their voting decision or recommendation and whether, what and how they report on those steps and their voting decision or recommendation to their asset owner or other client

- in the case of institutional investors that are asset owners, whether or in what circumstances they control or execute voting decisions and whether they require their asset managers to advise them, prior to voting, how votes should be cast and the manager's reasons for that advice and what use they make of that advice.

In addition, institutional investors are encouraged:

- to disclose in a timely manner all their voting decisions⁶, and
- when they have decided to vote contrary to the board's recommendation, to communicate to the chairman of the company at the time of the decision their reasons for so voting.

Institutional investors are also encouraged to disclose their policies on stock lending.

1.2: Institutional investors explain how you engage with companies

Institutional investors should clearly explain to companies the activities and processes the institutional investor carries out, and what third-party engagement or other service, if any, the institutional investor uses, in respect of engaging with companies.

The explanation should cover how the institutional investor, and service used by the institutional investor, engages with the company both at management level and also at board level.

The explanation should include the company roles with which, and issues on which, the institutional investor, and service used by the

institutional investor, typically engages (for example, with the company's CEO and CFO at management level on operational, including ESG operational and performance issues, and with the company's chairman and remuneration committee chairman at board level on ESG and performance issues).

1.3: Institutional investors explain your resources and set-up for voting and engagement

Institutional investors should clearly explain to companies how the institutional investor is resourced and set up to conduct the activities and processes under voting and engagement.

The explanation should cover, in respect of voting:

- whether voting is part of the role of the institutional investor's investment personnel, or
- whether the institutional investor has a governance manager handling voting, governance and any associated matters in respect of investee companies and, if so, the contact details of the governance manager and the type and extent of interaction, if any, between the governance manager and the institutional investor's investment personnel in connection with voting.

The explanation should cover, in respect of engagement:

- whether the institutional investor is a member or part-owner of or otherwise uses a collective engagement service for the purpose of engagement, such as ACSI or Regnan, and, if so, the contact details of the head of the service

- whether or in what circumstances the institutional investor participates in engagement exclusively via the engagement service, jointly with the engagement service, directly one-on-one with the company or directly with one or more other institutional investors with the company
- whether engagement at management and/or board level is wholly or partly the role of investment personnel or any collective engagement service used by the investor and the issues that are typically the subject of that engagement
- if there is a separate governance manager, whether engagement at management and/or board level is wholly or partly the role of the governance manager and the issues that are typically the subject of that engagement
- whether, for reasons of limited resources or otherwise, the institutional investor prioritises its engagement with companies to a limited constituency and, if so, how it determines that constituency (for example, the largest stocks by value, plus any other holdings representing a material percentage of a company's equity capital, in the investor's portfolio).

1.4: Asset owners explain how you invest

Institutional investors that are asset owners and have appointed external asset managers should clearly explain to companies who those managers are and other appropriate details of those managers.

Institutional investors that are asset owners and have developed or are developing some internal asset management capability should also clearly explain to companies appropriate details of that information, including contact details of the head of internal asset management.

1.5: Companies keep abreast of the information disclosed by institutional investors

Companies should keep themselves up-to-date with, and take appropriate account of, the information disclosed by their significant institutional investors.

Companies should allocate responsibility for knowledge of this information, and appropriate dissemination of it within the company, at both management and board levels, to appropriate resources of the company (for example, the company secretary and/or the company's investor relations function, whether employed internally or sourced externally).

Companies should clearly explain to institutional investors how they have allocated that responsibility.

1.6: Companies explain how you engage with institutional investors

Companies should clearly explain to institutional investors, and to any collective engagement service used by the institutional investor, the activities and processes the company carries out in respect of engaging with institutional investors.

The explanation should cover how the company engages with institutional investors, or any

collective engagement service used by the institutional investor, both at investment personnel level and at governance manager level.

1.7: Companies explain your resources and set-up for engagement

Companies should clearly explain to institutional investors, how the company is resourced and set up to conduct the activities and processes of engagement.

The company should make disclosures in accordance with Principle 6 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

Companies are also encouraged to explain to institutional investors:

- how or through whom management or the board may be contacted for engagement
- what periods during the year are best for the company for engagement, and whether any periods are problematic for engagement, whether with institutional investors' investment personnel or governance managers or any collective engagement service used by institutional investors
- whether, for reasons of limited resources or otherwise, the company prioritises its engagement with institutional investors to a limited constituency and, if so, how it determines that constituency (for example, any institutional investor holding five per cent or more of the company's equity capital, plus the remaining top 20 investors by value).

