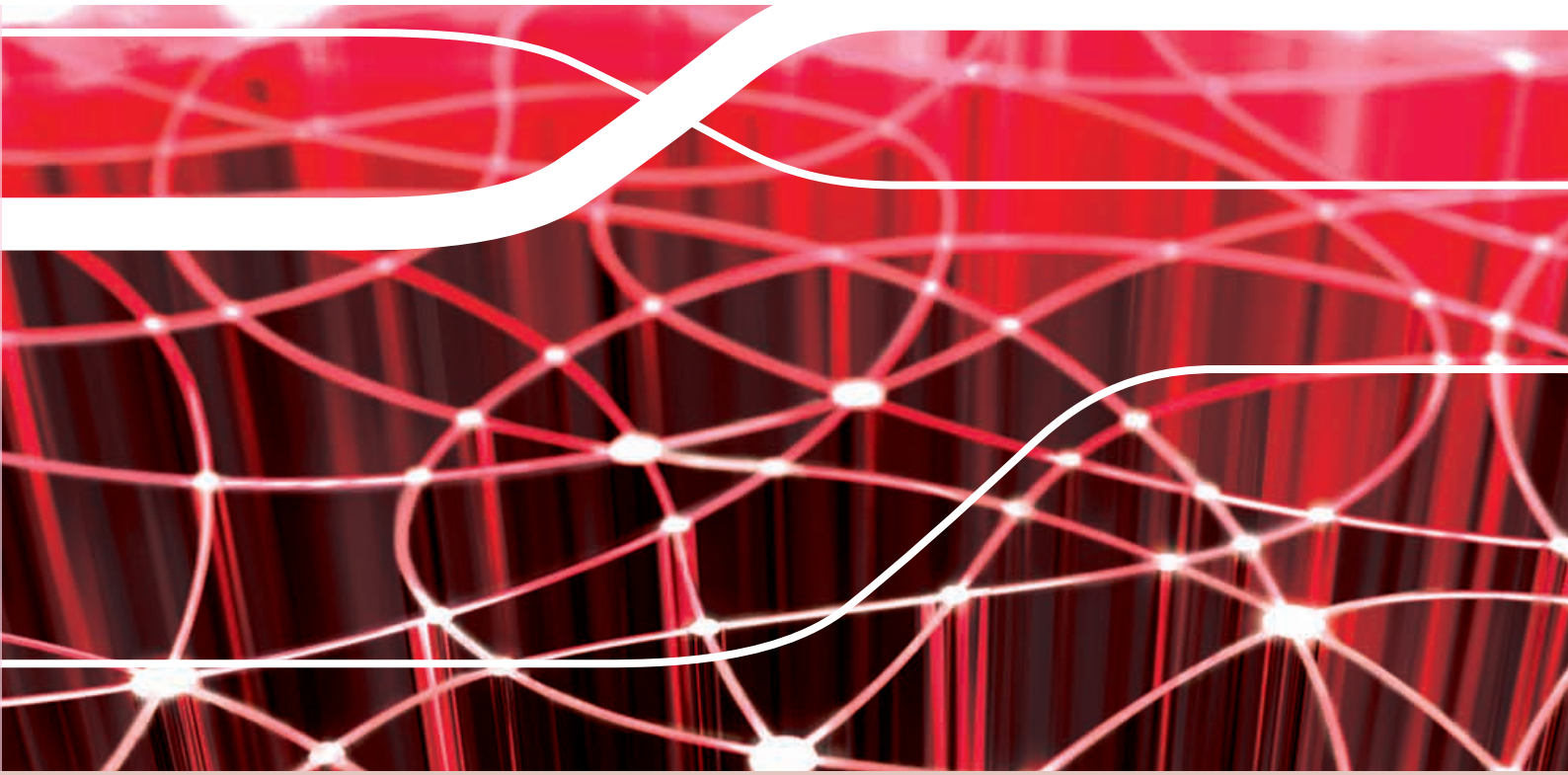
INSTITUTIONAL SHARE VOTING AND ENGAGEMENT

EXPLORING THE LINKS BETWEEN DIRECTORS, INSTITUTIONAL SHAREHOLDERS AND PROXY ADVISERS



AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

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AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Australian Institute of Company Directors
The Australian Institute of Company Directors is a member institute for directors dedicated to having a positive influence on the economy and society by promoting professional directorship and good corporate governance. We deliver education, information and advocacy to enrich the capabilities of directors, influence the corporate governance environment in Australia and promote understanding of and respect for the role of directors. With offices in each state and more than 30,000 members, we represent a diverse range of organisations, from the top 200 publicly listed companies to not-for-profits, public sector entities and private companies.

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Foreword

STRENGTHENING THE understanding between company directors, institutional investors and proxy advisers can lead to better decision-making, more valuable corporate disclosure and enhanced communication.

The origins of this research stem from the Chairman's Forum of the Australian Institute of Company Directors. The Chairman's Forum brings together chairmen of Australia's major listed companies to promote discussion of current and emerging corporate governance issues. During these discussions, it became apparent that Australia's chairmen were increasingly interested in improving engagement between boards and institutional investors and were keen to meet with the actual 'decision-makers' in the share voting process. In addition, chairmen wanted to better understand the role and influence of key intermediaries, including proxy advisers.

In light of these discussions, the Australian Institute of Company Directors commissioned Mercer to undertake independent research to explore these themes in more detail. We are now pleased to present the outcomes of the research.

The report is divided into three parts. Readers with a solid understanding of the institutional voting process in Australia may be interested to start with the "Key Findings" in Part One and continue by considering the views of participants which emerged from the surveys and interviews in Part Two. Readers who are unfamiliar with the share voting system in Australia may benefit by first reading, Part Three, "A Map of the Institutional Share Voting System", before returning to consider the views of directors, superannuation funds and managed funds as a result of the surveys and interviews conducted.

We hope that this report will continue to improve the dialogue between directors, institutional shareholders and proxy advisers about the issues which impact upon the voting of significant shareholdings on company resolutions in Australia. Further, we are hopeful that the research will be a catalyst for constructive discussion and will make a valuable contribution to the analysis of current engagement and share voting practices in Australia.

We understand that many of the views concerning this topic are held strongly, so we would like to thank all of the participants that contributed to the research by responding to surveys and by giving up their time to be interviewed. Without the willingness of respondents to participate and speak candidly, the issues addressed in this report would still be largely considered through lenses of anecdote and speculation. It is in everyone's interest that engagement and voting practices in Australia are as effective as they can be, given that shareholder's interests, national productivity and Australia's economy in part, depend on it.

I trust that you will find this publication interesting and of practical use.

John H C Colvin
CEO & Managing Director

Australian Institute of Company Directors
September 2011

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About this Report

THE LINKS BETWEEN directors, institutional share owners[1] and proxy advisers, focusing on issues of communication, engagement and voting, are not clearly understood in the context of the mechanism of the share voting process. This report maps the share voting process from end to end and examines the quality of communication between industry participants.

The research was designed to explore the effectiveness of the communication and engagement between companies, proxy advisers and institutional investors. Mercer surveyed and interviewed directors of ASX 200 companies, representatives of superannuation funds, managed funds and investor relations personnel. Mercer also interviewed key industry participants in the share voting process. Additional details of the methodology used and the survey and interview process are discussed in Part Two of this report, "Surveys and Interview Results".

Part One covers Key Findings.

Part Two addresses Survey and Interview Results and contains:

- Section I - an overview of the research methodology in relation to the survey and interview components of this project.
- Section II - research findings detailing the results of the surveys of ASX 200 company directors, managed funds, Australian superannuation funds and investor relations personnel. Contained within this section are quotes from interviews with 48 industry participants in the share voting process.
- Section III – a summary of the key findings from the surveys, interviews and desk research.

1 Managed funds and superannuation funds

Part Three – A Map of Institutional Share Voting in Australia is based on desk research and interviews with industry participants and is divided into the following parts:

- An introduction covering an overview of the structure and chronological approach to discussing the share voting process and roles of industry participants and timing of the process, and
- Participants in the share voting market.

The remainder of this section maps the process and participants in the Australian share voting process:

- Stage one: formulating the meeting agenda.
- Stage two: issuing notice to institutional shareholders.
- Stage three: making the voting decision.
- Stage four: votes are aggregated, lodged, finalised and disclosed.
- Key issues: identifying major issues and knowledge gaps relating to the key active participants and the voting process.

Appendices are included at the end of the report.

1. Key Findings

A SUMMARY OF THE KEY findings from this research is set out below. More detailed analysis of these findings is included at Section III of this report, "A Map of Institutional Share Voting in Australia".

Finding 1: The institutional share voting environment is characterised by high-volume decision making in a compressed time, and this has an impact on how institutional share owners (both managed funds and superannuation funds) conduct share voting – in particular what functions they do themselves, and what functions they outsource.

- About 80 per cent of votes cast by institutional investors on listed company resolutions occur in a six- to eight-week period (the "peak proxy season"); approximately 80 percent hold their annual general meetings in October – November each year. At the peak of the season there may be 30 or more company meetings to be considered in a week.[2]
- Superannuation funds and large managed funds are broadly invested, often including small-capitalisation ("small cap") investments. This means they will have resolutions from 300 public company meetings or more to deal with in a year.
- The pressure generated by this number and concentration of meetings has an effect on how institutional investors organize their share voting activities - there is a strong incentive to outsource parts of the process (including research/proxy advice) to service providers for cost and efficiency reasons,

2 The Corporations Act requires all listed companies to hold their annual general meeting within five months of the end of their financial year. In Australia, this means there is a "mini" proxy season in April-May and a main proxy season from early October to early December. Almost all company meetings are compressed into these two periods. These volumes are confirmed in the course of interviews with institutional investors, and material made available by both ISS and Glass Lewis.

while the 'lumpiness' of the work in the proxy voting season means also that there is a disincentive to in-source.

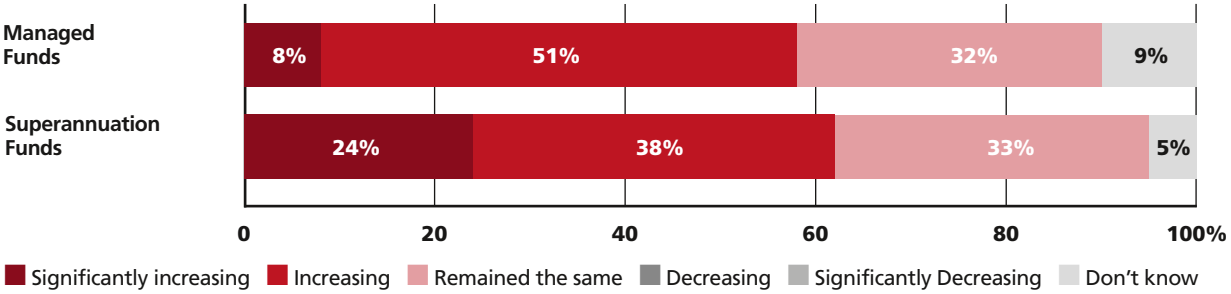
Finding 2: That institutional share voting is a high volume, compressed time business, shapes how the parties in the institutional share voting process communicate with each other[3]:

- Access by companies to institutional share owners and proxy advisory firms is limited in the peak proxy season with communication restricted to exceptional matters – institutional share owners are busy with voting lodgment at this point. Company directors, however, wish to have greater access to institutional share owners and proxy advisers during the peak proxy season.
- Communication between companies and institutional share owners is likely to be more effective outside of the peak proxy season.
- Although opinion is divided on this matter, most participants (including company directors) do not think that continuous disclosure provisions pose any real barrier to effective communication with share owners prior to the issue of the Notice of Meeting for instance, discussions could be held following interim results, and/or discussions could focus on principles rather than specific outcomes (for example, on remuneration matters).

Finding 3: Institutional share owners have been increasingly active in voting their shares and are increasingly willing to vote "against" company resolutions if it is in their interests to do so – there is also some evidence (from interviews) that superannuation funds are becoming more active in voting and that they are doing more of the voting themselves rather than leaving this function with managed funds.

FINDING 3

Superannuation Funds and Managed Funds – How would you describe the willingness and capability of share owners to vote against company resolutions over the past 10 years?



3 This finding is based on interviews with managed funds, super funds, proxy advisory firms and company directors.

Finding 4: When directors think of institutional share owners, they think of managed funds rather than superannuation funds. Although this is changing, directors tend to underestimate the importance of superannuation funds.

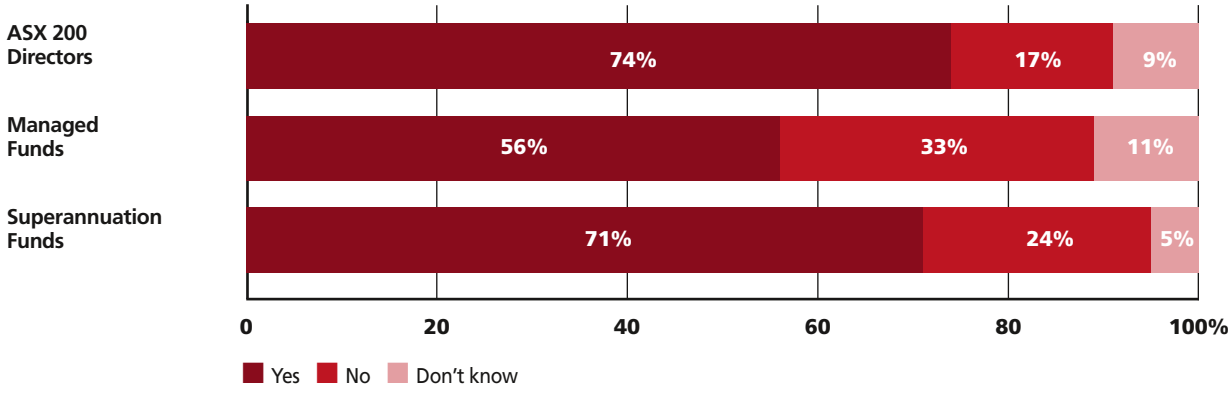
- The directors interviewed for this research tended to automatically think of managed funds as the investor, and would generally not speak of superannuation funds at all if not prompted to do so. Nonetheless, directors were aware of the power of superannuation funds even if they did not first think of them as the 'investor'.
- Directors did not have a clear idea on how to communicate with superannuation funds – nor were they clear on who they would contact within a superannuation fund.

Finding 5: Share voting policies of institutions, proxy advisers and industry groups are important influences on institutional share voting.

- There are many share voting and governance policies, such as the Financial Services Council's "Blue Book" and the Australian Council of Superannuation Investors' (ACSI) *Governance Guidelines*. Companies listed on the Australian Securities Exchange (ASX) must report against the ASX *Corporate Governance Principles and Recommendations*. These policies are very similar, differing only at the margins.
- Almost all participants in the system say these share voting policies are (or should be) guidelines only and that votes should be determined according to companies' individual circumstances. However, there is a risk that guidelines become de facto rules because of volume and time pressures.
- Companies should be aware of these share voting policies and guidelines. If a proposal is important, a company should be prepared to explain to share

FINDING 5

Do you take account of share voting policies prepared by industry bodies and proxy advisory firms?



owners why it should be approved, even if it varies from guidelines.

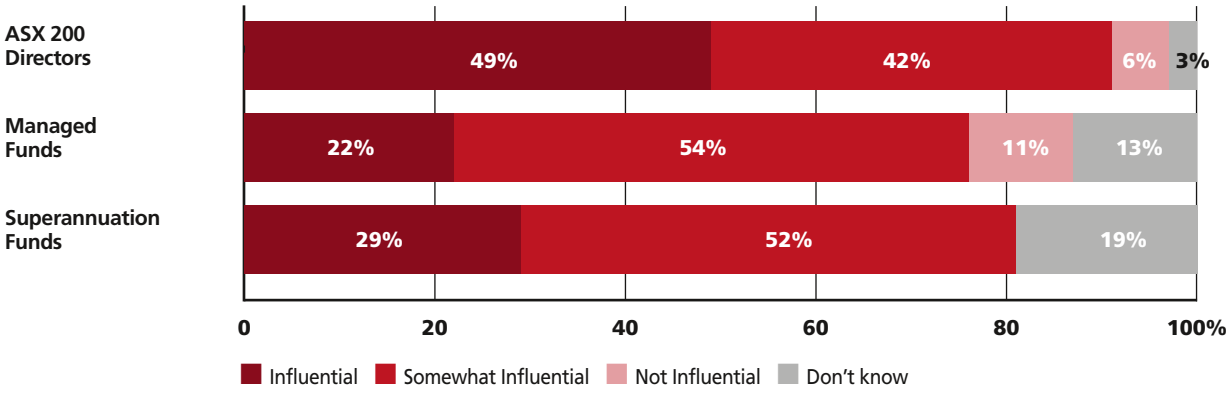
- The existence of published share voting policies and guidelines means companies should not be surprised at a high "against" vote on a resolution that contravenes general policy (according to the interviews conducted for this research, few directors are now surprised by high "against" votes).

Finding 6: Proxy advisory firms are an important influence on institutional share voting in Australia.

- That proxy advisers are influential is a near universal view of all key participants in the share voting system: company directors, managed funds and superannuation funds.
- The high-volume, time-pressured environment means proxy advisers perform a function that most institutional share owners would consider prohibitively costly to do themselves.
- A theme that emerged from the interviews is the growing acceptance of the role of proxy advisory firms and the evolving relationship between companies and these firms, which is becoming less adversarial and more professional in tone.

FINDING 6

How influential is the advice provided by proxy advisory firms to institutional shareholders?



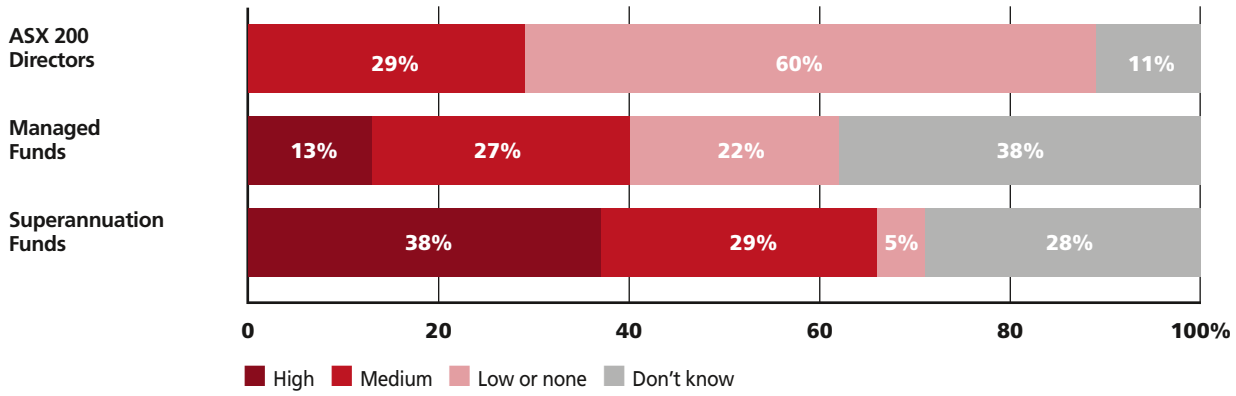
Finding 7: A significant minority of company directors think proxy advisers are improperly influential. They believe too much has been outsourced by institutional investors, making proxy advisory firms de facto decision makers.

- A significant number of directors felt very strongly that it was the clear responsibility of institutional investors to actively make voting decisions and to devote sufficient time and resources to think about the issues involved. To do otherwise, they argued, was to abrogate an important responsibility.

- It is significant and logical that where directors held these concerns they also had concerns about the capacity to understand share owner value, independence, training, experience, resourcing and general competence of proxy advisory firms.
- These views are reflected in the survey results: 49 per cent of directors thought proxy advisers were influential (see Finding 6); however, 60 per cent of directors thought they had insufficient experience, expertise or knowledge to do their job (see chart below). This assessment contrasted strongly with the views of institutional share owners (particularly superannuation funds).

