

# LIGHTHOUSE

OCTOBER 2019 | AUSTRALIAN EDITION

MORROWSODALI

AGM SEASON 2019

EMERGING THEMES,  
EVOLVING ROLES,  
& CHANGES AHEAD



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# TRENDS & ISSUES FROM THE 2019 AGM SEASON UNDERWAY

The 2018 Australian AGM season was unique, being set against the backdrop of the Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry. As we approach the mid-way point of the 2019 AGM season, we examine key trends which are having an impact on publicly listed companies in Australia.

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## WHAT HAPPENED IN 2018, AND WHAT ARE RECURRING THEMES THIS YEAR?

### Remuneration

Remuneration remains a key focal point in the 2019 AGM season. In 2018 there was a record 26 'strikes' (votes of 25% or more against a remuneration report) at ASX300 companies, however, it was not just the number of strikes which were significant, but the scale of votes against resolutions. With the publication of the final report from the Royal Commission in February, there is an expectation among shareholders that companies demonstrate they have acknowledged issues raised and taken steps to address them. There is also keen interest in how companies will address the appetite for non-financial measures to be integrated into remuneration performance measures and metrics.

### Activism

There were 18 ESG related shareholder proposals at ASX200 companies in 2018. Year on year this number continues to grow, as does support, with over 40% support received for two resolutions in 2018.

Shareholder resolutions are only one way to place this on the agenda at AGMs. Boards should expect to receive specific questions regarding planning and commitment to specific projects which do not align with shareholder sentiment on climate change.

So far this year, 11 companies in the ASX200 have put 30 requisitioned resolutions to their shareholders, all of which have been ESG related.

### Emerging 2019 themes

In the US, where directors face annual elections, opposition to director elections was the highest in nine years. Seen in the context of ACSI's proposal to introduce annual director elections in Australia and the growing desire for Boards to demonstrate both accountability and ongoing assessment of corporate culture, investors are no longer reluctant to vote against directors up for re-election and are prepared to express their dissatisfaction by targeting individual directors.

Another notable theme was an increase in shareholder proposals relating to social issues such as human rights, board diversity and gender equality. Australia has seen a trend in shareholder proposals relating to the environment and specifically climate change, however, social issues tend to have been addressed through other forums. Again, ACSI highlighted this at their annual conference, calling for regulatory intervention should companies not set a timeframe where they expect to be able to achieve gender balance.

The AGM season is likely to evolve further over the coming weeks, however, we believe the focus of investors will continue to expand from the traditional areas of remuneration and executive awards to include the following topics:

**Culture - How is it defined, measured and what are the consequences?**

**Climate Risk - Has the risk been assessed and what will the impact be?**

**Director Skills & Performance Accountability and demonstrating the diversity of skills across the Board. Including identifying skills gaps and prudent succession planning.**

**Shareholder Activism Broader mandate for change and increasing willingness to support.**

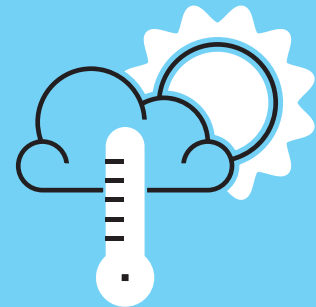
## Culture

The discussion around corporate culture and the importance of managing it effectively has reached considerable momentum. Companies and investors alike are still grappling with the concept, seeking a clear explanation as to what exactly constitutes corporate culture so that such concerns can be addressed with relative uniformity. Irrespective of the challenge in standardising how corporate culture is defined, valued and measured, the need for a system of checks and balances, and the ability to demonstrate how companies manage risks and opportunities arising from their existing and/or desired culture, have been acknowledged by institutional investors, proxy advisors, ESG research providers and other governance stakeholders including the Australian Council of Superannuation Investors (ACSI).



## Climate

Investor focus on climate risk management is now a global phenomenon and over the past few years Australian investors have been steadily becoming more involved to keep pace with other global peers. It is expected that investor (and wider stakeholder) focus on climate risk management and its impact on investment, engagement and voting behaviours will continue to intensify. It is important for companies to keep abreast of investor expectations with respect to climate change, and understand how this may impact engagement, voting and investment outcomes, as well as its broader attractiveness from a capital allocation perspective.



## Director Skills & Performance

In Australia, there are very definite ideas about what makes a board effective.