1.8: Institutional investors keep abreast of the information disclosed by companies

Institutional investors, and any collective engagement service used by them, should keep themselves up-to-date with, and take appropriate account of, the information disclosed by their significant investee companies.

Institutional investors should allocate responsibility for knowledge of this information, and appropriate dissemination of it within the investor, to appropriate resources of the investor (for example, the investment team and/or the governance manager).

Institutional investors should clearly explain to companies how they have allocated that responsibility.

Commentary

The mosaic of voting and engagement

Asset owners have traditionally outsourced, on the advice of their consultants, investment of their funds to panels of external asset managers with accepted expertise and experience in the selected investment area. This was mainly due to the generally small size (relative to today — a few major company-based funds were exceptions to the rule) and minimal in-house resources of those owners.⁷

The appointment of each asset manager has been pursuant to a specified mandate, under which the manager has traditionally handled all aspects of the mandate. This includes, in the case of equities, selection (including changes) of stocks, voting of those stocks and

any engagement with each investee company.

Traditionally, engagement by the asset manager has been with the company management on financial results and prospects and operational matters but it has expanded to also cover governance and associated matters typically at company board level, and usually with the company's chairman. At times the chairman is accompanied in such engagement meetings by another representative of the company (for example, the chairman of the remuneration committee).

In some asset managers, all aspects of the mandate, including voting and engagement, are carried out by the investment team. In others, investment aspects are handled by the investment team and there is a separate person or team handling the governance and associated matters, including voting and board-level engagement. In these latter cases, the type and extent of interaction between the investment and governance elements can vary. In other cases still, the asset manager plays no role in engagement with companies (for example, certain passive or quantitatively-driven portfolios where stock selection is driven by technical input rather than company fundamentals).

However, as the pool of compulsory superannuation contributions in Australia has increased⁸, so have the size (accelerated by consolidation, for various reasons, in the industry), resources and sophistication of the asset owners that control the investment of those monies.

Some consequences of that increasing maturity are:

- asset owners have become or are becoming increasingly active in selecting, and monitoring the performance of, their external asset managers, including, in the case of equities, the managers' performance of delegated voting and other aspects of monitoring the corporate governance of investee companies. Typically, in such cases, the asset manager has to report its activity to the owner client 'after the event' on a quarterly or other basis, including how it voted on securities owned by the client and the reasons why it took those voting decisions
- many asset owners have accordingly developed their in-house capacity to handle the selection and monitoring of external managers, including the manager's voting and governance activity. As in the case of asset managers, in some asset owners that work is part of the role of investment personnel; in others, there is a separate person or team handling voting and associated matters
- in a considerable number of cases, asset owners have reserved to themselves by various mechanisms the ultimate control of voting decisions. This can range from voting on a limited number of controversial, high-profile and/or company-specific decisions, where the asset manager has to consult in advance with the asset owner and vote as decided by the owner, through to the asset owner itself voting, via one of the available

electronic proxy voting platforms, on all resolutions submitted for shareholder vote for all stocks owned by the owner. The latter is usually to ensure that individual stocks owned by the asset owner, which may be duplicated in asset manager portfolios, are always voted the same way and votes do not 'cancel each other out' if managers vote differently from one another

- more recently, a growing number of larger asset owners have developed or are developing some internal funds management capability, in part to improve their capability and expertise in external manager selection and monitoring
- again more recently, a growing number of larger asset owners are directly engaging with selected investee companies in the asset owner's portfolio, for example, the top 20/25 stocks by value plus any other 'substantial' holdings (representing five per cent or more of the investee company's equity capital). In turn, this limited direct engagement is selected by the asset owner to make the best use of its limited resources for direct engagement
- a different and earlier important development has been direct engagement with companies by a body, such as ACSI or Regnan, acting on behalf and with the authority of a client group of asset owners. In some of these cases, the asset owner client delegates engagement exclusively to the collective body and, in other cases, the owner may also conduct limited direct engagement itself.

Notwithstanding the increasing participation of asset owners in voting and engagement, as outlined above, it can still be deeply ingrained in some companies that those roles are outsourced to asset managers. As a result, those companies are not accustomed to including the beneficial — or asset — owner in the engagement process.

For those companies, the term 'institutional investor' compounds the difficulty, because it blurs the line between the asset manager and the latter's client, the asset owner.

This can be further compounded if the company hears from the asset manager that the company does not need to engage with the asset owner and, indeed, a considerable number of asset owners have not (yet) developed a model of seeking to engage or, as indicated above, have delegated engagement exclusively to a body such as ACSI or Regnan.