FINDING 7

What level of experience, expertise and knowledge do proxy advisory firms have in understanding what drives shareholder value in companies?

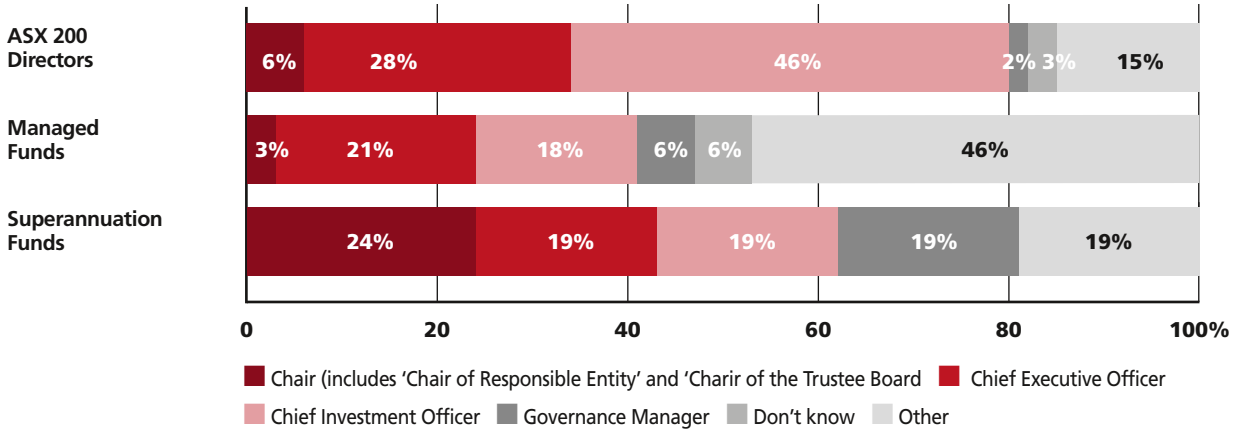


Finding 8: Companies and directors are often not communicating with the real decision makers in institutional investors. Whereas companies think the decision makers are, or should be, at the peak of the organisation (for example, the chief executive or chief investment officer), the reality is that voting decisions are made lower down the organisational chain, at the portfolio manager, analyst or governance officer level.

- A common assumption on the part of the directors surveyed and interviewed was that communication should be at the most senior level to be effective. This view was at odds with the views of institutional share owners.
- The difficulty of mapping who (or what role) is responsible for making decisions on share voting should be acknowledged. Nevertheless, this is crucial knowledge for a company that wants to effectively communicate the basis for a resolution that may be controversial or "outside policy".
- These differences in views are reflected in the chart on page 8.

FINDING 8

Who, within share owners, should companies try to engage with on significant issues?



(Note that "Other" in the response from the managed funds represents portfolio managers, investment analysts, investment specialists, sector specialists and other analysts within portfolio teams.)

Finding 9: There are basic problems with the share voting process and machinery which lead to "lost" and miscounted votes.

- Discussions with custodians, sub-custodians and registry companies reveal a common story:
  - o most voting communication, from the custodian or sub-custodian to the registry company, is still by fax and not by electronic lodgment
  - o there is currently no effective audit trail for institutional share voting in Australia.
- It is likely that the problems with the voting system identified by AMP Capital Investors in 2007 which led to lost votes have not substantially changed.[4]
- Share registries expressed difficulties reconciling the votes received with the correct number of shares held by the share owner within the 48 hours between the receipt of proxy forms and the company meeting.
- There is a substantial and relatively recent body of work that addresses share voting process and machinery issues, including a report by the Parliamentary Joint Committee on Corporations and Financial Services[5].

4 AMP estimated a vote 'loss' rate of about 4% - reported in AMP Capital Investors Corporate Governance Report, August 2006, p. 2.

5 There are two recent substantive reports on this subject: the Parliamentary Joint Committee on Corporations and Financial Services *Better Share owners – Better Company, Share owner and Engagement and Participation in Australia*, Commonwealth of Australia, June 2008, and the preceding report by IFSA (now the Financial Services Council) *Improving the Proxy Voting System in Australia*, 14 September 2007.

2. Survey and Interview Results

Overview

The purpose of this research was to assess the links between directors, institutional share owners and proxy advisers, focusing on issues of communication, engagement and voting. The research was designed to quantify the extent to which ASX 200 company directors, Australian equities managed funds, Australian superannuation funds and company investor relations managers communicate and engage in the Australian share voting process.

In particular, the research was designed to:

- explore the effectiveness of the communication and engagement between companies, institutional investors and proxy advisers
- better understand the system of institutional share voting in order to improve communication between companies and institutional investors
- gather the views of industry participants on the role of proxy advisers in the current corporate governance environment as well as their likely future role
- determine the impediments that prevent companies from identifying their share owners and any barriers to the level, quality, effectiveness and timing of the communication/engagement between industry participants
- explore how proxy voting services are used by institutional investors.

I. Methodology

Surveys

To explore the themes set out in the overview Mercer:

- surveyed 468 ASX 200 company directors who at the time of the survey were members of the Australian Institute of Company Directors, receiving responses from 66
- surveyed 145 mainstream Australian equity managed funds through Mercer's Global Investment Manager Database, receiving responses from 63
- surveyed 100 Australian superannuation funds through Mercer's database, receiving responses from 21
- surveyed 94 investor relations personnel through the Australian Institute of Company Directors membership database, receiving responses from 10.

The surveys contained 35 to 40 questions, including multiple choice and open-ended questions. The key themes addressed included a range of practical matters such as the views of participants on share voting processes, the degree of engagement between participants at different times of the year, the role of share voting policies, the part played by proxy advisers and the nature of communication between companies and institutional investors.

In particular, participants were asked whether they:

- are signatories to Australian or international bodies that focus on environmental, social and corporate governance (ESG) investment issues or company engagement and share voting
- are guided by the policies of proxy advisory firms and industry bodies (when formulating company resolutions or when voting directly or indirectly)

- are satisfied with the level, quality, effectiveness and timing of the communication between institutional share owners, companies, proxy advisers and other industry participants inside and outside the peak proxy season
- are satisfied with the nature of proxy advice and the resourcing of proxy advisers for effective decision making
- are satisfied with the standard of disclosure and communication between companies and institutional investors
- are able to easily identify relevant share owners, institutional investors or company directors in communicating and resolving issues in the share voting process
- are satisfied with the share voting system, including its accuracy and the level of verification and audit available.

Some groups were not surveyed due to the small population size involved (proxy advisory firms, custodians, share registry firms) and these groups were instead included in the interviews for this research project. The findings from the investor relations personnel are not included in this report due to the low response rate to the survey from this group.

Interviews

In addition to the surveys, 48 interviews of 60-90 minutes (with a small number by telephone) were conducted with:

- ASX 200 company chairs and directors
- Australian equities managed funds: chief investment officers and portfolio managers
- Australian superannuation funds: chairs, chief investment officers and governance specialists
- proxy advisory firms
- institutional investment industry bodies: chief executives and chief investment officers, executives, policy experts
- company engagement firms
- custodians
- sub-custodians
- share registry companies
- voting platform operators.

The interviews were conducted by senior Mercer specialist investment consultants. (As mentioned above, a small number of the participants interviewed were not

surveyed due to the small population size of some groups.)

The purpose of the interviews was to identify impediments to share voting communications. Interviews covered all the key areas in the surveys, such as the engagement and voting process, share voting policies, the role of proxy advisers in the decision making and communication, communication between companies and institutional investors and the effectiveness of the share voting system.

Other factors were also examined, such as:

- sources of information used by industry participants when making decisions about share voting and corporate governance
- timing in the share voting process (explored in detail in part III of this report, A Map of Institutional Share Voting in Australia, including the legislated time frame and the operational time frame imposed by service providers performing the administrative work necessary to meet the legislated time frame
- the impact of the volume of votes in the "peak" share voting season, particularly how this might affect the actual time available to make decisions and its impact on how decisions are made and the extent of "default" or process-type decisions
- perceptions about the influence of proxy advice on institutional investment share voting decision making
- views on the effectiveness of communication between institutions and proxy advisers and how it has changed over the past 10 years
- views on the role of intermediaries held by principals and agents and vice versa
- "hot button" and contentious issues
- how internal processes could be improved to integrate active ownership practices among company directors, equity managed funds, superannuation funds and investor relations managers.

II. Research Findings

THIS PROJECT WAS based on research, as well as interviews with and surveys of the key participants in institutional share voting in Australia. This section provides information on the interview and survey components of this research project.

Interviews

The intention was to conduct interviews with all of the key participants in the institutional share voting process in Australia: directors and chairs of Australian listed companies; managed funds; superannuation funds; industry bodies; proxy advisory firms; voting platform operators; custodians and sub-custodians; and registry companies. The great majority of interviews were face-to-face with some interviews conducted by telephone. The duration of interviews was generally 60 to 90 minutes. Interviews took place from June to August of 2011. A common template was developed for each interview participant category to enable comparison of interview results.

Of the total number of 48 interviews conducted, the break-down of interviews was as follows:

- 16 directors/chairs of Australian companies (including a round-table of 6 directors)
- 9 managed funds
- 5 industry bodies and professional associations
- 7 superannuation funds
- 5 proxy advisory firms
- 6 custodians / sub-custodians / registry firms and other technical participants.

Surveys

Company directors, managed funds, superannuation funds and investor relations professionals were surveyed for this project as follows:

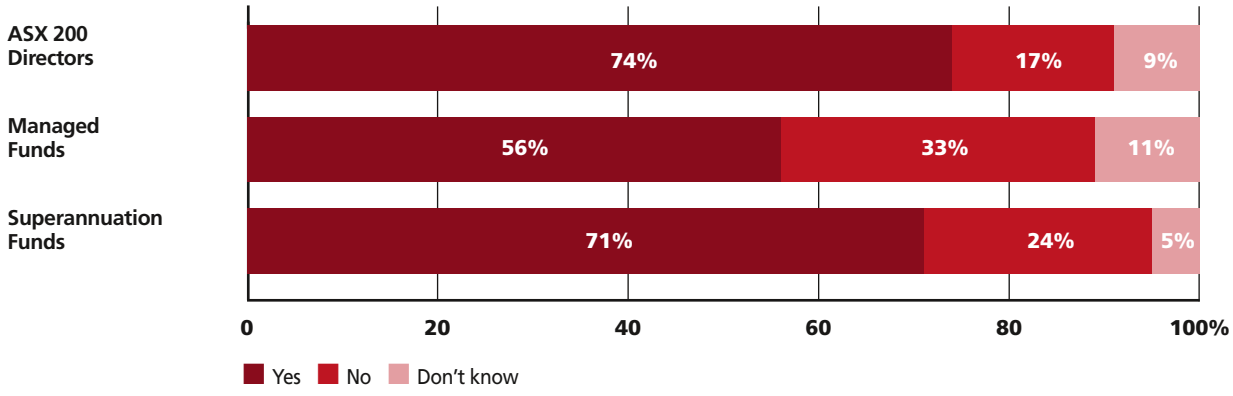
- surveyed 468 ASX 200 company directors through the Australian Institute of Company Directors database, received responses from 66 directors
- surveyed 145 Australian equity managed funds through Mercer's Global Investment Manager Database, received responses from 63 managed funds
- surveyed 100 Australian superannuation funds through Mercer's database, received responses from 21 superannuation funds
- surveyed 94 investor relations personnel through the Australian Institute of Company Directors database, received responses from 10 investor relations personnel

Influence of share voting policies

The following chart summarises whether surveyed ASX 200 company directors, managed funds and superannuation funds take account of share voting policies prepared by industry bodies and proxy advisory firms.

CHART 1

Do you take account of share voting policies prepared by industry bodies and proxy advisory firms?



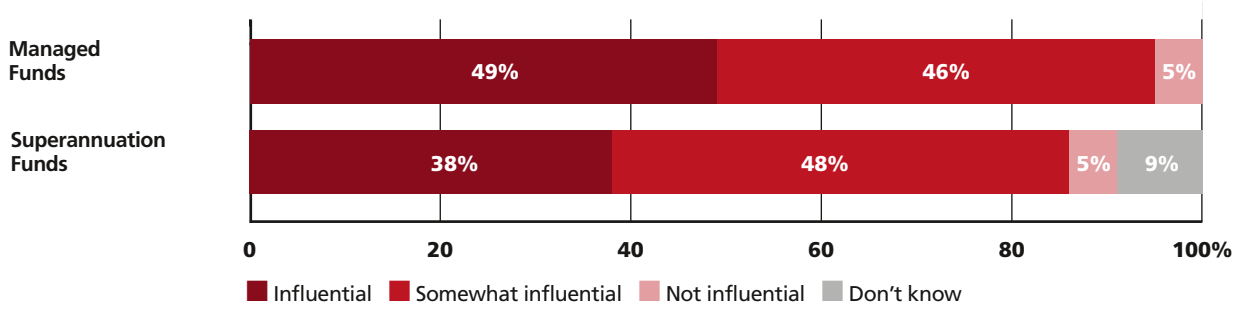
The majority, with the greatest proportion among company directors (74 per cent), do take account of such policies.

The following chart summarises how much influence surveyed managed funds and superannuation funds believe share voting policies have on voting decisions.

Managed funds believe share voting policies are more influential than do superannuation funds. Only 5 per cent in both surveyed groups believe they are

CHART 2

Superannuation Funds and Managed Funds – How influential are share voting policies on voting decisions?



not influential. In interviews, institutional investors said although managed funds and/or industry bodies such as the Financial Services Council (FSC) and ACSI produce different share voting policies, they generally had the same content. In interviews, company directors had a different view: they did not know which policies to take account of and said that they were all different, making it difficult for companies to respond to them.

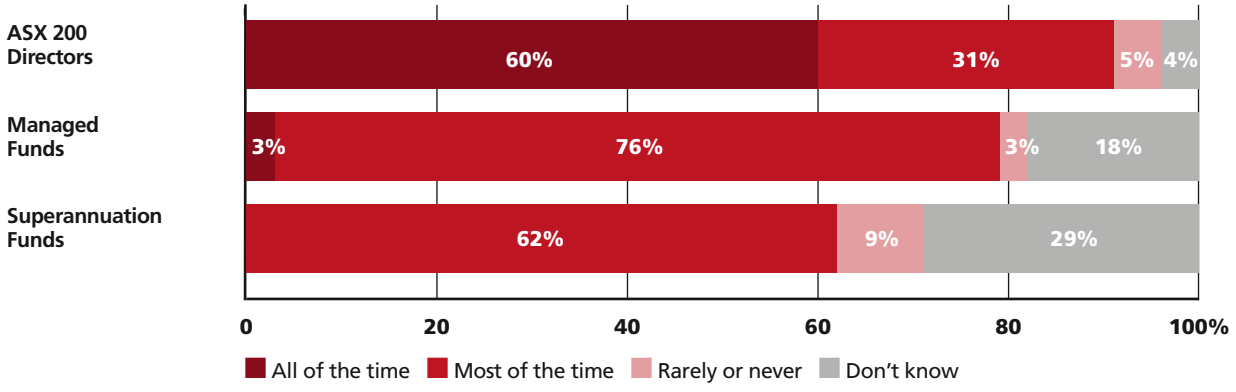
Value of information provided by companies

The following chart summarises perceptions of the company information provided to institutional investors and proxy advisory firms when making share voting recommendations.

Overall, each group says companies provide valuable and sufficient information

CHART 3

Do companies provide valuable and sufficient information so that institutional investors and proxy advisory firms can make informed share voting decisions (recommendations)?



most of the time. However 60 per cent of companies surveyed believe they provide valuable and sufficient information all of the time, compared to just 3 per cent of managed funds. No surveyed superannuation funds believe companies provide valuable and sufficient information all of the time.

In interviews a communication gap was apparent, as superannuation funds that were surveyed said they wanted better disclosure from companies when making decisions on share voting.

From interviews:
is it is easy to communicate with major share owners?

"We know who to talk to … no, that's not a problem …" (company director)

"Yes, we'd meet with the top 10 share owners … one trick is to make sure you've got the economic decisions and the governance decisions covered." (company director)

"Yes, directors and corporations spend a huge amount of time speaking with investors on strategy, projects, staffing. Chairs talk governance and CEOs/execs talk operations." (company director)

[On superannuation funds] "… it's a foreign world to us …" (company director)

"Communication is improving … the main difficulty is in identifying share owners due to the high rate of ownership turnover." (company director)

"Companies should be proactively contacting super funds and offering to meet." (superannuation fund)

"The good directors and companies are very effective communicators, fantastic, and should be acknowledged … but in general we [institutional share owners] have to chase them … why don't they contact us if they're worried about a resolution or meeting … they should, that's their job …" (superannuation fund)

"… communication between companies and their shareholders … a lot of this can be put down to the investment lifecycle and evolution … once companies would only speak to managed funds and most likely asset owners [super funds] wanted it this way … but this is changing and will further evolve … companies will want to and will have to communicate directly with asset owners …" (superannuation fund)

"The broken part of the process is the communication line between institutional share owners and non-executive directors." (managed fund)

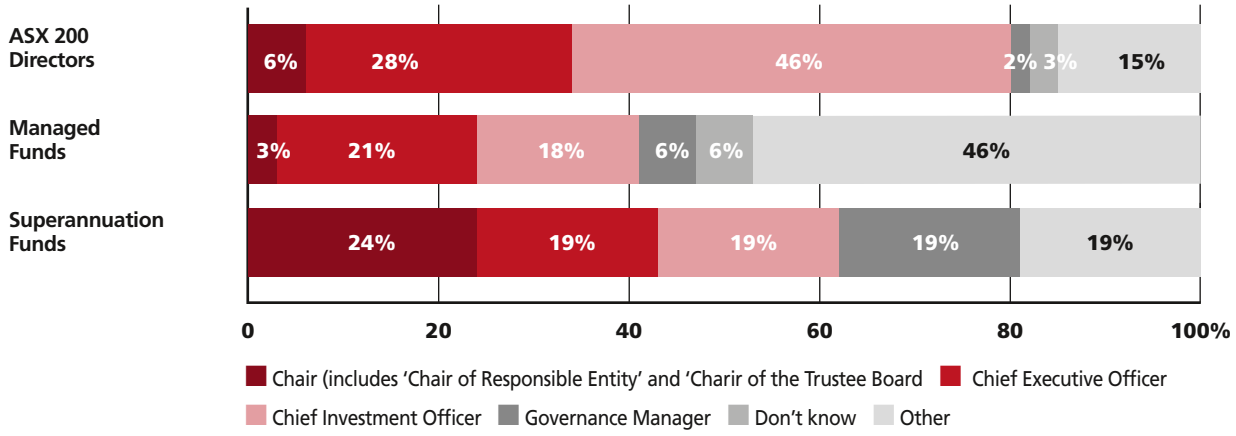
"… a really key issue that affects voting is the quality of the dialogue between asset owners and managed funds … the asset owners are acquiring more investment expertise … but more importantly the whole of that dialogue has been affected by ESG considerations and debate … the dialogue has improved substantially …" (superannuation fund)

Engagement between companies and institutional investors

The following chart summarises who companies should contact within institutional investors on significant share voting issues.

CHART 4

Who, within share owners, should companies try to engage with on significant issues?



About 80 per cent of company director participants believe they should talk to the most senior levels in the institutional investor, such as the chair, chief executive or chief investment officer. In comparison, managed funds and superannuation funds suggest companies may pitch too high, assuming the top of the hierarchy is the best place for communication to be effective whereas in reality it might not be the case.