Directors of publicly listed companies will continue to be subject to increasing scrutiny regarding their accountability and oversight. There is an increased appetite to hold directors accountable for performance and risk management and it is absolutely essential for board directors to have the right skills across all channels to manage risks. The trend of increasing dissenting votes against director re-elections is here to stay as large investors are now prepared to 'put their money where their mouth is' in cases where they believe that director performance and board responsiveness fails to meet their expectations and commitments that may have been made.



## Shareholder Activism

The volume and significance of activist campaigns in Australia continues to rise. Activists have targeted ASX-listed companies with increasingly sophisticated public campaigns. Separately, they have pressured on ESG issues, with seven of the ASX 50 having an ESG-related shareholder resolution put forward at their AGM [1]. With the Modern Slavery Act 2018 coming into effect this year, we may see activists calling more attention to these risks and we expect shareholders will increasingly focus on these risks in the coming years.



<sup>1</sup> AICD Company Director September 2019 edition



# RISE OF AGM ACTIVISM & COMPANY RESPONSE

Given there is no one size fits all to proxy voting, and the fact that there will always be issues which produce legitimate differences of opinion, it can be challenging for companies to navigate the AGM season and keep all shareholders happy.

This challenge is further amplified by the increase in shareholder resolutions being lodged at AGMs by civil society organizations such as Market Forces and the Australian Centre for Corporate Responsibility (ACCR).

In 2019, Market Forces and ACCR (at times, with investors co-filing) have lodged 30 environmental and social related resolutions at 11 different companies. These resolutions largely relate to climate related strategy and disclosure, urging companies to set

emission targets and improve the usefulness of information provided to shareholders. These resolutions are typically followed up by the activist group and other related shareholders at the AGM where questions directed at the Chair request the company to commit to action.

The Australian Corporations Law does not provide a streamlined mechanism by which to lodge shareholder resolutions. Notwithstanding, civil society has become adept at navigating the legal framework to lodge resolutions which are typically intended to be 'advisory' in nature and essentially end up acting as a poll on an issue that is of concern to them (and the wider community).

Civil society in Australia is increasingly using shareholder resolutions to drive action on environmental and social issues. While such resolutions typically attract low votes in favour, they are effective in garnering publicity and attention and can impact the reputation of the target companies (and their investors). They are also effective at driving change within companies where investors have tried, but failed, through engagement with management and the Board.

The challenge for companies is to anticipate whether they will be a target and to take proactive steps to manage the issues and engage with civil society and investors.

Irrespective of whether companies like the tactics employed, it is clear that civil society groups are increasingly using AGMs and shareholder resolutions to draw attention to issues that are of concern to them (and often many asset owners, and their underlying members) and that may lack action at a political or regulatory level.

It is critical that companies build constructive relationships across their stakeholder base and be proactive in communicating key ESG issues before they become civil society targets.

Failure to do so potentially opens companies up to the spread of misinformation and to losing control of the messaging. It is not enough to be just doing a good job. It is invaluable to publicly reveal how and why this is the case through clear ESG disclosures – even if this means disclosing information about potentially uncomfortable issues.

It is no longer enough for a company to quietly just go about its business. It needs to be proactively managing its relationship with all stakeholders, even those with whom it feels it has little in common and be open to acknowledging, addressing and accepting feedback.

## WHAT SHOULD COMPANIES DO TO MONITOR, PREPARE AND RESPOND TO SHAREHOLDER ACTIVISM?

While every situation is different, we advise companies to take the following approach:

Ensure robust ESG governance arrangements and practices are in place, tailored to the demands of the business, industry, and stakeholders involved.