Consequently, while there is increasing appetite among both companies and institutional investors for constructive communication and engagement with each other, there is considerable variation both in how far each company and each investor has progressed in that regard and in how each is set up for that purpose. Correspondingly, although understanding these matters is fundamental to effective communication with and engagement by a company and an institutional investor, that understanding is often imperfect.

With some exceptions, the larger organisations (both companies

and institutional investors) are more advanced, competent and knowledgeable in these matters, which is generally a product of their available resources.⁹

However, all companies, large and small, should be able to readily and easily access such fundamental information in the case of their significant or potential institutional investors; and investors should be able to similarly access corresponding information about the company.

Companies are accustomed to disclosing a variety of governance information publicly for the benefit of investors — generally this is made available on the company's website as well as in the annual report.¹⁰ However, such disclosure by companies is not comprehensive or uniform across the board.

The manner in which institutional investors disclose how they manage voting; how they choose to engage, including the use of third-party engagement or other services; and how they are set up to engage on governance and associated matters is, with a few notable exceptions, much less comprehensive and is certainly not uniform.

How asset owners invest, in terms of who their asset managers are, or whether they have developed or are developing internal asset management capability, is also frequently unclear.

Disclosure is intended to address the current lack of consistent and comprehensive information.

Principle 2: It is good practice for institutional investors and proxy advisers to explain their voting and other governance guidelines; how they apply them to voting; when they can engage; and for companies to keep abreast of this information

Guidelines to Principle 2

2.1: Institutional investors explain your voting and other governance guidelines and how you apply them

Institutional investors should clearly disclose to companies the voting and other governance guidelines (for example, their own set of guidelines or one of the publicly available industry guidelines¹¹), or a summary of the key points of the guidelines, that they apply to companies.

Institutional investors should clearly disclose to companies how they apply guidelines and voting recommendations, including whether they vote the company's securities:

- in strict accordance with the institutional investor's voting and other governance guidelines or with the voting recommendations of the institutional investor's proxy adviser or with some other predetermined system, or
- on a case-by-case basis, taking into account the institutional investor's voting and other governance guidelines and/or the voting recommendations of one or more proxy advisers and other information considered relevant by the institutional investor, including the particular circumstances of the company and, in the case of asset owners, information received from their asset managers.

2.2: Proxy advisers explain your voting and other governance guidelines and how you apply them

Proxy advisers should clearly disclose to their clients, and to the

companies on which they report to their clients, the voting and other governance guidelines, or a summary of the key points of the guidelines, that they apply to those companies and how they apply them in making voting recommendations.

2.3: Institutional investors and proxy advisers explain when to engage

Institutional investors should clearly disclose to their investee companies what periods during the year are best for engagement with the institutional investor, and any collective engagement service used by the institutional investor, and whether any periods are problematic for engagement.

Proxy advisers should clearly disclose to their clients, and to the companies on which they report to their clients, what periods during the year are best for engagement with the proxy adviser and whether any periods are problematic for engagement.

2.4: Companies keep abreast of this information

Companies should keep themselves up-to-date with, and take appropriate account of, the information disclosed by their significant institutional investors, and the equivalent and other information disclosed by proxy advisers.

Companies should allocate responsibility for knowledge of this information, and appropriate dissemination of it within the company at both management and board levels, to appropriate

resources of the company (for example, the company secretary and/or the company's investor relations function, whether employed internally or sourced externally).

Companies should clearly explain to institutional investors how they have allocated that responsibility.

Commentary

Governance and voting

In Australia the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* are the benchmark for companies and their primary source of governance guidance. They have achieved market consensus, as the Council comprises 21 stakeholder bodies representing all interested parties, including institutional investors and listed companies. The Council's guidelines have widespread support, and importantly recognise that there is no 'one-size-fits-all' approach to governance.

However, many institutional investors (asset managers and asset owners) have adopted guidelines (either their own guidelines or one of the publicly available industry guidelines) for the voting of ASX-listed stocks in their portfolios and other aspects of the governance of those companies. While there can be commonality in some areas between these investor guidelines and the ASX Corporate Governance Council guidelines, they can conflict at times.

Many institutional investors and proxy advisers already provide their guidelines or a summary of

the guidelines to companies or otherwise make those guidelines or a summary publicly available, including through disclosure on their website. However, the practice is not comprehensive or uniform across all asset managers, asset owners and proxy advisers.

It is not always clear to companies how proxy advisers apply their guidelines in their analysis of a company, including in making voting recommendations, and how institutional investors apply their guidelines and proxy adviser voting recommendations in making a voting decision.