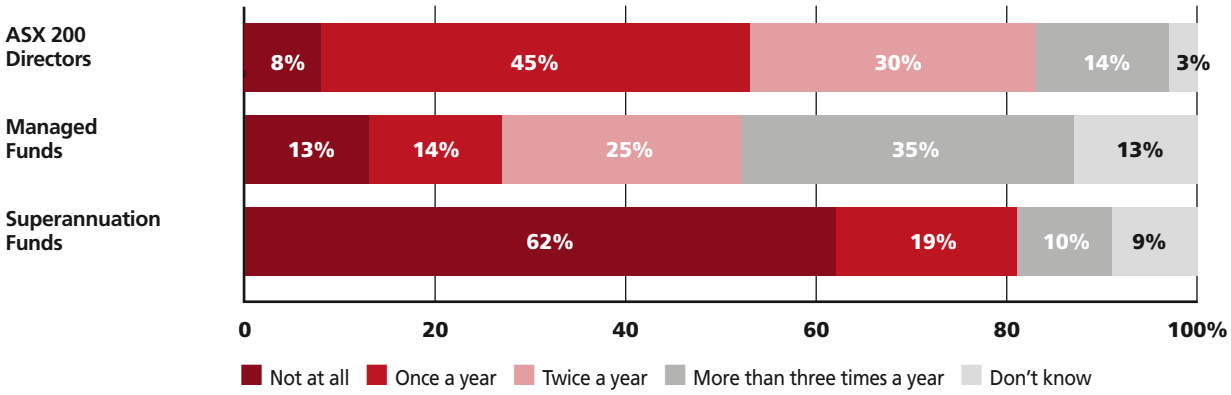
Managed funds, in particular, do not see the chair of an institutional investor as an important point of contact for companies when they are trying to engage on significant issues. Nineteen per cent of superannuation funds nominate the governance manager as a point of contact for companies, as opposed to two per cent of companies.

A significant proportion of the surveyed managed funds (46 per cent) said companies should talk to someone other than the chair, chief investment officer, chief executive or governance manager when trying to engage with institutional investors on significant issues. Managed fund survey participants nominated portfolio managers, investment analysts, investment specialists, sector specialists and other investment analysts in portfolio teams as key contacts.

The following chart looks at the frequency of meetings between surveyed ASX 200 chair/directors and institutional investors, comparing responses from either side of the equation.

CHART 5

How often do companies (Chair / Directors or CEO) meet with institutional investors in a year?



In some ways this chart reflects the fact that superannuation funds are not as close to the companies they are invested in as are managed funds.

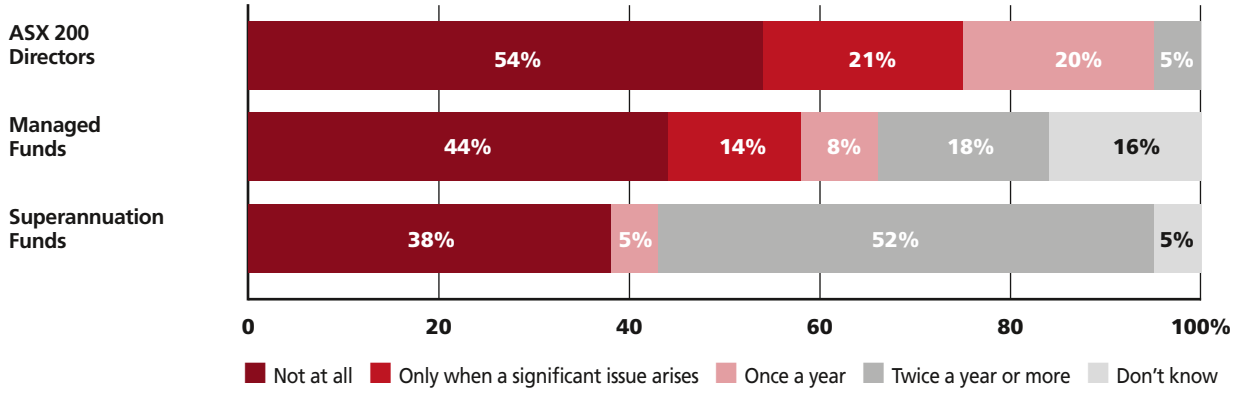
Engagement between companies, institutional investors and engagement firms

The following chart summarises how often company directors, managed funds and superannuation funds meet engagement firms in a year.

More than half of the company directors surveyed do not meet engagement firms at all, followed by managed funds (44 per cent) and superannuation funds (38 per cent). The responses may reflect that superannuation funds meet engagement firms twice a year or more, as they pay them, while companies do not pay engagement firms. A further reason is that the business model of engagement firm is that they will target a small subset of (as they see it) 'problematic' companies – hence contact will be limited. (See also Part Three of this report, Stage One: Formulating the meeting agenda, Company Engagement Firms.)

CHART 6

How often do you meet with engagement firms over a year?



Making the voting decision

Chart 7 summarises whether managed funds make the decision to vote Australian shares (excluding pooled vehicles).

The majority response was 67 per cent "mostly", followed by 22 per cent "yes always". Nearly 90 per cent of surveyed managed funds said they made the decision to vote.

Chart 8 summarises whether surveyed superannuation funds make the decision to vote Australian shares (excluding pooled vehicles).

Thirty-eight per cent of superannuation funds state they made the decision to vote.

Chart 9 shows the level at which the majority of voting decisions are made in managed funds and superannuation funds.

The 38 per cent of superannuation funds that said the voting decision was under

CHART 7

Do managed funds make the decision to vote Australian shares (excluding pooled vehicles)?

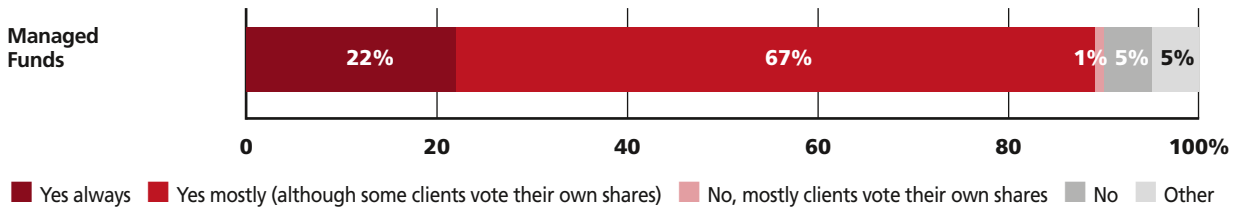


CHART 8

Superannuation Funds – Do they make the decision to vote Australian shares (excluding pooled vehicles)?

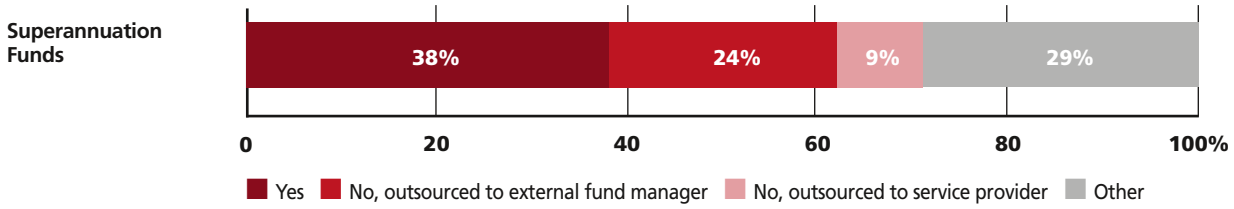
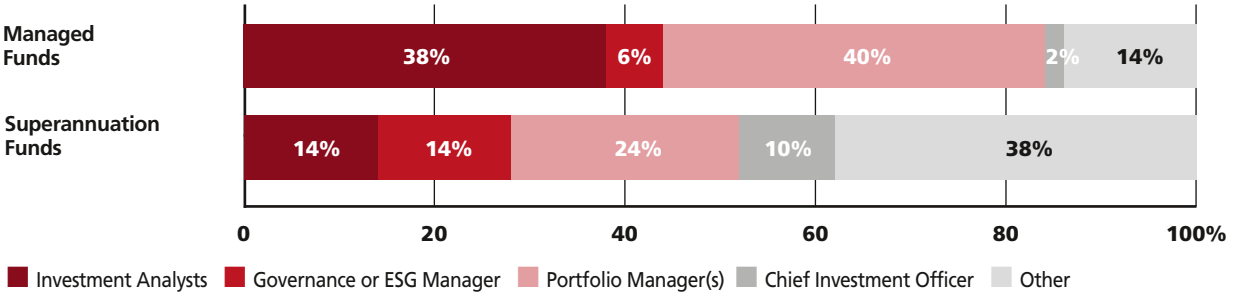


CHART 9

Superannuation Funds and Managed Funds – Who makes the majority of share voting decisions (greater than 80% of decisions made)?



the "other" category listed the following decision makers: trustees, outsourced implemented consultants, a committee, as delegated by the investment committee to the investment management group (a committee that meets weekly); external managers; ESG manager in consultation with the portfolio manager and chief investment officer; and on advice from ACSI.

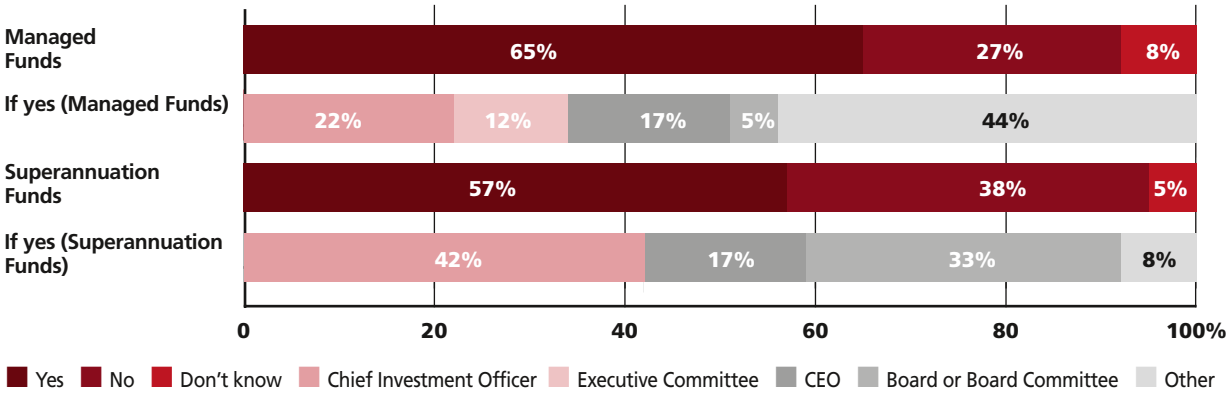
The following chart summarises whether there is a process for surveyed managed funds and superannuation funds to escalate voting decisions.

Most managed funds (65 per cent) and superannuation funds (57 per cent) have a process for escalating voting decisions: that is, certain votes, often those that might be controversial, such as company takeovers, are referred to a senior decision-making authority, often the investment committee or board.

Almost half the managed funds that do so assign the responsibility to individuals or groups categorised as "other", which includes the investment team, division director, the joint portfolio manager/other portfolio manager, chief investment officer and investment team, chief investment officer and chief executive, and head of equities. The prevalence of board or board committees escalation (33%) in super funds is noteworthy.

CHART 10

Superannuation Funds and Managed Funds – Is there a process for 'escalating ' some voting decisions (e.g. to a committee)?



From interviews: who are the decision makers?

"Super funds are taking away the decision making … they see they have an obligation to vote their shares rather than leaving this to managed funds … they see they have a broader, different interest as a universal share owner compared to a managed funds which is usually more short term." (company director)

"… companies assume that because superannuation funds outsource the buy / sell decision that everything else is also outsourced, including the voting decision … it isn't …"(superannuation fund)

"Share voting communication and engagement is not a high priority in my role as chair. This is more for our dedicated staff who have the expertise and focus." (chair of a superannuation fund)

"Institutional share owners have become more sophisticated over time … better processes and resourcing … not just 'box ticking'…" (superannuation fund)

"We meet with the major share owners at least once per year … we also talk to ACSI but they're not terribly interested in meeting individual companies …" (company director)

"Plenty of focus on remuneration reports … and not enough on director performance … not the same rigour with director capability." (managed fund)

"… fund managers hide behind proxy advisers a bit …" (company director)

"Fund managers will bleat about remuneration and controlling shareholders – but when it comes to do something…for example [provided] … they don't live up to their own standards…they should be held accountable … they should get involved in good governance…and they should not allow things to happen which should not …" (company director)

"… proxy advisory firms … they're governance experts, not necessarily commercial experts, and that's why our managed funds are such an important part of the process as well … but in the end it's us who makes the decision …" (superannuation fund)

Engagement between companies, institutional investors and proxy advisory firms

Chart 11 shows how often surveyed company directors, managed funds and superannuation funds meet proxy advisory firms in a year.

Chart 12 sets out to what extent those surveyed find communication with proxy advisory firms valuable.

Forty three per cent of company directors said communication with proxy advisory firms was valuable, managed funds slightly less so, while 57 per cent of superannuation funds said it was valuable. Managed funds said in interviews that the advice provided by proxy firms was only one input into their thinking and was valuable only to that extent.

CHART 11

How often do you meet with proxy advisory firms over a year?

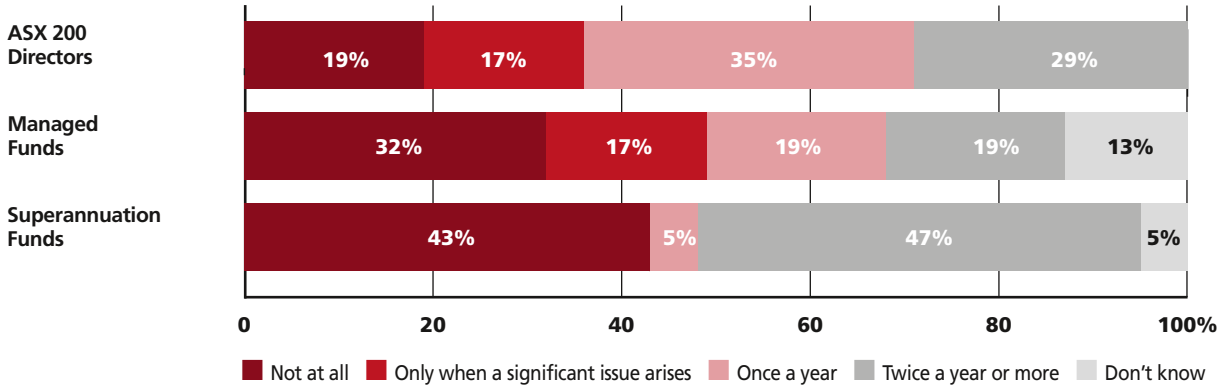


CHART 12

How valuable is the communication with proxy advisory firms?

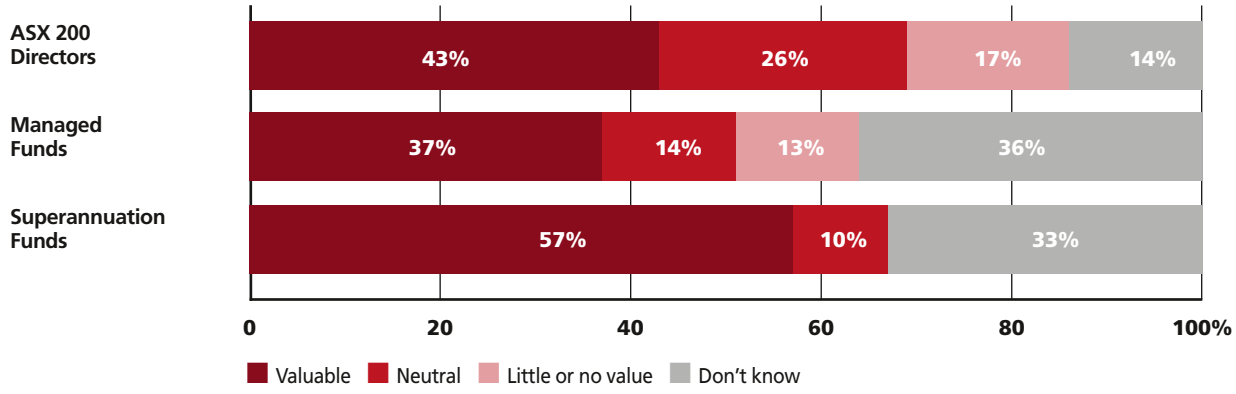


CHART 13

How easy is it to communicate with proxy advisory firms (not including the peak AGM season)?

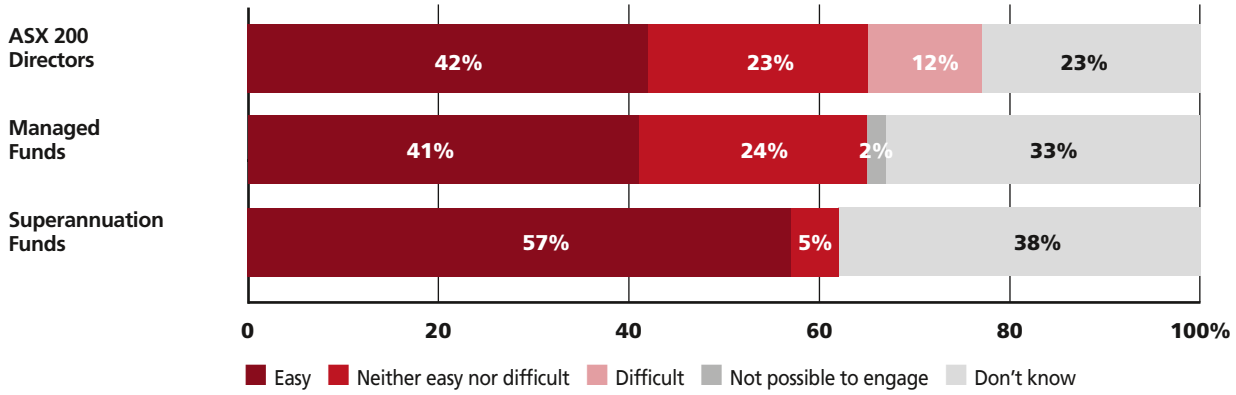
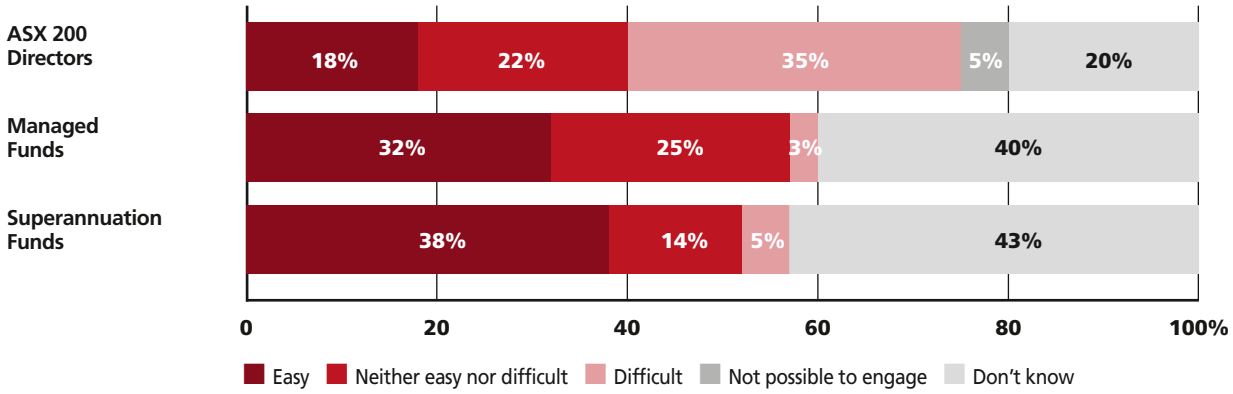


Chart 13 shows how easy it is for company directors, managed funds and superannuation funds to engage with proxy advisory firms outside the peak season for annual general meetings (AGMs).