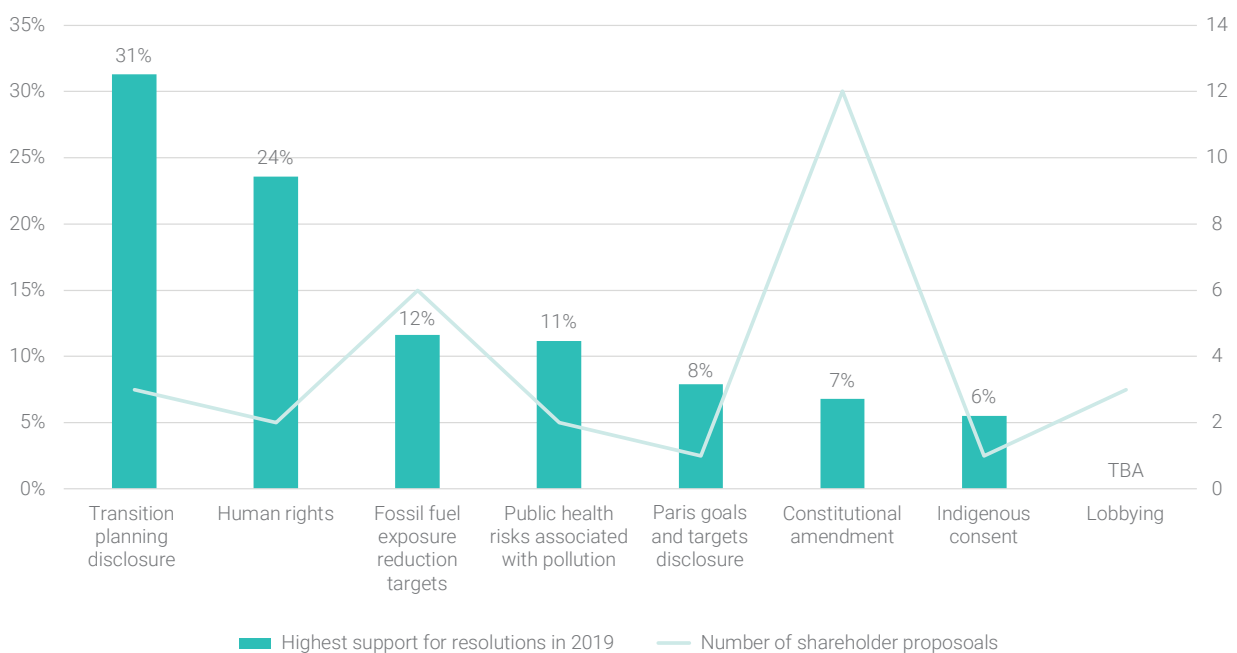
Transparently report on how the company is performing in relation to key ESG issues.

Regularly engage with investors to understand what they are focused on from an ESG perspective and why?

Engage with civil society groups outside of the lead up to AGM season in order to better understand their work, focus and interests.

Actively monitor the work of civil society groups and focus areas (what is happening with other companies in the same or different industries).

## 2019 AGM SHAREHOLDER RESOLUTIONS





# EVOLVING ROLE OF PROXY ADVISORS: THEN AND NOW

The key role of global proxy advisory firms is to provide services to institutional shareholders including research and voting recommendations, as to how to vote their shares at shareholder meetings. However, the nature and extent of this role is not uniform amongst investors and has evolved over time.

Historically, proxy voting recommendations were heavily relied upon by investors to inform their voting decisions. For example, a decade ago, it would be common for asset owners to instruct their investment managers to vote in accordance with proxy voting advice received, or at least advise them of any intentions to vote differently. Situations where asset owners would instruct their investment managers to vote a certain way, counter to proxy recommendations, were rare.

However, today's voting landscape has changed dramatically, with asset owners developing their own ESG expertise and increasingly bringing their investment function in-house rather than relying on external managers. This phenomenon has also extended to external fund managers, some of whom are also developing their own in-house ESG capabilities to assess investment and voting decisions.

Asset owners bringing ESG capabilities 'in house' reflects their increased focus on being active stewards of members' compulsory retirement savings, and this encompasses the need to make active and informed voting decisions. Consequently, there is less 'blind'

reliance being placed on proxy voting advice than in the past. Rather, proxy voting research and advice is increasingly becoming one of several inputs into the voting decision making process for both asset owners and investment managers.

It is important to note that voting recommendations given by proxy advisors should not be taken as investors 'blindly following' proxy research and recommendations. It is often the case that an investor will, based on their own analysis, agree with the recommendations of the proxy advisor. There are also many circumstances in which the issues are somewhat 'grey' and there are good arguments to vote 'For' and 'Against'.

In these instances, it may be the case that a proxy advisor has, on balance, recommended voting 'For', and an asset owner (or fund manager) believes that a vote 'Against' is warranted, or vice versa. This is increasingly the case where asset owners have internalised the investment management function and have a detailed and close working knowledge of the companies, senior management and the Board.