In particular, some institutional investors, notably some based overseas and without Australian-based resources, are believed to effectively outsource the voting of ASX-listed stocks in their portfolios, usually through an automatic electronic process. In these cases, the stocks are voted in strict accordance either with the voting recommendations of the institutional investor's proxy adviser or the voting guidelines or policies customised for the investor by the proxy adviser or another promoter of such a service.

This one-size-fits-all practice provides the institutional investor with the cheapest voting outcome. It also often includes a standard or customised electronic voting reporting system that enables the investor to report that it has carried out its own or delegated voting responsibilities in respect of all stocks in accordance with a consistent policy.

This approach should be contrasted with the well-evidenced practice of other institutional investors, notably those with significant Australian-based resources, to make their own case-by-case voting decisions.

They do so by taking into account research and recommendations from a range of sources, including:

- their own voting and other governance guidelines
- the voting recommendations of one or more proxy advisers — some asset managers and asset owners subscribe to more than one proxy advisory service — and
- other information considered relevant by the institutional investor, including the particular circumstances of the ASX-listed company, and in the case of asset owners, information from their asset managers.

This approach is, of course, more resource-intensive, and therefore more costly, for the institutional investor but results in a more considered and informed voting decision in each case.

For companies to be able to engage effectively with their significant institutional investors and proxy advisers, they need to understand all of these issues at both board and management levels.

For example, companies should understand institutional investor and proxy adviser guidelines and how they are applied, and their implications for the company generally and for the company's constructive engagement with the institutional investor in particular.

It is recognised that the proxy adviser and institutional investor guidelines can differ. For example, some guidelines will contemplate investors exercising discretion in determining whether to support or vote against a particular proposition, despite a company's apparent non-adherence to the guidelines, whereas others may recommend a vote against if the company does not meet the terms of the guidelines.

Consequently, engagement will be enhanced if companies understand the guidelines of their institutional investors, what is important to them and can discuss their consideration of their institutional investors' guidelines.

Such understanding will also assist companies to explain to their institutional investors why they have applied governance practices that may differ from those set out in the institutional investor's or proxy adviser's guidelines.

When to engage

The vast majority of ASX-listed entities are companies incorporated under the Corporations Act. The Act and the ASX Listing Rules impose requirements on listed companies in relation to the release of the results and the AGM, including:

- lodgment of results with ASX within two months after the end of the company's financial year, and lodgment of the annual report with ASIC and ASX within three months after the end of the company's financial year

- holding an AGM once a year no later than five months after the end of the company's financial year
- providing shareholders with a minimum of 28 days' notice of a general meeting.

In practice, this means that for the majority of companies (those with a 30 June balance date) the results are issued during August and the AGM is held on a day in the two-month period from October to November. This introduces constraints into the system, as multiple annual reports and notices of meeting are issued at much the same time, requiring analysis by institutional investors and proxy advisory services within a very tight timeframe. This period takes place from mid-September to mid-November and is referred to as the 'peak period' for institutional investors and proxy advisory services.

Consequently, an institutional investor or proxy advisory service will have difficulty finding time to communicate with companies between mid-September and mid-November unless they are seeking to engage with a particular company in relation to specific proposed resolutions. On that basis, companies should set up meetings in advance of the reporting season, which could provide useful input into any decision-making concerning matters that will go before shareholders later in the year.

Institutional investors and proxy advisers should also let companies know their capacity and policies for engagement with companies at various times of the year, both in respect of matters that may be the subject of voting analysis and in respect of broader issues that may be mutually useful topics of engagement.

Consequently, companies should allocate responsibility for knowledge of all of these issues and for their dissemination within the entity at both board and management levels. While companies should be free to nominate to which resource these responsibilities have been allocated, according to their resources and size, the company secretary and investor relations functions, whether employed internally or sourced externally, are good examples of where these responsibilities may sit.

Principle 3: It is good practice for companies to know their significant institutional investors; for institutional investors to know their significant investee companies; and for companies to know and engage with intermediaries

Guidelines to Principle 3

3.1: Companies know your significant institutional investors

Companies should know who their significant institutional investors are, at both asset manager and asset owner level.

Companies that do not already know who their significant institutional investors are should utilise the ownership tracing regime available under the Corporations Act to identify their significant institutional investors, at both asset manager and asset owner level.

Companies may always invite institutional (or other) investors (for example, those of a size and importance to the company commensurate with the company's resources to engage) to make contact with the company and indicate their interest in engaging with the company.

3.2 Institutional investors know your significant investee companies

Institutional investors that are asset managers should know who their significant investee companies are and should know enough about the businesses, governance and other relevant circumstances (including in relation to each proposal submitted for shareholder vote) of each company in a portfolio they manage to make informed voting decisions or recommendations in respect of the company (if their mandate includes voting or recommending voting decisions) and to undertake effective engagement in respect of the

company (if their mandate includes engaging with the company).