More than 40 per cent of company directors and managed funds said it was easy to talk to proxy advisers outside the peak meeting season. It is important to note that managed funds and superannuation funds pay proxy advisers. By comparison, company directors, who do not pay proxy advisers and so do not have the same economic relationship to the adviser firm, said it was more difficult to contact proxy advisory firms. Nonetheless, even from the company directors' point of view, access to proxy advisory firms outside the peak annual general meeting season does not appear to be a significant impediment to communication.

CHART 14

How easy is it to engage with proxy advisory firms during the peak AGM season?



The above chart shows how easy it is for respondents to engage with proxy advisory firms during the peak meeting season.

Company directors find it less easy than the other groups to communicate with proxy advisers during the peak season. When interviewed, Glass Lewis[6] proxy advisers said they would not, as a matter of policy, talk to companies during the peak annual general meeting season, effectively creating a "blackout period". ISS, ACSI and SIRIS take slightly different positions. One proxy adviser said that talking to companies during the peak meeting season was important. In interviews, a number of large managed funds said they did not, as a rule, speak to companies during the peak of the annual general meeting season because of the volume and timing pressure of share voting, and would only do so in exceptional cases or if it related to significant or contentious issues. (For further discussion see section Communication between companies and proxy advisory firms at p 43.)

Influence and expertise of proxy advisory firms

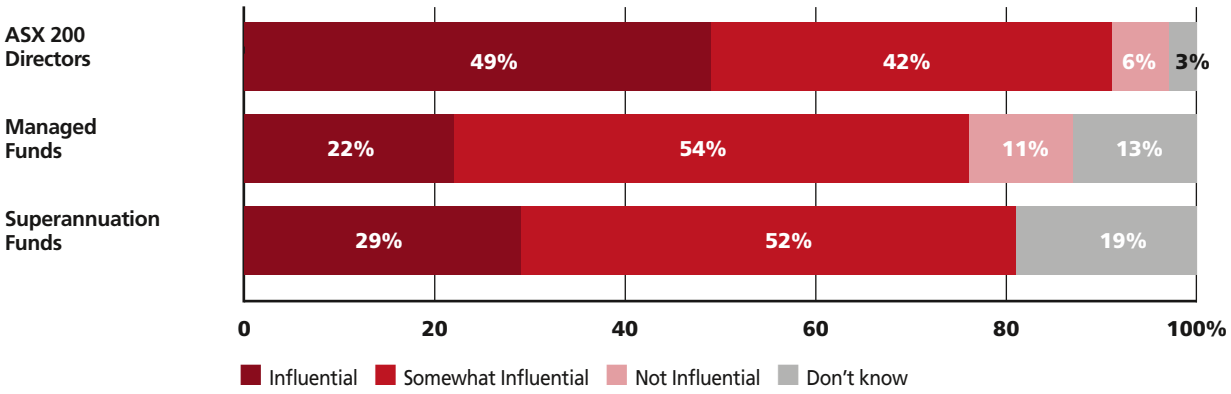
The following chart illustrates how company directors, managed funds and superannuation funds rated the influence of proxy advisory firms on institutional share owners.

There is general agreement that proxy advisers are influential, but that may mean different things to different participants.

6 Glass Lewis is the name of the global parent (which is wholly owned by the Ontario Teachers Pension Plan Board) and CGI Glass Lewis is the name of the wholly owned Australian subsidiary. To avoid confusion this report refers only to Glass Lewis. References to Glass Lewis should be taken to include the Australian subsidiary.

CHART 15

How influential is the advice provided by proxy advisory firms to institutional shareholders?



Almost half of the company directors surveyed consider advice to be "influential", compared to 22% of managed funds and 29% of superannuation funds. In interviews, some company directors were generally of the view that proxy firms had too much influence. In contrast, managed funds and superannuation funds said, "Yes, they are influential: that's why we pay them. If we didn't value their influence/advice we wouldn't see fit to pay for it." Managed funds also said that the influence of proxy advice lay in governance matters, rather than in the economic aspects they consider when voting on resolutions. A consistent theme that emerged from the interviews with managed funds was that proxy advisory firms had less influence than companies might think.

From interviews:
how influential is the advice provided by proxy advisory firms?

"Influence in the market is huge. Overseas investors and index funds rely almost solely on proxy voting advice; sector and industry funds rely mostly on ACSI. Very few have their own independent views …" (company director)

"Yes, they are influential. Probably because too much is outsourced big funds and super funds should do it [make the decision] themselves … For smaller funds, resourcing may be an issue." (company director)

"They shape share owner perceptions and views of the company … and they love to talk to the press." (company director)

"Any company that doesn't take proxy firms seriously, and that doesn't engage with them, is stupid … It's like any business issue … if you can resolve it, you do so …" (company director)

"Are proxy advisers influential? Less than companies think." (managed fund)

"We do not just blindly follow the proxy voting advice and merely 'tick boxes'. We are committed to engaging with companies. We are committed to being pragmatic and commercial". (superannuation fund)

"… proxy advisory firms help asset owners make better voting decisions … this is unremarkable … as with any decision, the more information that you have the more likely you'll make a better decision …" (superannuation fund)

"…proxy advisers are not as strong on shareholder value as on governance matters … which is not necessarily a problem for us as we make the investment decision … but it might be a problem if proxy advisers were used as a 'one stop shop' (superannuation fund)

[on the capacity of proxy advisory firms] "… are they best-placed to advise on takeovers? …probably not … but they do understand the transmission between governance and shareholder value …"(superannuation fund)

On capacity of proxy advisory firms: "… proxy advisers are governance experts …they are not necessarily commercial experts … and that's why our fund managers are such a crucial part of the process as well … in the end it's us who makes the voting decision …"(superannuation fund)

"Yes … but do not influence a single share or control a person. [We are] only influential if clients agree with us." (proxy adviser)

"Yes, of course they are influential. We wouldn't pay them otherwise, nor would the market pay them … but that doesn't mean we don't make our own decisions …" (managed fund)

Chart 16 shows to what extent surveyed company directors, managed funds and superannuation funds believe proxy advisory firms understand what drives shareholder value in companies.

There is a clear signal that company directors do not think proxy advisory firms have much understanding of what drives shareholder value, with 60 per cent of responses being in the "low or none" category. Only 13 per cent of managed funds consider proxy advisers have a high level of understanding. This was also apparent

CHART 16

What level of experience, expertise and knowledge do proxy advisory firms have in understanding what drives shareholder value in companies?

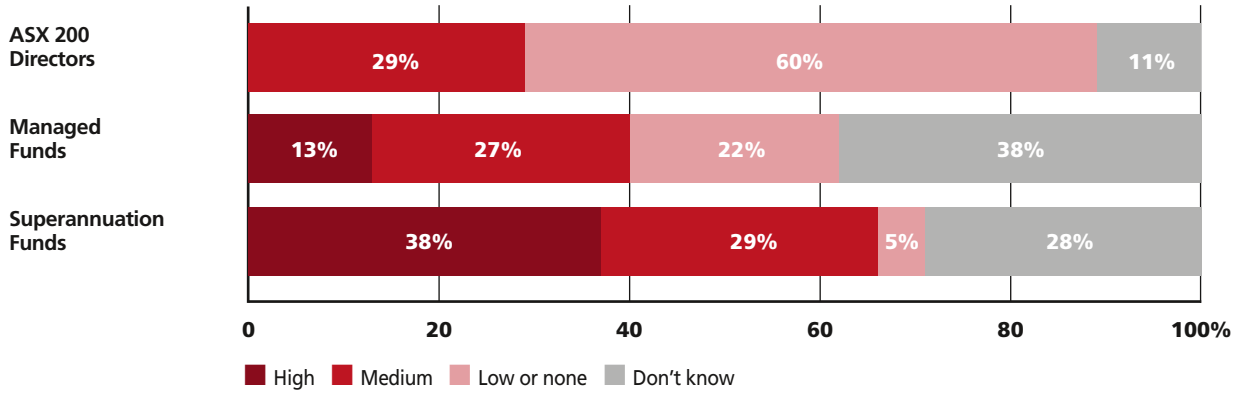
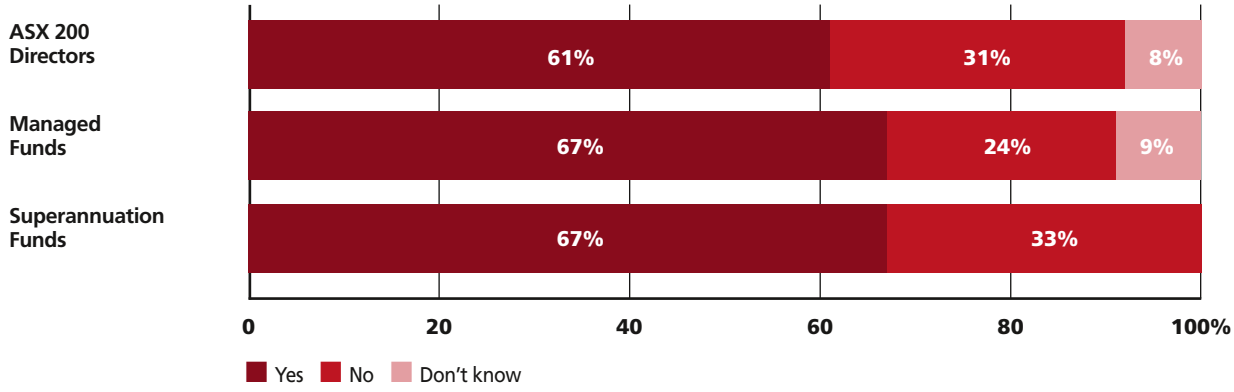


CHART 17

Do boards see reports and recommendations from proxy advisory firms?



in interviews, where managed funds said a proxy firm's area of expertise was in governance rather than in economics or shareholder value.

Chart 17 shows whether those surveyed obtain copies of proxy voting reports/ recommendations.

There is general agreement on this issue, with more than 60 per cent of each group obtaining copies of the reports.

Apart from Glass Lewis, which has a policy of not sharing reports with companies, interviewed proxy advisers will send the report to company directors if asked, after the report has gone out to subscribers (their clients). See "Proxy advisory firms as an external source of advice" at p 61 and footnote 22 on p 42.

Share voting processes and procedures

Chart 18 illustrates whether company directors, managed funds and superannuation funds audit or verify proxy votes, or instructions to vote proxies.

About half the company directors said they did undertake some form of verification or audit in the voting of proxies. However the other half said they did so rarely or never or that they did not know. The proportions for managed funds are similar, while superannuation funds more rarely use verification or audit procedures. It is important to note that respondents are commenting only on "their" parts of the share voting process and not the system as a whole. For company directors verification relates to the verification of votes received by the registry company, whereas for managed funds and superannuation funds verification relates to instructions recorded on the voting platform.

CHART 18

Are verification or audit procedures undertaken to ensure proxies are voted as instructed?

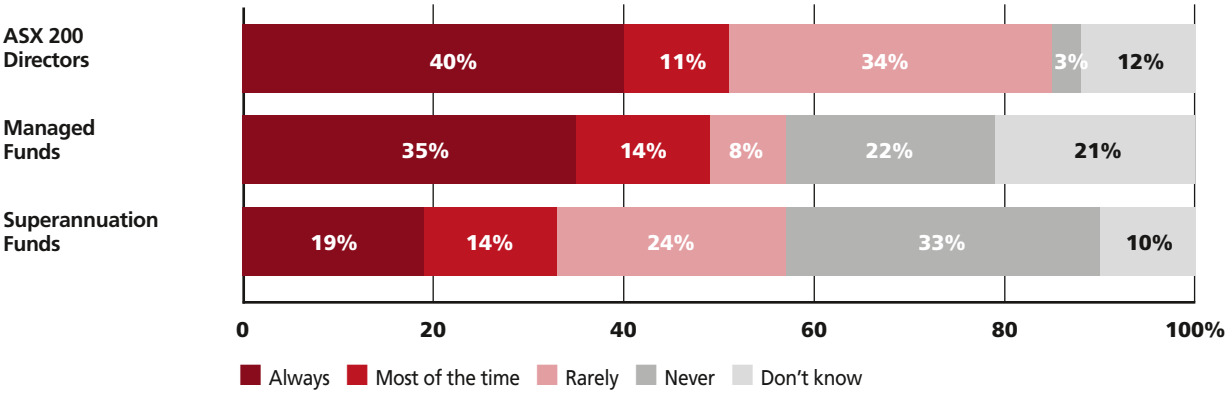


CHART 19

Superannuation Funds and Managed Funds – Is consistency in voting required?

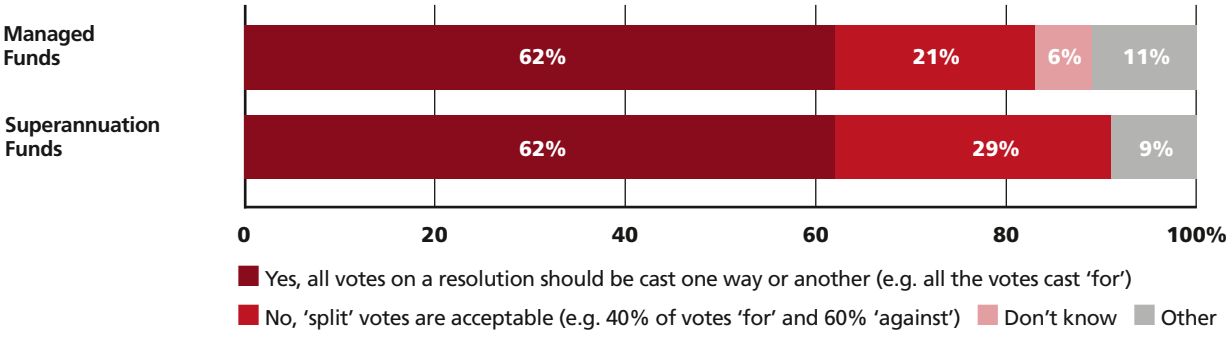


CHART 20

Superannuation Funds and Managed Funds – How would you describe the willingness and capability of share owners to vote against company resolutions over the past 10 years?

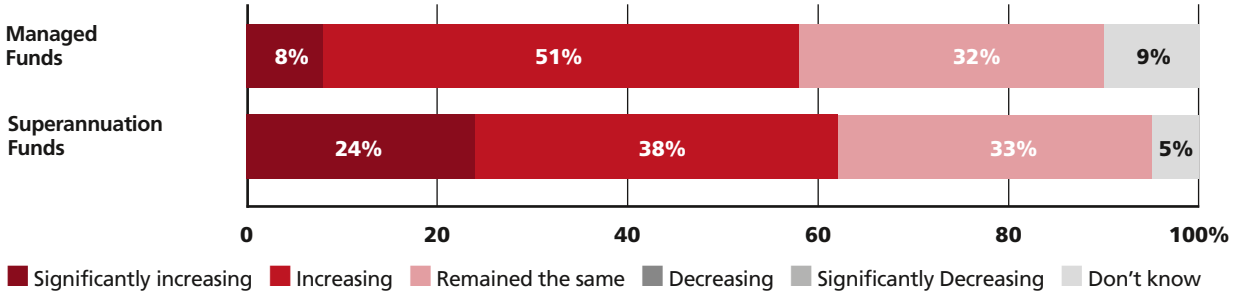


Chart 19 shows whether managed funds and superannuation funds try to be consistent in their voting.

A high proportion in each surveyed group, 62 per cent, do seek consistent votes across the portfolio.

Chart 20 illustrates changes in the willingness and capability of share owners to challenge and vote against company resolutions over the past 10 years.

About 60 per cent of managed funds and superannuation funds said "against" votes were increasing.

From interviews:
views of different stakeholders on the voting process

"… once you've published your annual report you're there with dozens of others and the proxy agencies are jammed with requests for meetings …" (company director)

"Managed funds should be held more accountable and get involved in good governance out of complete self-interest." (chair of a company board)

"Should proxy advisory firms be regulated? Regulating a research sector … is ridiculous … that sounds like censorship." (managed fund)

"… use of proxy advisory firms allows a much better allocation of resources … and certain parts of the share voting decision are done better by an external agency, because they have the focus on the technical aspects, and can lead to better overall decisions …" (superannuation fund)

"… super funds are placed to do voting really well and to have a very significant impact … they will have to address the issue of under-resourcing which as of now characterises share voting by super funds … this will come as super funds grow bigger, by growth and consolidation … but the framework is there now … they are naturally at the centre of what can be a high quality network of advisers combining investment and governance expertise such as brokers, data providers, proxy advisory firms, research houses and others …" (superannuation fund)

"The share voting system in Australia is … an accident waiting to happen." (industry service provider)

"… we take share voting very seriously…internal decision making is externally audited to make sure it accords with our policy … we focus on shareholder value…when we look at a company we look at its investment value to our fund, we consider the views of our investment managers as well as the recommendations of our proxy adviser, and we look at the previous performance of that company and how we've voted in the past … we don't do protest votes, we vote as though each of our votes will be successful …"(superannuation fund)

"The system is creaky, not just in relation to share transfer – the lot!" (company chair)

"Electronic voting … would help." (proxy adviser)

III. Summary of Research Findings

The shift of voting to superannuation funds

Overall, the survey results and interviews suggest that the shift in responsibility for governance and voting from managed funds to superannuation funds is increasing. Company directors tend to communicate with managed funds as the share owner, rather than the superannuation funds (but directors are becoming more aware of increased institutional share owner activity). Company directors also tend to focus on engaging with the chair, chief investment officer or chief executive in managed funds, whereas the expertise and decision making about share voting actually occurs within the investment function of these bodies. The survey and interview results suggest that this could contribute to a lack of effective communication between companies and institutional investors.

Proxy advisory firms are here to stay

Proxy advisory firms are important intermediaries. They are considered by many (not all) company directors to have become more professional and were often described in interviews as "part of the landscape" and "here to stay". While some company directors felt that the relationship between companies and proxy advisory firms had been adversarial in the past, most said the communication was "more professional" than it had been. Proxy advisory firms are perceived to be the decision makers by some company directors but not by managed funds and superannuation funds.

Are proxy firms accountable enough?

Other related issues raised by some company directors, in interview particularly, were that proxy firms were under-resourced and that their business models were

weak. They noted that there was not enough competition among the small number of firms. These directors felt that proxy firms lacked qualification and knowledge, faced considerable resource constraints, particularly during the peak annual general meeting season, and that there was a need for more accountability, possibly even extending to licensing or regulation of these firms.

However, the survey results of all company directors did not strongly support this line of thinking. While all respondents recognise that proxy firms have very limited resources for the time and volume pressure of the peak meeting season, managed funds and superannuation funds did not believe this created a need for greater accountability, for example through licenses or regulation.

"Two strikes" legislation – and remuneration generally

A strong theme emerged - on the part of company directors, managed funds, proxy advisory firms and engagement firms - that "two strikes" legislation[7] was not desirable. (Superannuation funds generally had more mixed views about this legislation.) Key concerns included: that it could be manipulated (by hedge funds, for example), that the 25 per cent threshold was too low and that the same ends could be achieved by existing share owner vote provisions (calling a special meeting of share owners, voting against incumbent directors). These views reflected a broader view (again, widely shared across participant groups but not universal) that there had been too much focus on remuneration. The issue, while important, was thought to have diverted attention away from matters of more significance for share owner value, such as major transactions and the broader question of director capability.

7 See the Productivity Commission's description of this legislation: *Two strikes and e-election resolution*': *25 percent 'no' vote on remuneration report triggers reporting obligation on how concerns addressed; subsequent 'no' vote of 25 percent activates a resolution for elected directors to submit for re-election within 90 days*, Productivity Commission *Executive Remuneration in Australia*, Report No. 49, at p. xxxv. The Productivity Commission recommended adoption of the 'two strikes' legislation.

3. A Map of Institutional Share Voting in Australia

IN THIS SECTION OF the report we provide an end-to-end map of the share voting and communication process. It is focused on the major participants: what they do, and how they communicate with each other.