Accordingly, the asset owners are well equipped to make a call that while the decision could go either way, they will support (or go against) the resolutions being put to them, balancing commercial and corporate governance considerations.



## PROXY RESEARCH AND ADVICE AS AN INPUT INTO THE VOTING DECISION PROCESS

In making a voting decision, diligent and sophisticated investors will bring their independent judgement to bear on AGM resolutions and consider a range of issues including:

Proxy voting research

General principles of corporate governance

Commercial considerations

Engagement history and experience with the company

Peer and external fund manager reviews

Its own internal portfolio manager and ESG manager views

Given that investors are typically being asked to vote on hundreds of resolutions within a compressed timeframe during the AGM season (many of which are of a procedural nature), proxy voting research and advice can be especially useful in flagging potentially controversial issues or 'Red Flags' warranting further investigation and analysis by the investor.

## 'RED FLAGS' FOR PROXY ADVISORS

While there can be a divergence of views between Proxy Advisors and investors on specific issues or policies when assessing AGM resolutions, there are several 'Red Flags' which remain universal for the most part.

In no particular order, these include:

- Lack of board diversity
- Lack of board independence
- 'Over-boarding'
- Remuneration plans that are overly complex
- Large fixed pay increases
- One off payments (incentives awarded on completion of a transaction, project or acquisition, or retention payments)
- Adjustments and impairments (one off exclusions of 'bad' items, or inclusions of 'good' items in calculating profit numbers which are relied upon to determine whether incentives vest and hurdles are met)
- The exercise of positive, but not negative discretion
- Lack of alignment between the shareholder experience and executive remuneration outcomes (magnitude of bonuses vs actual company performance)
- Persistence of bonus payments at high levels (lack of variability, which raises questions regarding how at risk any 'at risk' pay is)
- Re-testing of incentives
- Inadequate disclosure of incentive plan structure and metrics
- Insufficient deferral of incentive payments





# IN A WORLD OF INSTANT CONFIRMATIONS, PROXY VOTING IS STILL LIGHT YEARS BEHIND

Instant message notifications, payment confirmations, and taxi pick up locations. The world in which we live today demands instant confirmation for the day to day transactions we carry out.

However, by the end of November, over 150 shareholder meetings of ASX companies will have commenced, covering key governance topics such as board member remuneration and director elections, yet influential institutional shareholders who vote may have to wait for weeks to receive confirmation that their key vote has been successfully lodged.

This reality is due to the current processing practices of the myriad of intermediaries that exist between shareholders and the final destination of the votes, the share registry.

Most of the world's largest custodian banks outsource proxy voting to companies such as Broadridge and ISS. These companies take care of the full front to back processing of proxy votes, from notifying shareholders of their eligible positions in an upcoming shareholder meeting, to collecting the vote and then passing it on to the relevant local market sub-custodian.

However, such is the size of this undertaking (outsourced proxy companies receive many thousands of individual votes from shareholders) rather than pass on each vote as it is received, they wait until approximately 24 hours before the local agent's deadline and then submit one large collated vote.

What this means is that if a shareholder votes when they are initially notified of their eligible holding, their vote will

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effectively sit in limbo, sometimes for up to three weeks, before being passed down the voting chain towards the share registry.

Unlike other jurisdictions, in Australia, the 2001 Corporations Act allows issuers to request disclosure of any voting information received by a custodian bank or any intermediary collecting votes on their behalf.

This mechanism affords a level of transparency to Australian companies and helps identify unintended and missing votes. This regulation is specific only to Australia, meaning companies elsewhere in the world do not have any opportunity to actively monitor voting prior to the meeting.

However, due to increasing pressure from shareholders and issuers alike, as well as advances in technology, this may soon be about to change.

In 2020 the Shareholder Rights Directive is set to radically change the proxy voting process in Europe with the introduction of legislation similar to the 2001 Corporations Act in Australia enabling issuers to request disclosure of voting information.

More significantly though, the Shareholder Rights Directive states that Intermediaries (such as custodians and proxy outsource companies) will have to pass voting instructions on “without delay” once received, enabling the vote to reach the share registry much more quickly, thus providing greater transparency.