Institutional investors that are asset owners and control or make voting decisions should endeavour¹² to know who their significant investee companies are and to know enough about the businesses, governance and other relevant circumstances (including in relation to each proposal submitted for shareholder vote) of each such company to make informed voting decisions and (unless delegated to a collective engagement service) to undertake effective engagement in respect of the company.

Institutional (or other) investors may always invite investee companies (for example, those of a size and importance to the investor commensurate with the investor's resources to engage) to make contact with the investor and indicate their interest in engaging with the investor.

Institutional investors that are asset owners are also encouraged to consider ways to disclose to the company that the asset owner is the ultimate beneficial owner of the relevant number of the company's securities.

3.3: Companies know and engage with intermediaries

Companies should know, and at appropriate times engage with, the proxy advisers and collective engagement services (such as ACSI or Regnan) operating in the Australian market and used by their significant institutional investors.

Commentary

Companies should know who their significant institutional investors are, both at asset manager and asset owner level, bearing in mind that the company's securities owned by an asset owner may be duplicated in two or more of its asset managers' portfolios.

For this purpose, companies should know, and understand how to use, the beneficial ownership tracing provisions of the Corporations Act¹³ and how those provisions can identify their significant institutional investors on a regular and systematic basis¹⁴, including through use of one of the businesses that undertake such tracings for a fee.

Many companies already make judicious use of the ownership tracing provisions to ascertain who their significant investors are, including both asset managers and asset owners.¹⁵ By using that information the company can prioritise its investors for engagement and plan how and when it should engage with them, thereby best targeting its efforts and making best use of its available engagement resources.

The tracing notice regime is, however, bureaucratic and cumbersome to apply, and in conjunction with the breadth of different types of custodians and nominees it is not as efficient in providing information on the beneficial owners of the company as it could be.

Asset owners are encouraged to consider the benefits of letting companies know that the asset owner is the ultimate beneficial

owner of the relevant number of the company's securities.

Some asset owners appear directly and in their own name on shareholder registers, making the process straightforward for companies to identify their interests in companies. This can also be done by the asset owner communicating this directly to the company, which some major asset owners already do.

It is, however, important that shareholders continue to be able to structure their holdings in the manner best suited to them, which includes the capacity for the underlying beneficiary of the shares to be someone other than the shareholder whose name appears on the register (generally referred to as registration in a nominee).

Institutional investors also have the option to use, instead of pooled accounts, designated accounts, where the beneficial owner is identifiable and the securities of multiple investors are not co-mingled. This is a very relevant solution to all of the problems created by the voting processes for pooled accounts, as well as assisting companies to identify their owners. Voting remains a core governance mechanism, and the integrity of voting processes and commensurate enfranchisement of properly entitled investors is one key aspect of engagement.¹⁶

Voting the securities of companies to fulfil governance obligations appropriately requires sufficient understanding of both the company and the issues it faces. It is for the asset owner to decide how it will

access the information that will build this understanding. They may obtain advice from asset managers, or intermediaries such as ACSI and Regnan, as well as research from proxy advisory services. Many asset owners subscribe to more than one proxy advisory service, refer to that research and also take soundings from their asset managers, but make their own voting decisions.

Bodies such as ACSI and Regnan are authorised by some asset owners to engage on their behalf. As intermediaries, their role is to act on behalf of the collective, and their business model is to understand the operations and issues of the companies in which the asset owners invest in order to facilitate engagement. In these instances, the asset owners that utilise such intermediaries see the collective model as more efficient than any one owner seeking to build up the requisite expertise on the business and issues of the companies in which it invests — there is an economy of scale.

Collective engagement is also undertaken on the basis that as a group they are more likely to be influential, as well as that it is efficient and cost-effective. The asset owners also recognise that it is efficient for the companies.

Even the best-resourced asset managers and asset owners require quality, independent information gathered by proxy advisory services. Accessing quality, independent information in relation to a range of issues assists institutional investors to discharge their voting responsibilities.

Principle 4: It is good practice for companies and institutional investors to have a regular, efficient and meaningful engagement program

Guidelines to Principle 4

4.1: Companies and institutional investors engage regularly

Companies should engage on a regular basis and at appropriate times with their significant institutional investors, or, if appropriate, with the collective engagement service used by those institutional investors. Institutional investors, or, if appropriate, their collective engagement service, should engage on a regular basis and at appropriate times with their significant investee companies. Each should do so whether or not there are controversial or other matters that demand engagement.