Share voting is a complex process, with multiple key players, numerous inter-dependencies and communication requirements. We have provided a guide to the process in diagram 1 on p 36. The purple, blue and green boxes represent the "active" participants (those that may decide the vote, or have a view on what the vote should be, or seek to influence the vote), while the grey boxes represent the "process" participants (those that administer the voting process). This report will show the high level of interaction between active and process participants.

Structure and approach

This part of the report has been divided into the following sections:

- Participants in the system
- Stage one: formulating the meeting agenda
- Stage two: issuing notice to institutional share owners
- Stage three: making the voting decision
- Stage four: votes are aggregated, lodged, finalised (AGM) and disclosed
- Key issues: identifying major issues and knowledge gaps relating to the key active participants and the voting process.

Timing of the process

The timing of each step needs to be considered from three perspectives:

1) Legislated time frame
   - Is there a completion time requirement imposed in legislation? For instance,

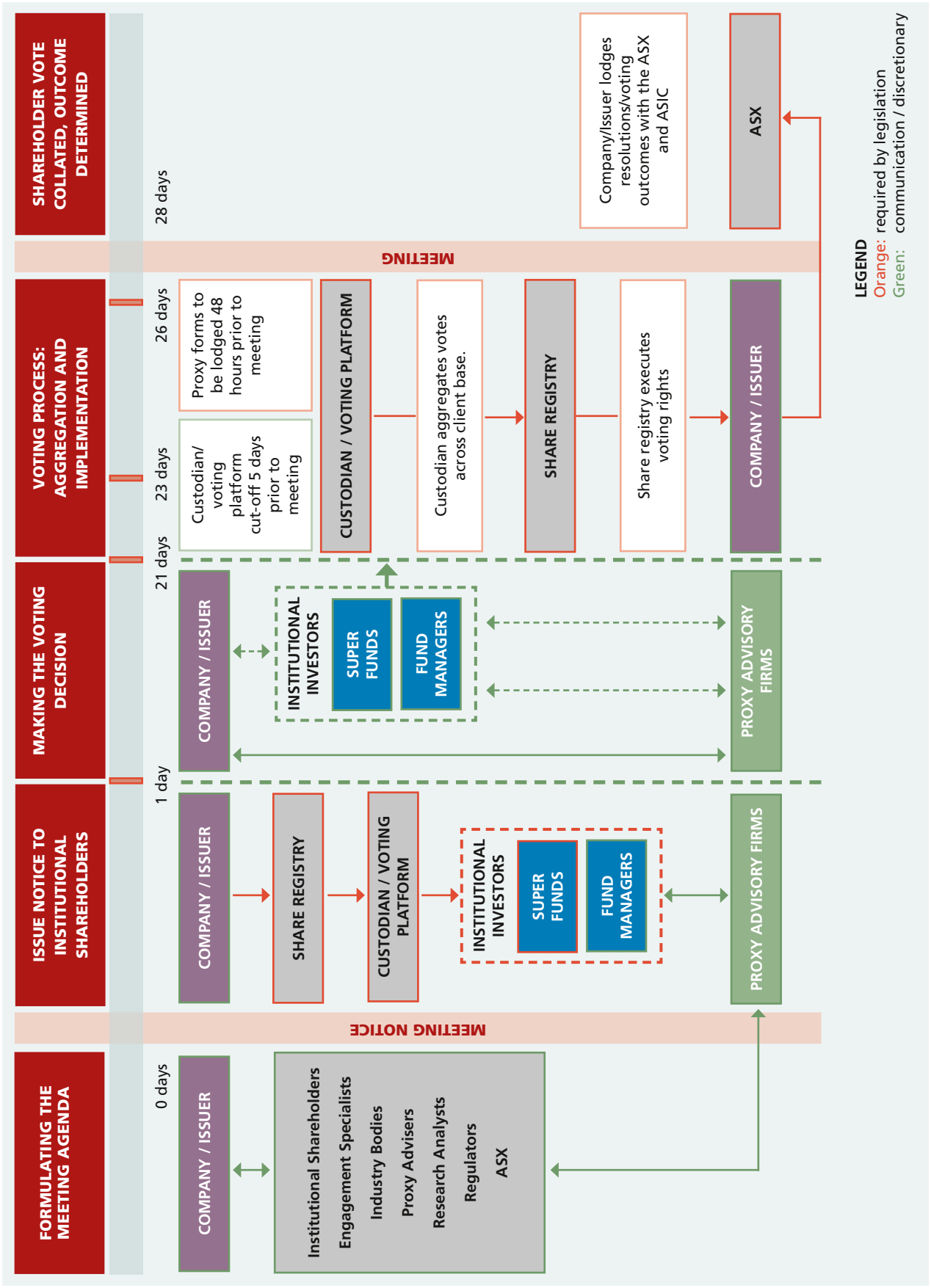


DIAGRAM 1: Institutional share voting process in Australia

Source: Mercer

public companies are required to hold an annual general meeting following the end of the financial year.

2) Operational time frame
   - Does a service provider impose a shorter time frame to allow administrative work to be performed to meet the legislated time frame?
   - How do the operational time frames affect the process as a whole?

3) Impact of the volume of votes in the "peak" share voting season
   - How might this affect the actual time available to make decisions as opposed to the theoretical time available?
   - Are decisions deliberative and evaluative, or are they compelled by the time constraint to become "default" or process-type decisions?

Participants in the Australian share voting market

Proxy advisory firms

Of the "active participants" in the process, institutional investors and companies (or "issuers" in this context) need little explanation. However, it may be useful to provide an overview of the proxy advisory firms in Australia as their structure, purpose and function is less well known.

There are four key proxy advisory entities operating in Australia. The two major entities, and also the major producers of primary research, are Glass Lewis and Institutional Share owner Services (ISS) (formerly Riskmetrics). SIRIS is a much smaller operator. The Australian Council of Superannuation Investors' product the Australian Voting Alert Service or 'AVAS' receives research data from ISS and combines that information with ACSI's corporate governance guidelines.

ISS dominates the market in the US, but there seems to be a more even balance of market share between ISS and Glass Lewis in the Australian market[8]. A large number of Australian institutions subscribe to the services of one or both of these providers. As many institutions subscribe to more than one proxy adviser, any attempt to dissect the market by specific investor type (such as managed fund, superannuation funds and so on) is unlikely to be meaningful.

The Australian Council of Superannuation Investors and the Australian Share owners' Association use the resources of ISS and Glass Lewis to provide their own proxy voting research to investors in Australia. ACSI is becoming an increasingly important service provider in its own right (notwithstanding its dependence on ISS for research), because of its profile in the industry, particularly among not-for-profit superannuation funds.

A distinctive characteristic of the proxy advisory market should be noted at the

8 Guerdon Associates, *The influence of proxy advisory firms on executive remuneration*, October 2007.

INDUSTRY PARTICIPANT	DEFINITION	EXAMPLES
Company/issuer	An entity that has share capital listed on the Australian Securities Exchange. Other participants invest in these companies by purchasing securities or shares. The company is the entity that issues the notice of meeting and sets the date for the annual general meeting.	Woolworths, BHP, Rio Tinto
Managed fund	An organisation that invests assets either as principal or (more usually) as an agent on behalf of third parties for a fee.	Blackrock, Colonial First State, AMP
Superannuation fund	A fund set up pursuant to a federal government-regulated investment strategy designed to provide retirement income for Australians.	AustralianSuper, UniSuper, HESTA, SunSuper, GESB
Proxy adviser	An organisation that provides clients with voting advice and recommendations on share voting decisions.	ISS, Glass Lewis, ACSI, SIRIS
Company engagement firm	A firm that provides clients with voting/engagement services on share voting decisions.	ACSI, Regnan, Hermes, F&C,
Proxy voting platform	An organisation that provides the operational capability to exercise proxy voting rights.	ProxyEdge (Broadridge), ProxyExchange (ISS), ViewPoint (Glass Lewis)
Custodian	An organisation that is responsible for safekeeping of assets (including shares), income collection and trade settlements, independent from the asset management function. Often the custodian is the legal owner of shares and is listed the same on company's share register.	JP Morgan, StateStreet, BNP Paribas, NAB Asset Servicing, RBC Dexia, Northern Trust
Share registry	An organisation that coordinates the share registry function on behalf of a company/issuer. The share registry conducts various registration and record keeping tasks associated with an investor's shareholding.	Computershare, Link Market Services
Proxy solicitation firm	An organisation (most often engaged by a company/issuer) that will try to influence share owners in a company to vote a certain way on specific matters of corporate governance. Often, in the US, this will extend to seeking authorisation of other share owners to vote on their behalf in a company ballot.	Georgesons, Thompson Reuters, GPS
Brokers	An organisation or person whose business is buying and selling shares and securities on behalf of others (clients), earning commission (brokerage) on trades.	Citi, Bell Direct, Austock Securities, Goldman Sachs
Regulators	Government or quasi government bodies that help to set, or to implement, the rules and regulations that govern the share voting process.	Australian Securities and Investment Commission (ASIC), Australian Prudential Regulation Authority (APRA)
Australian Stock Exchange	Organisation for the purpose of trading securities (shares and other securities such as derivatives). ASX is a publicly-traded company, which is traded on its own exchange. It co-regulates itself with the Australian Securities and Investment Commission.	Australian Stock Exchange (ASX)
Industry organisations	In this context, industry organisations are bodies that represent the interests of parties involved in proxy voting.	ACSI, ASA, AIRA, FSC,
Asset consultant	An organisation qualified to provide investment advice to trustees of superannuation funds or other responsible bodies.	Mercer, TowersWatson, JANA

TABLE 1: Participants in the Australian share voting process

Source: Mercer and the Australian Institute of Company Directors. The definitions provided are for the purpose of understanding this report. In other contexts, these key participants may be defined differently (for example, in legislation and regulations) and should not be relied on for any other purpose. Refer also to the glossary for more details.

outset. The proxy advisory service sector in Australia is highly concentrated with only two entities – Glass Lewis and ISS – producing primary research and offering broad coverage. The other two actors in the market are ACSI, which is not a primary research provider as the AVAS product is a governance overlay relying on primary research produced by ISS and SIRIS which is regarded as a niche player. Institutional share owners are therefore dependent on a highly concentrated service which, in one view, may be vulnerable to competition, takeover or key person risk. This situation poses a risk to the institutional share owners that engage proxy advisory firms. This environment may also present an opportunity as the barriers to entry in this market are not high.

The "agents" or "intermediaries" are central to the proxy voting process. Our view is best summed up by a recent Canadian report on the institutional share voting and communication process:

> Third party support structure has vastly improved the clearance and settlement of securities transactions and has also improved the efficiency of proxy materials distribution. Yet it has also made the proxy voting system more complex and less transparent.[9]

We have provided a brief overview of the four proxy advisory providers in the market.

Glass Lewis[10]

Glass Lewis is a wholly owned subsidiary of the Ontario Teachers' Pension Plan Board. It is a global proxy advisory firm with more than 110 staff worldwide. Glass Lewis' Australian operation is based in Sydney and is headed jointly by Bridget Murphy and Aaron Bertinetti. Their Australian client base comprises superannuation funds, managed fund and insurance companies.

Services offered by Glass Lewis include:

- proxy research and voting solutions
- mergers and acquisitions analysis
- risk monitoring
- trend reporting
- share recall services
- class action settlement.

9 C Hansell et al, *The Quality of the Share owner Vote in Canada – Discussion Paper*, 2010, Davies Ward Phillips & Vineberg LLP, p. 18.

10 Source: CGI Glass Lewis website (www.glasslewis.com) (accessed 26 July 2011), supplemented by discussions with Glass Lewis executives. As noted above, to avoid confusion this report refers only to Glass Lewis and references to Glass Lewis should be taken to include the Australian subsidiary, CGI Glass Lewis. See also the subscription-only paper *Proxy Season Review 2010 – an overview of the 2010 proxy season, Australia* (undated).

Glass Lewis publishes its own share voting and global governance guidelines, which are updated each year. The 2011 version, entitled *Proxy Paper Guidelines 2011 Proxy Season: An overview of the Glass Lewis approach to international proxy advice*, is available on its website.

The Australian operation covers the ASX 300 companies, and covers specific companies at the request of clients. During the Australian proxy season, the firm uses the resources of its international offices for help with the high workflow.

On the basis of research conducted for this study it would appear that there are no services offered by the parent company that provide a potential conflict of interest in the Australian market.

Institutional Share owner Services (ISS)[11]

ISS is a wholly owned subsidiary of MSCI Incorporated.[12] MSCI provides investment decision support tools to investors globally through products and services that include indices and portfolio risk and performance analytics tools. ISS is a global proxy advisory firm with more than 600 staff worldwide. Its Australian operation, which is headquartered in Melbourne, until recently was headed by Martin Lawrence (who left the organisation in July 2011).

Services offered by ISS include:

- proxy advisory and voting solutions
- merger and acquisition analysis
- risk monitoring
- trend reporting
- share recall services
- class action settlement
- environmental, social and corporate governance (ESG) solutions.

Most of ISS's services are based on an annual subscription and paid for periodically in advance. Its Australian benchmark proxy voting guidelines are the product of qualitative and quantitative research derived from a variety of local and international sources. These views are modified annually. The current Australian version is titled *2011 Australian Proxy Voting Guidelines Summary*.[13]

ISS claims it is completely independent in the application of its voting policies, the preparation of proxy analyses and the formulation of voting recommendations.[14] A code of ethics manages potential conflicts of interest, as outlined in section H

11 Source: ISS website www.issgovernance.com (access date 26 July 2011) and interview.
12 The ISS website forms a part of the MSCI website, which says, "ISS an MSCI brand".
13 Available on http://www.issgovernance.com/policy/2011/policy_information (access date 26 July 2011).
14 See for instance the Business Practices section of the MSCI/ISS website www.issgovernance.com/practices (accessed 26 July 2011).

of the 2011 policy information.[15]

ACSI and ISS[16]

ACSI is a membership organisation that represents the interests of not-for-profit superannuation funds ("industry funds"). ACSI's CEO is Ann Byrne. Its objective is to help its members manage environmental, social and corporate governance (ESG) investment risk by mutualising the costs associated with effective management of those risks. ACSI has a non-exclusive commercial relationship with ISS (at the time of writing). In this case, ISS provides research to ACSI, which uses it as a basis for its Australian voting alert service. ACSI adds value to the process by conducting its own research and including the insights of its engagement activities and application of its governance/share voting policy.[17]

ACSI cannot make recommendations on commercial matters such as mergers and takeovers as it does not have an Australian financial services license. ACSI records these matters "for client" decision.

Sustainable Investment Research Institute (SIRIS)[18]

SIRIS is a research organisation that also offers proxy advisory services and company engagement services, thereby providing a complete suite of services to its clients. SIRIS was founded in 2000 by the current chief executive, Mark Bytheway. SIRIS is an Australian firm based and headquartered in Melbourne and has about 20 staff.

Services offered by SIRIS include:

- portfolio construction and compliance services
- research and data services
- environmental, social and governance risk analysis
- proxy voting services[19]
- investment and credit risk analysis.

SIRIS maintains a broad database over the ASX 300 companies; but unlike the other service providers will provide proxy recommendations only on companies that are held by clients.[20]

15 See http://www.issgovernance.com/practices (accessed 27 July 2011).

16 Source: ACSI website www.acsi.org.au (access date 26 July 2011), supplemented by discussions with ACSI executives.

17 As one ACSI member noted in the course of an interview, "ACSI has a much greater connection with its clients than a commercial service provider … it is closer to its members and has a greater understanding of the challenges and nuances of what those clients are dealing with…"

18 Source: SIRIS website www.siris.com.au (access date 26 July 2011), supplemented by discussions with SIRIS executive.

19 The proxy voting service is described on the SIRIS website as including the following: "Applies ACSI, IFSA Blue Book ASX Good Governance standards / ASX 100 or 200 coverage / Coverage outside ASX 200 on request / Concise, summarised reports / Governance status / benchmarked against peer companies…" www.siris.com.au (access date 26 July 2011).

Communication between companies and proxy advisory firms

The following sections outline the communication between companies and proxy advisers. Our survey work and interviews conducted for this project highlighted directors' general view that companies can usually get access to and communicate with proxy advisory firms outside the peak annual general meeting season.

In the non-peak proxy season, 42 per cent of directors described communication with proxy advisory firms as "easy", while 12 per cent considered it to be difficult. In the peak season, the figures were 18 per cent "easy" and 35 per cent "difficult". (For more details refer to chart 13, "How easy is it to engage with proxy advisory firms (not including the peak AGM season)", and chart 14, "How easy is it to engage with proxy advisory firms during the peak AGM season".) In the course of the interviews, including with company directors, the question of access to proxy advisory firms did not emerge as a major impediment to communication.

This view is supported by the reported practices of proxy advisory firms. Most will meet companies "out of season"; but time constraints mean the firms will generally not meet companies in the "peak" proxy season unless there is a compelling reason or a significant issue involved.[21] All proxy advisory firms say they will inform a company of a proposed "against" vote prior to a meeting, but they will not allow access to the final report until their clients receive it.[22]

20 In 2011 SIRIS's database will cover the ASX 200, but recommendations will be prepared for only about 87 companies. Source: discussions with SIRIS.

21 Glass Lewis does not as a rule meet with companies during the peak season. ISS will generally discourage meetings unless there is a compelling reason, and this approach is shared by the larger managed funds such as AMP and Blackrock although there is no uniform 'ban' on contact or meetings. Sources: discussions with ISS – see also www.issgovernance.com/policy/EngagingWithISS (date of access 26 July 2011); discussions with Glass Lewis – also see the subscriber-only publication *CGI Glass Lewis 2011 Fact Sheet and Corporate Engagement*. SIRIS indicates that it will meet companies in the peak season and that it is important to do so.

22 In general a gap of at least a week between issuing a report to clients and then issuing to the company that is the subject of the report is required. ISS will give companies reports free of charge on request; Glass Lewis charges for reports. Source: interviews with ISS and Glass Lewis.

Stage One: Formulating the meeting agenda

THIS STAGE SETS THE environment in which the institutional share owners' communication process begins and involves (or may involve) all of the key players in the process. Despite the relative informality of this step, it is crucial in determining how the parties will interact with each other later in the process and may have a bearing on the nature of the voting decision by institutional investors and the recommendations of proxy advisory firms.

Communication on share owner votes almost always comes with a history and track record. There will usually have been a previous annual report and board structure on which proxy advisory firms have produced recommendations. The significance of this is that there is a body of precedent, in general (in policy terms) as well as for each company. Neither companies nor proxy advisory firms are bound by these precedents, but they will have regard to them. In the broader policy sense, if a proxy advisory firm (or an industry body) wishes to make the guideline on a particular issue more stringent (for example, on the definition of director independence), then there will be an expectation that communication on that point will occur. Similarly, if a company intends to depart significantly from what has occurred before (for example, board structure or remuneration), then it should consider communicating such developments. Of course, not all matters are the subject of precedent. For example, mergers and acquisitions, and company restructures, will to a large extent be unique and assessed on their commercial merits.[23] However, there will generally be a significant history of previous matters on which communication has occurred, albeit only by an exchange of documents.

23 It may also be that companies themselves have little or no track record: for example, a spin-off from a larger company, or a company that through growth or acquisition enters the ASX 300 for the first time.

Company / issuer perspective

In general, the company/issuer will consider the meeting agenda from about six months before the annual general meeting. At this point it will determine its strategy for the meeting and consider whether any item on the agenda is likely to be contentious and of concern to institutional share owners. Inputs to this deliberative process will almost certainly include the board itself, the chief executive and/or chief financial officer, other executives and investor relations personnel. It may include advice from external bodies such as the registry provider, executive remuneration advisers, auditors, legal firms and other consultants.