Beyond legislative changes, technological advances are also afoot. The emergence of blockchain is seen by many as the ultimate solution to increased transparency in proxy voting and Broadridge has wasted no time in putting the theory to the test. In March 2018 they partnered with custodian banks J.P. Morgan and Northern Trust to pilot the use of blockchain for Banco Santander’s AGM.

Santander, which is the largest bank in the euro zone by market capitalisation, has over four million shareholders and 60.7% of the capital belongs to institutional investors. The institutional investors had the opportunity during the last AGM to see how their votes could be counted and confirmed much more quickly thanks

to the blockchain technology. Future technological enhancements should allow this to be done instantly.

The pilot was run in parallel to the AGM, with blockchain being utilised to produce a “shadow” digital register of the proxy voting taking place in the traditional model.

Further to this initial pilot in Europe, Broadridge announced in 2019 that they had partnered with the Tokyo Stock Exchange to successfully conduct the first Proof of Concept of blockchain-based proxy voting in Japan.

**The Shareholder Rights Directive states that intermediaries will have to pass voting instructions on “without delay” once received, enabling the vote to reach the share registry much more quickly, thus providing greater transparency.**

The validation was performed in a test environment in which the role of local custodians, global custodians, the central securities depository, and local transfer agents was simulated. The final positions of these organisations were loaded on the ledger and reconciliation was performed using smart contracts. The result demonstrates that if position management is performed on a ledger for the purposes of proxy voting, the ledger could also be used as the single ‘source of truth’ for subsequent data reference needs, resulting in the reduction or elimination of complex reconciliation processes.

These developments in both legislation and technology illustrate that globally a complete overhaul of the current process is in progress, looking at the potential of instant voting notification in the not too distant future.



## INTRODUCING TALIEH WILLIAMS

Morrow Sodali welcomed Talieh Williams to the Australian governance team in August 2019 as Special Counsel, Corporate Governance.

Talieh previously worked at UniSuper, one of Australia's largest superannuation funds managing ~\$75B AUD, as the Manager of Governance & Sustainable Investment, where she worked for over 11 years. Whilst at UniSuper, one of Talieh's key accountabilities was to develop and implement its responsible investment program and embed ESG considerations into all decision-making processes. Talieh has over 19 years' experience across the law, oil industry, sustainability consulting and the institutional investment sector, where she has worked at the forefront of ESG, responsible investment and sustainable investment for the last decade.

She graduated from Monash University with a Bachelor of Laws (Honours). She also holds a Bachelor of Planning and Design (Urban Design) and a Master of Social Science (International Development). Whilst at UniSuper she held director positions at Australian Council of Superannuation Investors (ACSI) and Responsible Investment Association of Australasia (RIAA) and as a Member of the Committee of Management, Investor Group on Climate Change (IGCC).

### **What led you to undertake studies in Law?**

"I have always been interested in environmental conservation issues and I initially studied law as I was keen to become an environmental lawyer.

### **What attracted you to a career in corporate governance, in particularly with an 'ESG' and sustainability focus?**

Having worked in two large law firms and at Shell as an environmental project manager, I had the opportunity to obtain exposure to a broader range of ESG and sustainability issues such as safety, diversity and corporate responsibility all of which are interesting and engaging. As such, I wanted to head in a professional direction that tied the E, the S and the G together. This led me to EY and then to UniSuper where I was the head of the ESG team within the Investment Department.

### **Spanning your career, what has been your greatest achievement?**

I find it difficult to say any one achievement has been my own as it is always a team effort. Having led the ESG function at UniSuper (a large Australian pension fund) for over 11 years, I am really pleased that the investment team now has a very clear and genuine focus on considering ESG issues as part of its investment process.

### **What did you enjoy the most about working in sustainable investing?**

It is an incredibly interesting field; it has the potential to drive better ESG and sustainability outcomes 'in the real world' and it is a field in which a terrific group of people work. It is very collegiate (across firms) and it was a privilege to work with such a great group of people who all share a common purpose, which is to drive more sustainable outcomes for society and the environment, whilst also delivering retirement savings to individuals.

### **What is the one piece of advice you can give companies to become better corporate citizens?**

In the words of former Judge Neville Owen, who headed Australia's HIH Insurance Royal Commission in 2001, ask a very simple question: "Is this right?". Ask this question consistently and often, and, then act accordingly. I believe that doing the right thing is consistent with a Director's Duty to act in the best interests of a company."

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