4.2: Companies and institutional investors engage efficiently and meaningfully

The resources and time for engagement of both companies and institutional investors are finite. Companies, institutional investors and/or the collective engagement services used by them, should endeavour to arrange, plan and conduct their engagement so that each engagement is as effective, efficient and meaningful as possible for all parties. Having a clear purpose and scope for the meeting on both sides will assist this.

In particular each should:

- consider whether it would be effective and efficient to agree in advance issues for engagement, to provide relevant information, to become familiar with such information and to involve appropriate personnel

- consider whether there may be issues that are appropriate and suitable for group engagement, bearing in mind that there are likely always to be issues on which both companies and institutional investors will want to have one-on-one engagement, possibly after or in addition to group engagement
- maintain appropriate records of the outcome of any engagement and consider whether it would be mutually useful to exchange such records
- give due and timely consideration to any request of the other party for the purpose of a proposed engagement.

Companies and institutional investors should also endeavour to maintain appropriate continuity of engagement personnel and to institute succession planning for such personnel so that appropriate engagement capacity is maintained.

Commentary

Companies should not wait until a problem or controversial issue arises to attempt engagement for the first time.

It is a useful mindset for companies and their boards to make the time to have fruitful, non-rushed discussion with their institutional investors and their intermediaries that can influence decision-making. The engagement season for institutional investors and their intermediaries runs for at least six months of the year and should not

be 'crammed' into one month after the announcement of results or half-yearly results. Many asset owners seek to meet with the chairman and relevant committee chairmen at least annually to discuss strategy, governance and related matters.

All parties should aim for constructive, targeted discussion and debate based on sound evidence. With more parties seeking engagement, efficiency is essential.

While group briefings can be efficient in targeting more than one institutional investor simultaneously, these have their limitations. Such briefings tend to facilitate the provision of information by the management or chairmen of companies, but not the provision of feedback. That is, they tend to be one-way communication. Institutional investors are less likely to participate actively in such group briefings — they will listen, but be less inclined to ask penetrating questions. Such questions can be a source of competitive advantage for institutional investors.

One-on-one meetings provide for a two-way dialogue where issues can be addressed on a case-by-case basis, providing for the frank, informed discussion that is mutually beneficial.

An agenda may not always be appropriate, but without clarity as to the purpose and expectations of each engagement, the meeting could be unfocused, ill-informed and unproductive.

Engagement and continuous disclosure

In conducting their engagement, companies and institutional investors will be mindful of continuous disclosure requirements.

Practical steps for companies could include:

- having clear internal guidelines about what can and cannot be discussed
- ensuring that more than one person from the company attends/participates in the engagement
- making access to any group engagement as broad as possible
- keeping records of the engagement, such as voice recordings or detailed notes
- reporting all engagements to the person within the company who has executive responsibility for continuous disclosure obligations
- having procedures in place to review the information disclosed in the engagement to ensure the company meets its continuous disclosure obligations
- regularly testing that internal procedures are being complied with.

Institutional investors could also consider adopting these practices as appropriate.

Principle 5: It is good practice for institutional investors and companies to incorporate ESG issues in engagement

Guideline to Principle 5

5.1: Companies and institutional investors incorporate ESG issues in engagement

Companies and institutional investors, and the collective engagement services used by them, are encouraged to broaden the scope of engagement beyond remuneration and board composition to cover relevant long-term strategic issues, including investment risk, many of which may be ESG-related.

Companies and institutional investors, and the collective engagement services used by them, should discuss and endeavour to agree how engagement on ESG issues in respect of the company should be arranged, planned and conducted so that it is as effective, efficient and meaningful as possible for all parties. Engagement can be a useful tool by which companies and institutional investors can understand and usefully discuss each other's expectations on ESG issues.

In particular:

- companies and institutional investors, and the collective engagement services used by them, should discuss how responsibility is allocated within the company between management and the board for particular ESG issues, bearing in mind that the board has ultimate responsibility for such issues. For its own security as well as the security of investors, the board will need to be satisfied, and accordingly monitor, that those issues are being appropriately addressed

- companies and institutional investors, and the collective engagement services used by them, should seek to make engagement on such issues as effective, efficient and meaningful as possible for all parties.

Commentary

Governance issues must always be a board responsibility. However, environmental and social (E&S) matters, which are frequently of an operational nature and properly part of management's responsibility, may also be a matter for discussion with the board, including discussions of the risks attached to these areas.