The company/issuer may decide that its meeting agenda is routine and unlikely to be controversial. In this case it would be reasonable to decide that communication is not required beyond the annual report, company announcements and the notice of meeting itself. In the survey results of this research it is notable that there are significant minorities of companies that never meet proxy advisory firms (18 per cent[24]) or engagement firms (54 per cent[25]). This is because those companies have not been targeted by engagement firms and/or their agendas have historically fallen into the majority type of meetings that are routine and unexceptional.

If the company does decide that aspects of its meeting agenda are likely to be controversial, it may take soundings from some of the key players such as managed funds, specialist engagement providers and proxy advisory firms. Following that feedback (or skipping to the next step), the company may decide that additional explanation would be helpful and begin planning an investor communications strategy and campaign.

Companies may also engage a proxy solicitation firm to help devise a communications strategy. That may include:

- development of the communications plan
- identification of key institutional investors (with the assistance of the share registry, investor relations or the company secretary)
- identification of key industry groups who can facilitate communications (ACSI, FSC) and proxy advisory firms.

Company engagement firms

It is worth noting the role of specialist company engagement firms such as Regnan – Governance Research & Engagement. These firms (including ACSI in its

24 Chart 11 "How often do you meet with proxy advisory firms over a year?" p. 24.
25 Chart 6 "How often do you meet with engagement firms over a year?" p. 21.

engagement service capacity[26]) have a strategic approach to company engagement and will segment by issue, degree of priority, sector, company size and opportunity (for example, a company crisis or board restructure that may provide an opportunity for engagement). The clients of these engagement companies generally play a significant role in this prioritisation process.

A key point to note is that engagement firms will *not* publicly disclose the discussions they have had with companies. These discussions are usually held at board/chair levels. The engagement firms take this approach to increase the likelihood that companies will engage with them on key issues without the fear of adverse publicity.[27] This approach may imply that engagement providers are not influential, and certainly they tend not to be publicly visible during the share voting season. However, the activities of these firms, especially in the reports to their subscribers, can be highly influential in shaping the views of superannuation funds and managed funds. As a result, engagement firms help determine the meeting "environment" for companies. They tend to be more active in the share voting "off" season and less so during peak periods.

Proxy advisory firms

During the "off peak" periods, the proxy advisory firms tend to focus on areas that will support their core work in the peak season. This is an important period for the proxy advisory firms, particularly in terms of communication. These activities generally include:

- *Information collection:* A key activity at this time is collecting information from the public record, largely produced by the companies themselves (annual reports, ASX announcements, end-of-year results slideshows and so on). This information forms a large part of the "fact base" for reports and the recommendations that those reports contain when the notice of meeting is issued.
- *Policy and government:* Proxy advisers will be involved in reviewing their own share voting policies and contributing to policy reviews conducted by clients. They also contribute to key government reviews which may be either broadly based (such as the Cooper Review[28]) or focused on specific

26 As stated previously, ACSI is (amongst its other roles) a provider of engagement services and a proxy advice to its members.

27 This confidential approach is widely adopted by engagement firms in Australia and the UK, such as Regnan, Hermes Equity Ownership Services, F&C Responsible Engagement Overlay service. In North America the practice is more varied: some firms take an activist stance and are willing to comment publicly on company engagement. See, for example, Boston Common.

28 *Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (the "Cooper Review"), 2010, Commonwealth of Australia.

issues that may be the subject of share owner votes (such as the Productivity Commission's report on executive remuneration in Australia[29]).

- *Communication and marketing:* An important part of proxy advisory firms' work at this time is to communicate with clients. They conduct reviews of the upcoming proxy seasons, which are sometimes delivered by a combination of report, webinars, telephone hook-ups or mini conferences.[30] Some firms will also hold conferences on hot issues (for example, Glass Lewis and Guerdon Associates hold their remuneration forum in May each year[31]). In case of conferences, the speakers are broadly representative, including leaders of industry bodies, non- executive directors, legal firms, asset owners and so on. This type of communication is designed to serve a number of purposes, for example, to:
  - market to clients the professionalism of the firm and demonstrate that its capacities are, at least, adequate for the share voting process
  - refresh the client's memory of the proxy firm's policy and position on key issues
  - facilitate the exchange of ideas and views on important matters and establish areas of consensus to guide the vote and minimise areas of divergence between the share owner and the proxy advisory firm.

Superannuation funds and managed funds

This is a relatively fallow period for these parties as they have more time to talk to specific companies about upcoming issues and to industry bodies about broader trends and developments. The focus for the superannuation funds and managed funds at this stage is on systems, policy development, reporting formats, developing capacity for the voting season and longer-term issues. Again, this is the key time for policy review. This includes reviewing the entity's own policy and contributing to the views on voting policies maintained by proxy advisory firms and industry bodies. This input influences the recommendations that will eventually emerge from proxy advisory firms during the "peak" voting period.

Interdependencies

The economic interdependencies between the parties, particularly between the

29 *Executive Remuneration in Australia*, Productivity Commission Inquiry Report, No. 49, 2009.

30 ISS tends to communicate via webcasts before the main season. ACSI will hold member meetings and will communicate via newsletter and quarterly chief executive reports. Glass Lewis produces subscriber-only publications such as *Proxy Season Review 2010 – An overview of the 2010 proxy season (Australia)* and will also communicate via other means.

31 The most recent such session was Remuneration Forum 5, held by Glass Lewis and Guerdon Associates on 21 March 2011.

ECONOMIC FLOWS – PRINCIPALS, AGENTS / INTERMEDIARIES				
PRINCIPALS	**FLOW**	**AGENT/ INTERMEDIARIES**	**FLOW**	**AGENT/ SERVICE PROVIDER***
Asset owner (superannuation fund)	→ fee / performance fee	Managed fund (as agent)	→ subscription	proxy advisory firm
	→ global service fee	Custodian	→ corporate action based fee	voting platform operator
	→ subscription	Proxy advisory firm		
Asset owner (managed fund as principal)	→ subscription	Proxy advisory firm		
	→ global service fee	Custodian	→ corporate action based fee	voting platform operator
Company/issuer	→ service fee	Registry company		
	→ consultancy / service fee	Specialist advisers (share owner communications, remuneration, legal)		
	→ consultancy / service fee	Proxy solicitation firms		
	→ depending on provider: subscription or report free on request	Proxy advisory firm		* Some agents may be owned by other agents (for example, MSCI as owner of the ISS ProxyExchange voting platform)

TABLE 2: Economic flows – principals, agents/intermediaries

Source: Mercer

principals and the agents/intermediaries,[32] appear relatively straightforward. The fact that there is an economic dependency between the market participants should not be taken to imply that any one agent/intermediary is not performing its function in a professional and ethical manner.

32 The simple definition of 'principal' adopted for this report includes the companies themselves and the owners of the shares (superannuation funds and managed funds). The agents or intermediaries (these terms are interchangeable for our purposes) are the other parties in the process: legal advisers, remuneration advisers, proxy advisory firms, registry companies and so on. It is important to note that managed funds may be (and very often are) principals as well as agents: they are principals when they invest in companies in their own right, and they are agents when they invest on behalf of other parties (superannuation funds).

Timing

Time pressure is not a major concern in stage one, but it becomes an important factor for the process (especially decision making) in later steps. One timing issue that is relevant at this stage is whether the efforts of key participants to effectively communicate will pay off in terms of outcomes such as votes, considering the timing is (or may be) distant from the annual general meeting period. This may be a concern as there are limited opportunities for participants to engage in discussions at a later stage.

Stage Two: Issuing notice to institutional share owners

THIS PHASE REPRESENTS THE formal start of the annual general meeting process. The meeting will be called by sending a notice of meeting to all entitled parties, including share owners or "members" entitled to vote at the meeting.[33] Share owners of a company are those whose name is listed on the share register (or register of members).[34] Listed companies must provide share owners with at least 28 days' notice of the annual general meeting.[35]

A company has to complete its AGM planning and strategy, then make a decision on whether the issues to be discussed at the AGM require an advance communication notice with the share owners and the planning process for the communication. At this point the company will have finalised its notice of meeting, lodged the notice (including the explanatory material) with the ASX and then formally notified its share owners.[36] This stage represents the formal start of the share voting "machinery", that is, the systems that support, facilitate and sometimes inhibit communication between the participants and give effect to the voting process. This is the point at which the share voting "clock", as determined by the Corporations Act, starts to tick.

Company / issuer perspective and the registry company

Companies with securities listed on the ASX use a share registry company to update

33 Note that share owners are referred to as "members" in the Corporations Act 2001 (C'th). Although the terms "share owner" and "member" are not entirely interchangeable, "share owner" is used to substitute for and in preference to "member" throughout this report on the basis of common usage. See Australian Institute of Company Directors, *Annual General Meetings: A guide for directors*, 2009, p. 18.

34 For more detail see section 231, Corporations Act 2001 (C'th).

35 Corporations Act 2001 (C'th), section 249HA.

36 Depending on the resolutions contained in the notice of meeting, the notice may in some circumstances have to be lodged with the Australian Securities and Investments Commission.

and manage their registry and to notify share owners. There are two main share registry companies in Australia: Computershare and Link.

Companies must inform share owners whose name is on the company's share register of any company notices. Institutional share owners almost invariably use a custodian to hold the legal title to the shares. As a result, the custodian's name appears as the registered owner of the shares (at least in a legal sense). For this reason, it is usually the custodian (rather than the superannuation fund or managed fund) that must be issued with the notice of meeting.

Formal notifications of company meetings are generally issued according to the choice of the share owner: either by mailing the relevant documents (mostly retail investors) or by electronic means (mostly institutional investors). Our focus is on institutional investors and electronic means of communication.

The notification process

Listed companies are required by law to formally notify their share owners of company meetings (including AGMs) and do so as follows:

- Companies use share registry firms as their agents to issue the notice of meeting to all the share owners entitled to receive the notice on the share register.
- The registry also lodges the information on the notice of meeting with the voting platform (for an explanation of voting platforms see "Voting platform operators" below).
- The share owner (typically the custodian) is thereby formally notified of the meeting and the resolutions to be considered.
- Superannuation funds and managed funds, as the beneficial owners of the shares, have access to the voting platform and may be notified of the meeting by this means. This process is instantaneous. The data is loaded onto the voting platforms in batches, allowing the company to assume formal receipt of the notice by the institutional share owner.[37]

Note that the principals (companies, superannuation funds and managed funds) are placed at the very beginning and end of the chain.

Custodian relationship with the voting platform providers

Custodians are pivotal to the proxy voting process as the registered owners of the shares. However, they act as a facilitator rather than a decision maker. They

37 Unless the company constitution provides otherwise, an electronic notice is deemed to have been given on the business day after the member is notified that the notice is available. See Section 249J (5) Corporations Act 2001 (C'th).

facilitate the provision of information on companies' upcoming meetings and other relevant information through the voting platforms; otherwise, they do not have a significant involvement in the voting process.[38]

Each custodian will generally use a single share voting platform provider, and the custodian's clients access that service's voting platform to track upcoming votes and lodge votes. Custodians have different fee structures for this service and the fees also vary among their clients. However, ultimately, the relationship with the platform provider resides with the custodian and not with the custodian's clients.

Voting platform operators

The voting platform operators are absolutely central to the institutional share voting process. They are the means by which the custodian and the institutional share owners are formally notified by the company/issuer. At least as important is the fact that these platforms enable the institutional share voter to "see"[39] the system and plan accordingly: what company votes are coming up, what to seek advice on, what the timing requirements are and so on.

There are two main voting platform operators in Australia:

- ISS's ProxyExchange
- Broadridge's ProxyEdge.

Note that ISS is a proxy advisory firm (ProxyExchange and ISS are in the same stable of MSCI wholly owned subsidiaries).

The information on these platforms is fairly similar, with the exception that the ProxyExchange platform also includes ISS's recommendation for each resolution — in other words, the system will reveal management's recommendation and the ISS recommendation. ISS's full research reports are also made electronically available to its subscribers via the platform.

It should be noted that there are other platform providers, notably Glass Lewis' ViewPoint system, that provide similar functions with some limitations. For example, Glass Lewis' reports are available to subscribers via the ViewPoint platform, but its recommendations are not available to non-subscribers.[40]

38 There is one potentially important exception to this, which is explored in "Stage four: votes are aggregated and lodged" at p. 81.

39 The information contained on the voting platform is mostly consistent across the platforms and will contain: the company name, resolutions, management recommendation for each resolution, the custodian's vote "cut-off" date, the record date, the date of the meeting, the total number of shares held by the investor and number of available shares (important in being able to see if shares have been loaned), and (if relevant) who is holding shares on behalf of the investor (for example, a number of managed funds may be identified in different "accounts" as holding shares on behalf of the investor). The ISS platform is slightly different in that it also provides ISS' recommendation for each resolution (not the underlying ISS report) as well the management recommendation for each resolution.

40 Source: discussion with Glass Lewis.

As voting platforms are an important ingredient in this process, consideration should be given to the following matters:

- First, it is not surprising that there are only two main providers operating in Australia, as the systems investment and development represent significant barriers to entry. Equally, it is unlikely that there will be a significant increase in competition in this area in the near future.
- In the case of ISS there is a potential conflict of interest, as it is owned by MSCI. The parent entity has divisions that offer the voting platform (ProxyExchange), a proxy advisory arm (ISS) and a corporate advisory service.[41]
- Broadridge is a relatively new entrant to the Australian market, but occupies what seems to be a natural monopoly in the US and Canada.[42] Unlike MSCI/ISS, Broadridge does not provide a proxy advice service in Australia (nor does the Broadridge system carry the recommendations of proxy advisory firms on its system).
- Each of these platforms allows for some degree of customisation. This is an important point as it means institutional investors can establish a de facto voting position (for instance, the voting is to be in accordance with the ACSI or ISS position) but override the position on an exception basis, from time to time.

Proxy advisory firms

Proxy advisory firms synthesise a variety of information at this stage of the process, including:

(1) collating and reviewing the basic information on companies included in the proxy adviser's coverage (this will largely be completed by the early stage of the proxy season)

(2) reviewing resolutions against policy settings (principally the proxy advisers' policy, but possibly also those of clients)

(3) reviewing recommendations made by the proxy advisory firm in previous years for specific companies

(4) contacting companies (or being contacted by companies on significant matters) to discuss issues of concern and flagging potential "against" votes.

The methodologies and processes used by proxy advisory firms are discussed in "Methodology for the proxy advisory process", p 61.

41 Reference is made here to the MSCI ESG Research custom consulting service and also the ESG Solutions tools. See www.msci.com (site accessed 28 July 2011).

42 C Hansell et al, op. cit., especially at ch. 42, "Issues related to Broadridge's place in the market".

Stage Three: Making the voting decision

IN THIS SECTION OF THE report, our focus will be on the specific action and process followed to determine the vote for a proposed resolution (for, against, abstain, take no action). In some cases, the conclusion may be not to vote by deliberate decision or through oversight or inattention. Ultimately, this stage is about the process by which a voting decision is formed and how the voting intention is crystallised. (For more details on the lodgment of the votes, see "Stage four: votes are aggregated and lodged", p 81.)

The key players at this stage of the process include the company/issuers (and service providers), the owners[43] of the shares (superannuation funds and managed funds) and providers of external advice to the entity that is making the share voting decisions (proxy advisory firms and managed funds).

Generally, cost and time are two fundamental influences on the institutional share voting process. Naturally, having the requisite skills and knowledge to assess the company information provided as well as the share voting process will enable the participants to minimise the time and cost of share voting decisions. For instance, the cost of making share voting decisions is integral in determining the processes that are most commonly adopted for share voting and the policy settings and standards and decisions on outsourcing. It should be kept in mind that one of the main motivations is the incentive to reduce the number of cases where an active decision is required. Without this active filtering of decisions the process either becomes unmanageable or the resource demands escalate to unacceptable levels.

43 Even though custodians are often the legal owners of the shares, we refer to superannuation funds and managed funds here as owners.

Given this emphasis on efficiency and cost, it is worth briefly asking why, since voting at company meetings is not compulsory, institutions go to the effort and expense of voting. In fact, many institutions have either not voted their shares in the past or have very passively voted "with management" as a default position. For instance, IFSA (now the Financial Services Council) in a study conducted in 2003 stated that "the average managed funds in the survey lodged votes on 92 per cent of all resolutions where they had the opportunity to vote."[44] It is suggested that this approach has become something of a rarity in the last decade.[45] Although voting is optional for share owners in company law, institutional share owners are subject to other legal obligations (for instance, those arising from trust law rules, the Superannuation Industry (Supervision) Act 1993 (C'th) and the Life Insurance Act 1995 (C'th)) that make not voting problematic.[46]

A bigger influence than the law has been the development of an industry standard that institutional share owners have a clear obligation to vote their shares — and that this is no longer "best" or even "good" practice but an expected minimum professional requirement. This is evident in the stated positions of most superannuation funds, managed funds and industry bodies such as the FSC, ACSI, the Australian Institute of Superannuation Trustees (AIST) and others. It is unacceptably risky in terms of reputation and professional profile to decide not to vote.

How well that voting is carried out is, of course, another matter. This section will discuss how voting decisions are made with reference to:

1. Key players in the institutional share voting process
2. Proxy advisory firms as an external source of advice
3. Policy standards and settings as an influence on decision making
4. Share voting environment
5. Share voting decision making and communication process.

44 IFSA & KPMG, Share owner Activism Among Managed Funds: Policy and practice, July 2003 at page 2.

45 See for example the ISS submission to the Joint Committee on Corporations and Financial Services (2008), which said the share owner vote had increased from 35 per cent in 1999 to 58.2 per cent in 2006. See Parliamentary Joint Committee on Corporations and Financial Services, Better Share owners – Better Company: Share owner engagement and participation in Australia, Commonwealth of Australia, 2007, at p.12.

46 Stapledon, Geoff, Sandy Easterbrook, Pru Bennett & Ian Ramsay, "Proxy Voting in Australia's Largest Companies", 2000, research report, Centre for Corporate Law and Securities Legislation, the University of Melbourne, and Corporate Governance International at pp. 6-7. See also the discussion of the issue of voting as a "requirement" in Kathryn Watt, "Proxy Voting Trends: Funds managers in the United States of America and Australia", Bond Law Review, vol. 15, issue 1, Special Issue: Comparative Corporate Governance, article 3, 2003, pp. 1-35 at p. 26.

Institutional share voting in context

This section provides some indicative statistics on share voting by some Australian institutional investors. The intention is to give a sense of the volumes and flows and to provide a context for some of the key issues that are addressed in this section.[47] (It is not claimed that these statistics are fully representative of institutional share voting in Australia.)

Please refer to Appendix B "Links to voting reports".

Table 3 illustrates two key points that will be addressed later in this section:

- the impact of the number of decisions to be made in the decision-making process itself. This is explored further on page 70 in "The share voting environment".
- decisions must be made in a highly compressed time period (about 80 per cent of meetings are held in October and November each year[49]) and this has an impact on decision-making models adopted by institutional share owners.

INSTITUTIONAL SHARE OWNERS — SUMMARY STATISTICS: VOLUME/TYPE OF VOTES, 2010[48]

2010	NO. OF RESOLUTIONS VOTED	DIRECTOR ELECTIONS (% OF RESOLUTIONS) VOTED	REMUNERATION REPORT (% OF RESOLUTIONS) VOTED	OTHER REMUNERATION (e.g. SHARE PLANS) (% OF RESOLUTIONS) VOTED	TAKEOVERS/ MERGERS/ COMPANY STRUCTURE (% OF RESOLUTIONS) VOTED	OTHER (% OF RESOLUTIONS) VOTED
Australian Super	1,082	43%	15%	22%	15%	5%
HESTA	1,533	40%	17%	21%	1%	21%
AMP	1,748	40.7%	14.4%	19.8%	25.1%	-

TABLE 3: Institutional share votes – indicative statistics: volume/type of votes

47 Where published statistics allowed, this information was taken from data published on the websites of these organisations. In other cases information was sought from corporate governance teams in these organisations. Where data did not match the specifications in these tables each type of vote was counted and summed into the appropriate categories, calculating the percentage of each type of vote from the total, and the percentage of each no vote from its respective sub-total.