Institutional investors have concerns about the longer-term implications of mismanagement of E&S risks for the value of the investment. Even if there is no risk at present, these broader issues can have an impact on long-term investment. E&S matters can be potential warning signs of poor cultural values and management of material risks generally. On that basis and in line with the increasing focus on risk management as a key aspect of governance, the board's responsibility to oversee the proper handling of E&S matters can be a subject of engagement.

The significance of key ESG risk factors such as bribery and corruption exposure and the management of labour and human rights practices in a company's supply chain, particularly for companies with offshore operations, as well as climate risk exposure are examples of where board oversight would be of interest to institutional investors in an engagement.

As long-term investors in economies and markets, institutional investors' consideration of investment decisions with an integrated approach to sustainability is intended to enhance returns while minimising risk. As such, they are considering the consequences and implications of the themes that will drive global economies over the next five, 10 and 15 years, such as potential resource scarcity, technology, aging population and population growth more generally.

Importantly, institutional investors do not look on ESG matters in terms of promoting ethical or other investment values but as a matter of risk management to guard against longer-term damage to their investment's value.

All such engagements must, of course, observe the continuous disclosure regime.

Principle 6: It is good practice for companies and institutional investors to take advantage of technology to facilitate disclosure and engagement

Guideline to Principle 6

6.1 Take advantage of technology to facilitate disclosure and engagement

Companies and institutional investors are encouraged to employ technology, preferably a discrete, public-access and user-friendly section of their websites, to provide, and to update in a timely manner, the disclosure elements of the Principles and Guidelines.

Companies and institutional investors should for ease of reference appropriately label, link and index their websites, which provide and update the disclosure elements of the Principles and Guidelines.

Should an institutional investor have a valid reason not to provide any of the disclosure elements of the Principles and Guidelines on its website, it should contact the companies in which it invests to provide them with, and to update in a timely manner, that information in a user-friendly way. Correspondingly, should a company have a valid reason not to provide any of the disclosure elements of the Principles and Guidelines on its website, it should contact its institutional investors to provide them with, and to update in a timely manner, that information in a user-friendly way.¹⁷

Hedge funds and other institutional investors whose business model or investment style does not include engagement should disclose that information on their website so that companies understand the position.

Companies and institutional investors should also employ technology to facilitate engagement, as appropriate. They should endeavour to use technology for the timely distribution of information that is appropriate and suitable for such distribution prior to conducting engagement.

Companies and institutional investors should also explore whether technological channels of communication, such as webinars, may facilitate engagement, as appropriate.

Commentary

Using technology facilitates the provision of governance and other information and access to it. In particular, the use of a discrete governance section on the website of a company or institutional investor, which is easily accessible and easy to navigate, facilitates disclosure and understanding.

The 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* includes a new recommendation that a listed entity should provide information about itself and its governance to investors via its website. This recognises that, in the digital age, market participants expect information of key stakeholders to be freely and readily available on their websites.

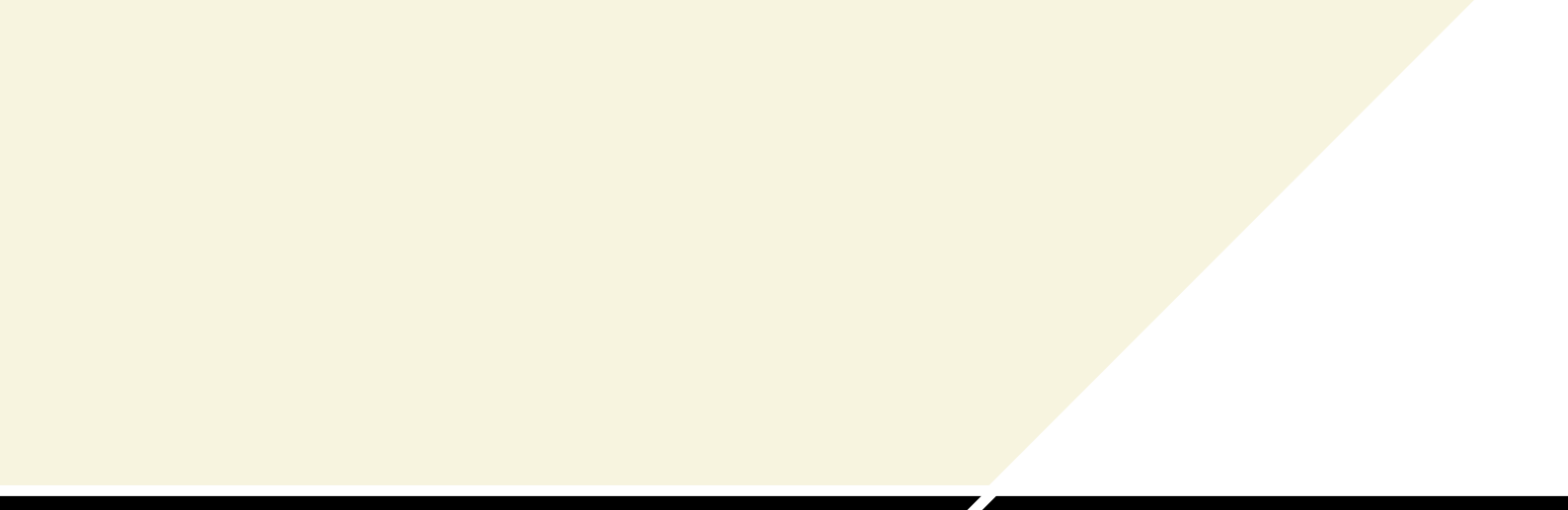
While the websites of asset owners are focused properly on their members rather than on the needs of the companies in which they invest, company websites are not