48 Statistics compiled by aggregating statistics published on websites for AustralianSuper, HESTA and AMP. Note that some definition issues mean that direct comparisons are not always possible – this most affects the last two categories, "Takeovers/mergers/company structure" versus "Other".

49 Source: discussions with ISS and Glass Lewis. In addition, the client subscription-only publication by Glass Lewis referred to earlier: *Proxy Season Review 2010 – An overview of the 2010 proxy season (Australia)*.

2010 'AGAINST' VOTES: SUPERANNUATION FUNDS AND MANAGED FUND		
	DIRECTOR ELECTIONS (% AGAINST)	REMUNERATION REPORTS (% AGAINST)
Super funds (average)*	5.5%	43.5%
Managed fund (average)**	8%	21.5%

TABLE 4: Institutional share votes – indicative statistics: levels of 'against' votes

* Average of AustralianSuper, HESTA and UniSuper. ** Average of AMP and Blackrock.

This table illustrates a significant level of share owner activism.

Company / issuers and service providers

A company will be monitoring the implementation of its decisions (meeting arrangements, media planning, share registry functions) and will be actively monitoring votes on meeting resolutions as they are received by its share registry. The company will assess the response of major institutional share owners to the meeting resolutions and will examine the trends of the proxy voting "season". The company may also:

- launch a share owner communications program (directed at institutional share owners, retail share owners or both), usually with the assistance of a specialised communications firm
- arrange meetings between senior delegates of the company (such as the chair or chair of relevant board committees[50]) and institutional investors to explain the proposed resolutions to influence the institutional share owner vote.

The owners of the shares — superannuation funds and managed funds

The owners of the shares will have already made arrangements to vote. If the owner of the shares does the voting itself, it will be actively engaged in an established process to make voting decisions during the "proxy season". This will include collecting information from sources such as proxy advisory firms, industry bodies and managed funds. If the superannuation fund or managed fund does not make the voting decision itself but delegates that responsibility to another party, it will monitor its delegated arrangements to ensure voting takes place.

50 For example, the nominations or remuneration committee.

It is important to note that the owner of the shares may not be the same entity that makes the voting decision. The entity that has the right to vote the share is usually the superannuation fund or the managed fund, even though a custodian may be the registered owner and hold the legal title to the shares.[51] Funds frequently delegate their voting rights to other institutions that do not own the shares but can exercise voting rights on behalf of the funds. The party with the voting rights can influence the casting of the votes.

An additional complexity is that whether or not the institutional investors make the voting decisions in respect of their shares is not an "either/or" situation. The decision-making process may be shared with some of the other participants in the process (such as managed funds and proxy advisory firms), who in turn may have varying degrees of influence or full responsibility for making voting decisions. (The existence of share voting policies may be understood as a response to this complexity – they represent an effort to reduce the number of matters requiring active consideration and to drive some consistency throughout the decision-making chain.)

Voting decisions are made in many different ways, but the major patterns are as follows:

- *in-house:* the superannuation fund (or the managed fund as principal) makes the decision
- *outsourced to multiple decision makers:* the superannuation fund or managed funds (as principal) outsources the decision to its managed fund
- *outsourced to multiple decision makers with some central control:* the superannuation fund outsources the decision to its managed fund, but specifies that they must vote according to a policy and that exceptions must be escalated to the superannuation fund
- *outsourced to a single external authority:* superannuation funds' votes are to be cast in accordance with ACSI or ISS recommendations. This means a voting platform can be used, allowing voting to be automated according to recommendations issued by one of these bodies, or according to predetermined policy settings.

Superannuation funds often delegate their voting rights to other agents or service providers because:

- They may not feel they have the expertise or the knowledge to vote the shares, or not as much as other parties in the process. This is particularly the case with a superannuation fund that outsources decision making (most often along with the actual voting) to its managed funds, as they are thought to be "closer to the action" and in a better position to judge

51 Generally custodians will not undertake to vote shares on behalf of superannuation funds and managed fund.

resolutions on their merits. It is assumed that managed funds deal with companies all the time, speaking to their executives and boards, analysing results, attending company road shows and conducting site visits. This approach is more commonly adopted by international investors, who expect managed funds to have greater local market knowledge and therefore be in a better position to make the voting decision.[52]

- As discussed in the introduction to this section, making considered voting decisions is a time-consuming process and requires specialised knowledge and skill. If the voting function can be safely outsourced, it may be an economically viable option.

Providers of external advice — proxy advisory firms and managed funds

The other key players in the institutional share voting process are managed funds and proxy advisory firms. These parties can be significant and influential players in their own right.

As shown in diagram 2, share owners may delegate their voting rights to managed funds, to vote either as the managed funds see fit or in accordance with their own proxy voting policy or their clients' specific policy settings. Proxy advisory firms may have similar powers, although the process is a little different in regards to "delegation" of responsibility to these firms. Usually, the share owner stipulates that shares will be cast in accordance with the recommendations of a preferred proxy adviser, thus giving the proxy advisory firm de facto voting rights.

The more usual role of managed funds, and especially proxy advisory firms, is as providers of advice. They will recommend whether a vote should be "for", "against", "abstain" or "take no action" and they will be prepared to explain the reason for that recommendation. The advice provided may or may not be acted on by the share owner.

Generally, the voting process will be initiated by share owners:

- having subscribed to one (or more) of the proxy advisory firms. The share owner's nominated person (usually the governance manager) will receive the reports according to the subscription (for example, reports on ASX 100 companies)
- being aware of the upcoming meetings via the voting platform and may ask its managed fund to provide recommendations on all company meeting resolutions as a matter of course

52 As we shall see, the owner of the shares will also seek to provide safeguards or limits in empowering managed funds — for instance, via reporting obligations and policy settings.

- receiving recommendations from a proxy advisory firm and forwarding, on an exception basis, the recommendations to the relevant managed funds for comments or obtaining consensus.[53]

The share owner will usually require advice five days before the custodian/voting platform's cut-off times. The amount of time required (and/or the time compression that occurs) will depend on the decision-making model adopted by the share owner.

In providing and receiving share voting advice, all participants in the process that have fiduciary obligations will seek to fulfill these obligations.[54] For example, institutional share owners will be guided by the requirement that the voting decision is in the best interest of the beneficial owner of the shares. The pathways to that decision, however, can vary considerably.

For managed funds the key elements in share voting recommendations generally include:

- The request for a recommendation from the share owner be directed to the most senior person in the managed fund with direct knowledge of the company. This will tend to be a sector analyst.
- The recommendation being reviewed by the portfolio manager or some other principal of the firm. This can be an important step and is done for the following reasons:
  - to ensure quality control and firm-wide consistency
  - to ensure policy consistency in terms of the managed funds' in-house share voting or governance policy, or that of the share owner, or that of an industry body[55].
- The larger the managed fund, the more formalised and specialised the steps would be, as:
  - the process as a whole may be managed by a share voting specialist or governance specialist
  - sector analysts' and portfolio managers' views will be sought, and may be supplemented by information received by one or more proxy advisory firms
  - for issues where a consensus view is not available, a decision is required to finalise the recommendation. This generally takes place by referring the decision up to:

53 For example, all "against" recommendations or all director independence issues may be forwarded. It is important to note that generally only the recommendation is forwarded (rather than the report itself) as the report must be obtained by subscription.

54 It should be noted that proxy advisory firms — unlike superannuation funds, managed funds and companies — do not owe fiduciary duties to any other party in the process.

55 The reference to the latter two may be specified in the investment management agreement.

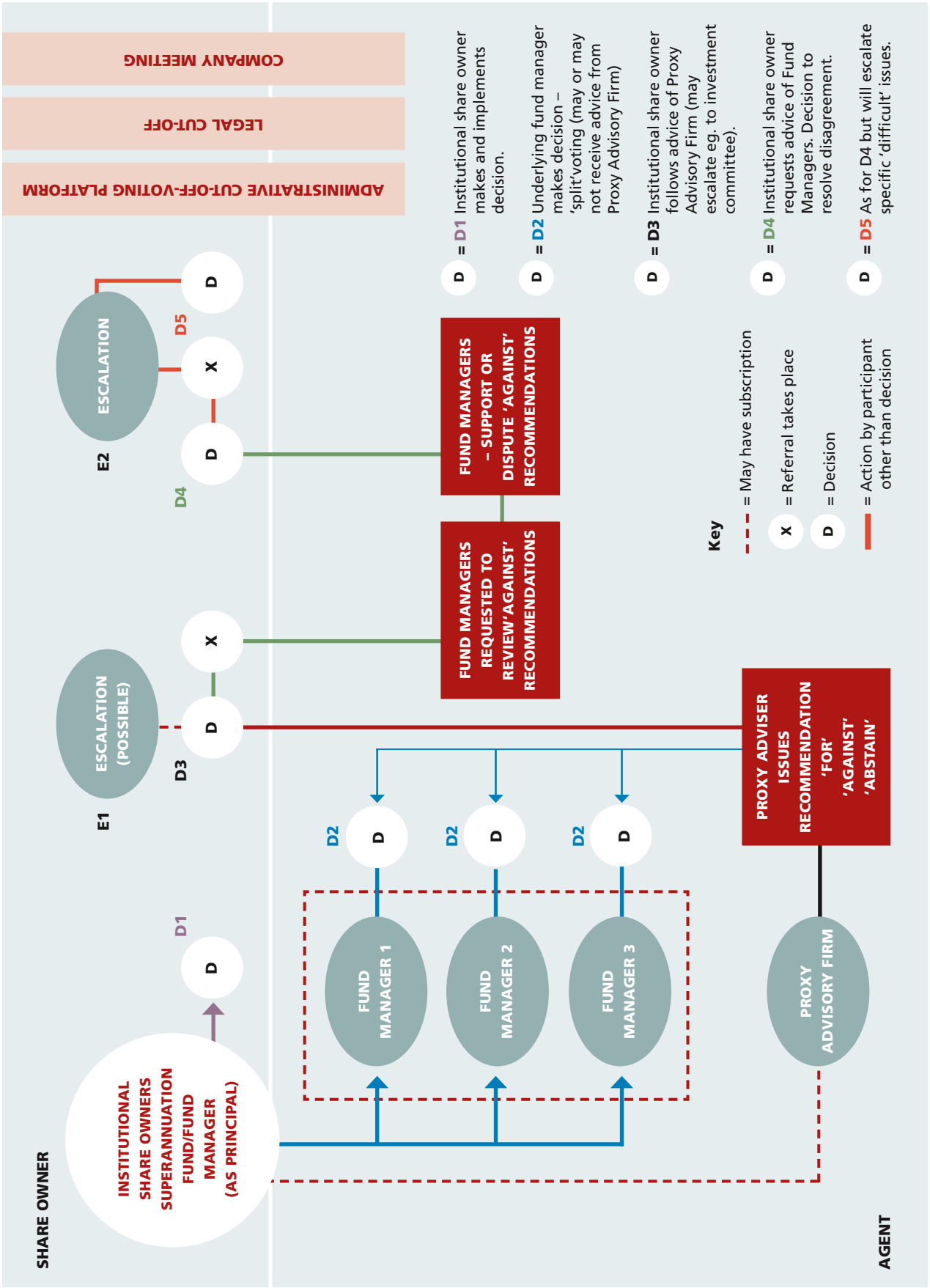


DIAGRAM 2: Institutional Share Voting – Main Decision – Making Models

Source: Mercer

- the governance manager responsible for the overall process, or
- a portfolio manager or some other designated senior manager, or
- an investment or governance committee operating by a charter developed for this purpose and
- once a decision is made, recommendation is then forwarded to the share owner.

Proxy advisory firms as an external source of advice

It has been said that investors use proxy advice to make voting decisions in much the same way as stock broking research is used in making investment decisions.[56]

Methodology for the proxy advisory process

The proxy advisory firms generally follow a standard process, with some variations, to formulate their voting recommendations.

The process is as follows:

- company meetings and resolutions are obtained by the proxy advisory firms from the ASX database (announcements) usually via an automatic feed from an information / data provider
- proxy advisory firms divide up the workflow, for example, according to sectors such as resources, banking and so on
- proxy advisory firms review company resolutions against their guidelines in terms of share owner value, commercial pragmatism and their recommendations on the same company in other years
- a decision is made to recommend a vote "for", "against", or (if this is allowable) "abstain"
- if an "against" vote is recommended:
  - a verification check (review of the factual information, such as public disclosure in the annual report) will be carried out
  - the company will be contacted[57]
  - the decision will be authorised by a senior manager in the proxy advisory firm.

In terms of this process, the last step is the most uncertain and variable. It is not possible to state how thoroughly the factual review is undertaken either in the initial stage or in the event of an 'against' vote. One measure would be to assess how often proxy advisory firms make factual mistakes which should be distinguished from legitimate differences in matters of interpretation such as whether a

56 This characterisation is from *AMP's Corporate Governance Report* (2011), op cit., p.3.

57 Source – interviews with proxy advisory firms – it is reported that such contact is made for ASX 100 companies, beyond the ASX 100 such contact will usually occur but will be on a best endeavours basis.

particular director is independent or not. There are no reliable measures of this kind of factual accuracy. However, the result of our research indicated that factual errors are not a major factor influencing the institutional shareholder voting in Australia.

Whether proxy advisory firms were accurate in reporting company information was raised as a potentially significant issue at the beginning of this research study. As such this issue was included in the survey questions. Directors were asked the following question "Do proxy advisory reports accurately report publicly disclosed company information?" with 75.4% of directors reporting "most of the time" (9.2% "rarely and 15.4% "don't know"). Accuracy did not seem to be a significant issue and this was borne out by the interview results, where accuracy was raised as an issue by only a small minority of directors and not at all by managed funds or by superannuation funds. It is perhaps to be expected that where this was an issue it made a lasting impression on those involved – about 70% of directors said they knew who to contact within a proxy advisory firm to correct any inaccuracies in reporting, however a bit over 30% reported that actually correcting any mistakes was "difficult"[58]. It is noteworthy however; that companies are not sent proxy reports before they are issued to the clients of proxy advisory firms – hence, in process terms, there is limited ability for companies to engage with proxy advisory firms in the event there is a factual error.

The Role of the Proxy Advisory Firm

It is important to keep in mind the role of the proxy advisory firm in considering the processes they undertake. Their multiple roles include:

- providing reports and information on meetings at which share owners may vote
- providing expert advice (interpretation) on resolutions
- enabling share owners to outsource part (or all) of the research and deliberative costs associated with share owner voting and reducing the number of matters (and therefore costs) that institutional share owners have to consider
- doing so in a way that enables the share owner to fulfil its duties to the

58 Directors were asked the following questions:
- "Do proxy advisory reports accurately report publicly disclosed company information?" ('most of the time' 75.4% , 'rarely' 9.2%, 'don't know' 15.4%)
- "If an error is identified in the factual information provided in a proxy report, does your company know who to contact in the proxy advisory firm?" ('yes'69.2%, 'no' 6.2%, 'don't know' 24.6%)
- "If an error is identified in the factual information provided in a proxy report, how would you describe the engagement process with the proxy advisory firm to rectify the error?" ('easy' 13.9%, 'neither easy nor difficult' 24.6%, 'difficult' 32.3, 'it is not possible to engage' 3.1% and don't know 26.2%).

beneficial owner of the shares and to mitigate potential legal and reputation costs by seeking the advice of a suitably qualified "expert".[59]

How influential are proxy advisory firms?

This question opens up considerable differences of opinion between directors, institutional share owners and proxy advisory firms. It is a complex and nuanced area, and one that the interview and survey components of the research project were very helpful in disentangling. However, our research confirms that proxy advisory firms are clearly influential in the share voting process. This is based on:

- an assessment that proxy advisers are important in the process in a structural sense. They form part of the infrastructure of the process that enables the share participants to cope with the time, volume and cost constraints inherent in the system
- the research findings obtained through interviews and survey-based material.[60]

The question of measuring this influence is addressed below. However, at this point let us consider the concept of "influence", which has different meanings for different participants in the process. One perception is that influence is somehow improper or may be construed to be improper. This gives rise to a certain defensiveness for proxy advisers. Note the comment that proxy advisers "do not influence a single share or control a person; [we are] only influential if clients agree with us"[61] or the comments attributed to Dean Paatsch (formerly with ISS) that "We [proxy advisory firms] don't fire the bullets; we make them".[62] A different statement was provided by a managed fund: "Well, of course they are important … we wouldn't pay them otherwise, nor would the market pay them … but that doesn't mean we don't make our own decisions".[63]

The point is not so much that proxy advisory firms may be "influential" – that is accepted as part of being an adviser – and most participants in the share voting process, including company directors, accept this kind of influence. What is not acceptable is if the reality goes far beyond mere 'influence'(which is the view of some directors) and that the decision making function in all its most important and substantive respects has been effectively outsourced to a third party in the form

59 Note that there is a difference of opinion on whether proxy advisory firms are suitably qualified. Sixty per cent of company directors believe they have "little or none" expertise and knowledge in understanding what drives share owner value in companies, with only 5 per cent of super funds and 22 per cent of managed funds of the same opinion. See graph "What Level of Experience, Expertise and Knowledge do Proxy Firms have in Understanding What Drives Shareholder Value in Companies?" on p. 31.

60 See the chart "How influential is the advice provided by proxy advisory firms to institutional share owners", p. 21.

61 Interview with proxy advisory firm for this project.

62 Quoted in AMP's Corporate Governance: 2010 full year report, January 2011, p. 3.

63 Interview with fund manager.

of a proxy advisory firm. As expected, this meaning of "influential" is very much disputed by institutional share owners and proxy advisory firms.

The key point is how proxy advice is used by institutional investors:

– *As an input.* The view here is that institutional investors use proxy advisory firms as an aid to decision making. Investors have outsourced some of the work (collection of company information, assessment according to guidelines) because it is efficient to do so. As one interviewee put it, institutional investors have every right to avail themselves of the cost efficiencies of outsourcing.[64] The key point is that the institutional investor is the party that actively makes the decision; the proxy advisory firm is simply an input to that decision. Karin Halliday of AMP outlines this basic model (and some variations to the model) quite well:

> Investors use proxy advice to make voting decisions in much the same way stockbroking research is used when making investment decisions. More specifically, institutions with fewer resources dedicated to the task may be more reliant on the advice as a cross-check or as an input into their own analysis and decision making. In Australia, where the number of discreet portfolio holdings is generally not as large, some investors choose to be more hands-on with their voting. Other investors may choose a halfway option and automatically follow the adviser's recommendations on "routine" matters, but may incorporate advice into their own analysis on more controversial issues.[65]

– *As a decision maker.* There is a different view, which emerges as a strong theme in interviews with Australian company directors and with some institutional investors (to a far lesser degree than with directors). The theme is that institutional investors have outsourced decision making to proxy advisory firms, and that they have done so because they do not want to bear the cost of making the decision themselves. To be clear, what is being stated here is that proxy advisory firms are not an input to the decision making process; they actually are the decision makers. It is said this occurs when institutional investors simply accept or rubber-stamp the recommendations of proxy advisory firms. This is regarded as both improper (a failure of duty) and as damaging to Australian companies because it imposes a "tick-the-box" or "one-size-fits-all" mentality. As directors have commented:

64 Interview with proxy advisory firm.
65 AMP, op. cit., p. 3

> … yes, they are influential. Probably because too much is outsourced. Big funds and super funds should do it [make the decision] themselves … for smaller funds resourcing may be an issue.
>
> … we're going to make sure you tick the boxes rather than spend time thinking and explaining why you might not fit the box.
>
> … 98 per cent of votes are obvious, automatic. Institutional share owners should take the remaining 2 per cent seriously — get the information themselves, call up the company, and make the decision themselves. They should take the responsibility seriously. [66]

These two ways of looking at proxy advisory firms and the use of proxy advice by institutional investors are significant. It is this particular point, more than any other that colours the views of institutional share owners and company directors of proxy advisers. If it is accepted that proxy advice is simply an input, then influence is considered acceptable and associated with a broader acceptance of the role of proxy advisers in the share voting landscape. If, however, the proxy advisory firm is regarded as the decision maker, then its influence is considered not to be acceptable, but an abrogation of a fundamental duty. This latter view gives rise to a number of related concerns about proxy advisers, in terms of the adequacy of their training and experience for their jobs, the independence of the advice given to institutional share owners and whether they should be subject to regulations in the same way as other professionals such as financial advisers and accountants.