focused solely on their members (shareholders) but are also focused on providing relevant information to customers, staff and other stakeholders. It is good governance practice for both companies and institutional investors to take account of and satisfy, preferably via their websites, the information needs of a wider set of stakeholders.

Consideration also needs to be given to introducing further efficiencies into the process of engagement. Technology such as webinars could be used to disseminate information when an entity seeks to provide information to a range of investors, for example, if it is introducing a new remuneration framework.

Notes

- 1 AIMA was merged in 1998 with two other investor bodies into a single organisation that is now called the Financial Services Council.
- 2 Smaller companies, many of which have little or no revenue and limited and stretched human resources, tend to be focused on raising and conserving capital (which requires close attention to satisfying existing, and seeking to attract further, major financial backers and/or partners) and on the daily demands of their incipient businesses; whereas institutional investors, in the case of ASX-listed companies (specialist small cap asset managers excepted) tend to be focused on the larger companies, where most of their clients' or beneficiaries' funds are invested.
- 3 For example, in pre-arranged out-of-proxy season visits to a Perth venue convenient for many of the smaller explorers, miners and others based in Western Australia.
- 4 The structure, including the numbering, of the Principles and Guidelines differs from that of the exposure draft material, including the Background Paper, but the substance of the two versions does not significantly differ.
- 5 While Guideline 1 deals with voting and that issue is important in the context of engagement, effective engagement involves far more than voting issues.
- 6 FSC Standard No 13: Voting Policy, Voting Record and Disclosure requires all members of the FSC to formulate a voting policy (including proxy voting) for each scheme it operates; whether or not it engages the services of a voting or proxy consultant in the exercise of its voting rights; and to require disclosure of these matters and details of the exercise of its voting rights (on 'an entity and resolution level' basis) in respect of each financial year.
- 7 Some asset owners are legally required to invest exclusively via third-party asset managers.
- 8 Superannuation investments now exceed the \$1.8 trillion mark in Australia and represent the fourth largest pool of such monies globally.
- 9 It should also be recognised that engagement with their investee companies is simply not part of the business model of some asset managers. Consequently, those managers do not engage and are not resourced to do so.
- 10 The 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* clarifies in Principle 6 that all ASX-listed entities should provide a clearly accessible section on their website related to corporate governance.
- 11 For example, those published by ACSI and FSC.
- 12 It is recognised that some hedge fund and other asset managers do not disclose the identity of investee companies to their asset owner clients.
- 13 For the beneficial ownership tracing provisions, see s 672 of the Corporations Act.
- 14 A number of companies arrange for such tracings to be conducted quarterly, although newly listed companies and those facing particular circumstances may conduct them more regularly.
- 15 Companies that do not do their own tracing employ one of the businesses that undertake such tracings to do so for them.
- 16 Computershare has undertaken research on the effects of pooled accounts on the integrity of the voting process. The research shows that a number of issues can arise, including over-voting, a lack of transparency and concerns about timeframes, all of which have implications for governance outcomes. See Computershare response to CAMAC discussion paper, *The AGM and shareholder engagement*, 21 December 2012, at www.camac.gov.au/camac/camac.nsf/byHeadline/SubmissionsAGM?openDocument;Computershare/Georgeson,IntelligenceReport,Insightsfromcompanymeetingsheldin2013,Australia,Mar2014;andTransparencyOfShareOwnership,ShareholderCommunicationsAndVotingInGlobalCapitalMarkets,Mar2014
- 17 Companies should note Recommendation 6.1 in the 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, which states that: 'A listed entity should provide information about itself and its governance to investors via its website'.



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