There is a consensus among company directors, managed funds and superannuation funds that the "proxy adviser as decision maker" model is undesirable. There is agreement that institutional share owners have a clear duty to make the voting decision themselves (even if they accept advice), and that to outsource decision making to a third party is simply unacceptable. The difference of opinion is about what happens in actual practice. Institutional share owners are strongly of the view that they do retain the voting decision themselves; that the "proxy adviser as an input" model applies. A significant number of company directors are of the view that the "proxy adviser as decision maker" model applies.

This, then, is largely in the realm of perceptions. There is one observation that did not emerge from the interviews or survey, but that comes from our understanding of the voting decision process itself. It is suggested that whether the "input" model applies or not will depend largely on whether there is sufficient resourcing to enable different views to be actively evaluated and considered. It is clear that

66 Comments from three separate directors in the interview process.

managed funds usually have the resources to be able to evaluate different sources of information and make a considered decision (whether they actually apply those resources in this way is open to question). Superannuation funds, on the other hand, generally have fewer resources and may not be as well placed to operate the "input" model.

Measuring the influence of proxy advisers

One theme that did clearly emerge from the interviews is captured in the following quote from a managed fund:

> … yes, they [proxy advisory firms] are influential, but far less than companies think.[67]

If this view is correct, company directors overstate the influence of proxy advisory firms.

It is important to briefly touch on measurement of influence, principally to address the commonly held assumption that if share owners vote mostly in line with proxy adviser recommendations, then it is evidence of influence. It is suggested that influence is not so easily measured by a lack of variability in the votes of proxy advisers and institutional investors. It is worth looking at ways to measure the degree of proxy advisory firms' influence. AMP has taken an admirably direct approach to this matter in what is probably unique research published in Australia:

A comparison between votes cast by AMP Capital and proxy advice shows:

- 61 per cent of AMP Capital's votes matched adviser recommendations
- 21 per cent were voted "more strongly" (either abstain or "against", rather than "for")
- 18 per cent were voted "more loosely" (e.g. in favour rather than "against", and usually based on further discussions held with companies).[68]

There is very little comparable evidence, and what there is would suggest that a variability rate of nearly 40 per cent might be unusual.[69] However, the industry-wide level of variation is unknown.

The proxy advisory firms themselves say their influence is limited and point to

67 This view was expressed in one way or another by most of the managed funds that were interviewed. It might be said that it was in their interests to make such a statement, given that they do not agree with the "proxy adviser as decision maker" model; nevertheless, this view was strongly held.

68 AMP, op.cit., p. 3

69 A confidential client study, published in 2011, conducted by Mercer for a large Australian institutional asset owner on voting conducted in 2010, suggests a variability rate closer to 5 per cent. However, it is not suggested that this result is more representative than AMP's outcome.

high-profile occasions when both the main proxy advisers — ISS and Glass Lewis — have recommended "against" votes, and resolutions were carried ("for") by a significant margin.[70]

A recent study conducted by the University of Pennsylvania Law School suggests that the influence of proxy advisers in the US is exaggerated and estimates that it is likely "that an ISS recommendation shifts 6 per cent to 10 per cent of share owner votes — a material percentage by far less than commonly attributed to ISS".[71]

This brings us to issue of variability: what significance can be ascribed to the fact that institutional share owners may vote broadly in line with proxy voting advisers' recommendations? If proxy advisory firms and share owners vote the same way, it might suggest that proxy voting advisory firms are influential and "lead" the vote, especially if there is a high level of contested or "against" votes.

It is suggested here that the equation of lack of variation with influence is not valid and may even be misleading as an indicator of influence, for the following reasons:

- Given the influence of share voting policies as a basis for decision making (and as clients usually have some influence over proxy advisory firm voting policy), it is likely that proxy advisers and share owners would vote the same way in any case. The lack of variation is not an indication of "influence" but of agreed policy flowing through to operational outcomes.[72]
- Proxy advisory firms, for market reasons, will seek to anticipate the views of their clients and mirror consensus views on issues.[73] There are some differences here, as some firms take the view that part of their value is in warning of potential issues by being more stringent in the application of guidelines (or being more "purist" than their clients), while others seek to replicate the internal decision making of their clients.

70 Martin Lawrence (ISS) gave the following example:
- 20 April 2010, Seven/Westrac: 88.8 per cent for, 11.2 per cent against (Glass Lewis and ISS both against).
It is also significant that Glass Lewis's recommendations of "against" votes are much higher (in the region of 50 per cent) than institutional share owners' actual votes (closer to 20 per cent against remuneration reports). Sources: discussions with Glass Lewis and subscriber-only access report *Proxy Season Review* 2010 (Australia) published 2011.

71 Stephen J. Choi, Jill E. Fisch and Marcel Kahan, "The Power of Proxy Advisors: Myth or reality?", *Emory Law Journal*, vol. 59, 2010, pp. 869–918, at p. 906.

72 It is worth bearing in mind the survey results here: 95 per cent of managed funds and 86 per cent of superannuation funds consider share voting policies to be either influential or somewhat influential. See chart 2 "Superannuation funds and managed funds – how influential are share voting policies on voting decisions?" on p. 18.

73 Note, however, that the proxy advisory market in Australia is highly concentrated with only two major players. This market dynamic is expressed very well — albeit from a different jurisdiction — in the study previously cited from the *Emory Law Journal* (Choi, Fisch and Kahan, op. cit., p. 906): "… we find evidence that ISS's power is partially due to the fact that ISS (to a greater extent than other advisors) bases its recommendations on factors that share owners consider important. This fact and competition among proxy advisors place upper bounds on ISS's power. ISS cannot issue recommendations arbitrarily if it wants to retain its market position. Doing so would lead institutional investors to seek the services of other proxy advisory firms. Thus, ISS is not so much a Pied Piper followed blindly by institutional investors as it is an information agent and guide, helping investors to identify voting decisions that are consistent with their existing preferences."

Policy standards and settings to influence decision making

Share voting and governance policies are important in the share voting process, as shown by the number of documents relating to the area:[74]

- ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (the "if not, why not" approach)
- superannuation funds' own share voting and governance policies (at the least, they will generally refer to an industry policy as a guide to how voting decisions are made)
- Australian managed fund' own policies (some of the larger global managed fund have a global policy and regional policies)[75]
- proxy advisory firms' own share voting and governance policies
- industry bodies such as the FSC (the 'Blue Book') and ASCI also have their own versions, on which they actively seek the views of their members
- international policies such as those published by the International Corporate Governance Network.[76]

With this profusion of policy documents, one would expect some confusion or uncertainty about the expectations these bodies have of companies/issuers. In fact, the policies are remarkably similar to each other. For example, there is general agreement in Australia that it is not a good idea to have the roles of chair and chief executive performed by the same person and that variable pay should be linked to company performance (although what is meant beyond that universal point of agreement is less clear and more open to interpretation).

The function of share voting and policy documents is:

- to communicate to companies the expectations of institutional investors, their agencies and intermediaries, in terms of company resolutions
- to communicate to clients (which may be superannuation funds or managed funds) that these share voting activities (including recommendations) are conducted according to professional standards
- to reassure clients that the majority of these matters can be safely outsourced to a third party and can be publicly defended and that voting recommendations will not be made arbitrarily and can be publicly defended (reputation)
- to provide an effective (and defendable) means of reducing the number of

74 See appendix B for links to share voting policies.

75 See, for instance, Blackrock's governance and share voting guidelines at http://www.blackrockinvestments.com.au/index.htm.

76 See, for example, the ICGN Global Corporate Governance Principles: Revised (2009) and the ICGN Statement of Principles on Institutional Share owner Responsibilities (2007).

matters that require active consideration by the share owner (cost efficiency/resource allocation).

Share voting and governance policies are generally very carefully considered by the bodies that produce them and also by their clients. Their operational influence is beyond doubt, as they shape institutional share voting in Australia in a real and profound way. They arise from and respond to cost and resource allocation issues by filtering matters that have to be actively considered.

However, share voting is not (or should not be) as simple as applying a policy. Again, all the participants are agreed on this point. All policies are explicitly formulated as *guidelines* and not prescriptive rules. Essentially, this allows for variations according to an individual company's circumstances, the dynamics of the industry sector, a specific development, or a combination of these factors. A resolution may appear to violate the guidelines, but may be in the interests of share owners. This is the approach that underpins the ASX's "if not, why not" approach and applies to the operation of most guidelines. For example, a company may argue that due to its individual circumstances the chair and chief executive positions should be combined for a period, or that its industry circumstances do not allow for direct peer comparison for remuneration purposes, or that (again for remuneration purposes) a two-year performance period makes more sense than the policy-preferred three year period.

There is an unavoidable tension here between the incentive to standardise the process (by guidelines or rules) and acknowledgment that in competitive markets companies will be (and should be) different from each other.

It is difficult to find data on the extent to which actual share voting decisions deviate from the stated policy position. This is partly because many policy positions contain elements of subjectivity and judgment. For example, is a director to be regarded as "affiliated" after 12 or 15 years on the board, or should this be determined on a case-by-case basis.

A number of significant issues arise summarised as follows:

- Share voting and governance policies are critical in the institutional share voting process in at least four ways:
  - as principles
  - as guidance for companies
  - in providing reassurance for those outsourcing part (or all) of the function
  - in reducing the number of resolutions requiring active consideration by the share owner.
- Participants agree that judgment and subjectivity are important factors in the process. In other words, responsible execution of the share voting task requires active consideration of at least some voting matters.

- It may be that as voting becomes more transparent, those exercising the vote will become more risk averse and less likely to deviate from guidelines. This may mean that guidelines come to operate more as rules (even as de facto regulations) than as guides, regardless of what the sponsoring organisations may say.
- The operation of guidelines clearly has implications for share owner communication (addressed below), as the company/issuer must decide when and at what stage to communicate effectively[77] and if so, who to communicate with. The outcome depends on the decision pathway adopted by the share owners.

The share voting environment

There are three key environmental factors that have a fundamental impact on institutional share voting in Australia. By "environmental" we mean basic operational features of the existing system that are not easily amenable to change and that influence the behaviours of the key participants and how voting decisions are made. These factors might arise from the legal framework or administrative procedures developed by key participants to ensure they meet those requirements.

Three environmental factors are of most relevance in the present inquiry and are explored in the sections below:

- time and volume
- voting disclosure
- voting "cut-off" deadlines.

Time and volume — decision making-impacts

The key determinant of the time available for proxy voting is the Corporations Act, which requires a company to hold its annual general meeting within five months of the end of its financial year.[78] In Australia, this means there is a "mini" proxy season in April-May and a main proxy season from early October to early December. Almost all company meetings are compressed into these two periods. This is not especially onerous compared to some jurisdictions, such as Japan, but comparable to those in Canada, the US and the UK.[79]

This timing has a profound effect on the whole institutional share voting process, and in particular on how the voting decision is made. Proxy voting adviser figures on the Australian proxy voting season give some indication of time frames and

77 At the policy formulation/review stage and/or at the point it is determined that a resolution is against policy and/or at the stage where a potential "against" decision is being reviewed.
78 Section 250N, Corporations Act 2001 (C'th).
79 Source: discussion with proxy advisory firms – May 2011.

volumes – coverage is of about 550 companies of which about 80 percent hold their annual general meetings in October-November each year. At the peak of the season there may be 30 or more company meetings to be considered in a week.[80] This is backed up by other sources which indicate volumes of over 70 meetings in August and over 100 in September.[81]

It is important to note that this is not just a theoretical maximum volume. Large superannuation funds and managed funds will generally have index holdings in Australian equities, and will also often have small-cap managers in Australian equities as well. Thus, the number of votes required will not be a great deal less than the resolutions of ASX 300 meetings. Superannuation funds are increasingly and publicly adopting the credo of the "active owner" and aim to vote all shares. One director exactly captured this thought in interview:

> … super funds are taking away the decision making … they see they have an obligation to vote their shares rather than leaving this to managed funds … they see they have a broader, different interest as a universal share owner compared to a managed funds, which is usually more short term.

This volume pressure explains why share owners outsource much of the work to third-party providers. Even if cost was not a consideration, it would be difficult to provide an in-house pool of expertise and capability to deal with the volume of events that had to be addressed. It is likely that as foreshadowed by the Cooper Review,[82] superannuation funds will consolidate, grow in size and will be more able to locate this expertise in-house. Nonetheless, the lumpiness of the business flow will still make it an unattractive proposition for many.

This in turn has an impact on how decisions are actually made, with hidden decision-making costs involved. Therefore, what appears to be a careful and deliberative step in the process may be really a process step. By way of an illustration, consider a superannuation fund with a reasonable decision-making process to (1) receive advice from a proxy advisory firm; (2) if an "against" vote is recommended to then seek the view of a managed funds(s); (3) if there is no consensus view between the proxy adviser and the managed funds, to then escalate the decision to

80 Source: discussion and correspondence with Glass Lewis, May 2011, and Glass Lewis (2011) op.cit. (subscriber- only publication).

81 See for instance the calendar published by Boardroom Radio which lists the following volumes of AGM's and EGM's in August-November 2011: 30 in August, 49 in September, 71 in October, and 113 in November. http://www.brr.com.au/calendar (site accessed 24 August 2011).

82 See, for example, recommendation 1.6 in the Cooper Review (op. cit.), "Scale matters": "There are substantial benefits for members arising out of increased scale in the superannuation industry. MySuper providers would be exposed to scrutiny and pressure on this issue and would be required to consider each year whether they had sufficient scale to optimise outcomes for members." Highlights section, p. 1.

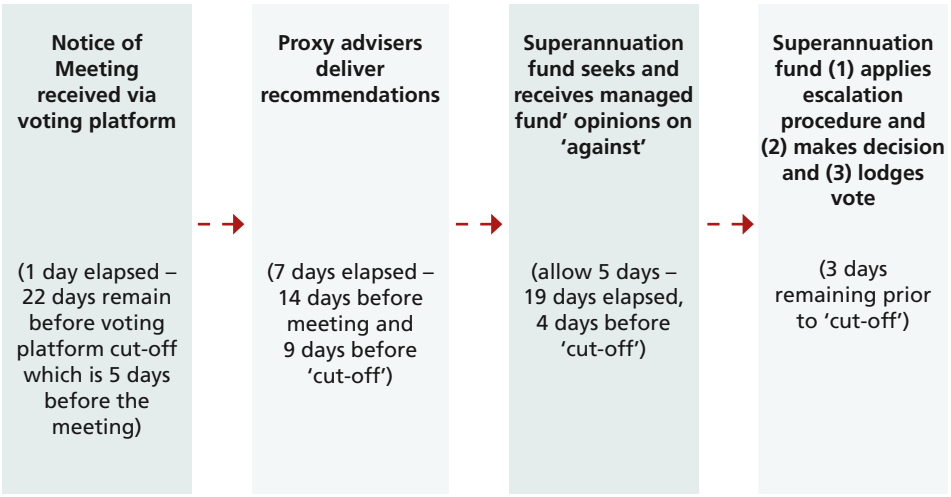


DIAGRAM 3: Indicative time for voting inputs and voting decision prior to voting platform/ custodian lodgement "cut-off"

Source: Mercer

an executive or board investment committee; and (4) the decision is returned to the governance manager and the vote is lodged on the voting platform.

The sequence is depicted in Diagram 3 above.

The above sequence is obviously indicative, as different decision-making models may be adopted and proxy advisory firms may deliver their recommendations earlier than this.[83] Proxy advisory firms state that their objective is to deliver recommendations 14 to 21 days prior to the company meeting, which will be nine to 16 days prior to the voting platform cut-off. However, this is a somewhat aspirational target, as the more complex and/or contentious a matter is, the longer the delivery time-frame by the proxy advisory firm.

Thus, the share owner will in reality have little time in which to make a voting decision, especially if it relies on external advice from proxy advisory firms and its managed fund.

It is suggested that time compression affects the decision-making process in ways that include:

- Undermining a genuinely deliberative process. As discussed above, the starting point is that there are "guidelines" or policy positions, but the individual circumstances of the company (and the interests of share owners) are crucial in the equation. Given the time/volume pressures the incentive will be to prioritise administrative efficiency.
- Tendency by the person charged with managing the voting process to agree

83 Discussions with Glass Lewis and ISS – May 2011.

with recommendations provided by proxy advisory firms, as to properly "test" these recommendations is time-consuming. This will in turn create an even smaller subset of contested recommendations than would first appear. This smaller pool will consist of those matters that are especially controversial, that attract strongly dissenting views from managed fund or other advisers, or where the company/issuer has made a direct approach to the share owner.

- Tendency, again by the person charged with managing the voting process, to avoid escalation procedures or to limit the number of votes that are escalated. The tendency will be to make matters fit those administrative pathways where escalation is not mandatory.

Voting disclosure trends: decision-making impacts

The second environmental factor is more of a strongly developing trend than a well-established feature of the institutional share voting landscape in Australia. This concerns disclosure of share voting by share owners.

Superannuation funds and managed fund are increasingly publishing how they vote their holdings on their websites. This disclosure is often at the most detailed level: by company, resolution and outcome ("for", "against", "abstain", "take no action"). This has come about partly through developing good practice, by share owners anticipating regulatory changes towards further disclosure,[84] and also via such bodies as the United Nations Principles for Responsible Investment. This process links the institutional share owner directly to the vote and makes them publicly accountable. This trend is likely to have a number of important effects:

- It will be an important influence on the decision-making model. For instance, it will make the "outsourced to multiple decision makers" model (see the decision-making models outlined on p. 57) far less desirable, as it will show a single entity (the institutional share owner) having "split" votes due to the multiple decision makers (for example, 80 per cent of votes "for", 10 per cent of votes "against" and 10 per cent of votes "abstain" on the same resolution).

84 Share owners have been given cause to think that regulators may adopt greater disclosure standards and some may well have decided to publish at a greater level of detail than they may otherwise have done in the belief that such disclosure will be required in the future in any case. See, for example, recommendation 3.6 in the Cooper Review: "All large APRA funds should publish their voting policies and procedures, and disclose their voting behaviour to members on their website" (op. cit., ch. 3, "Investment Governance", p. 90). Note that the term "voting behaviour" is left undefined. See also recommendation 12 of the Productivity Commission's Executive Remuneration in Australia (op. cit., p. xxxix): "Institutional investors — particularly superannuation funds — should disclose, at least on an annual basis, how they have voted on remuneration reports and other remuneration-related issues. Initially this should be progressed on a voluntary basis by institutions in collaboration with their industry organisations. The Australian Securities and Investments Commission should monitor progress in relation to superannuation funds regulated under the Superannuation Industry (Supervision) Act 1993".

- It will mean that the decision maker will wish to prove that it has sought advice on all votes: not just those that appear to be controversial, but also those that may become controversial with the passage of time. This is a kind of "safe-harbour" approach to share voting decisions. There will be increased pressure to find a reputable adviser to mitigate the risk should a voting decision turn out to be highly controversial.
- It may increase the degree of conservatism in the voting process. What is meant by conservatism in this context is a more pronounced reluctance to deviate from the standard view as expressed in industry governance guidelines and standards. The effect of this would be to transform what are intended to be guidelines into more or less prescriptive sets of rules.

Different voting cut-offs — legal requirements versus administrative requirements

The institutional share voting system in Australia has two different dates or "cut-offs" for the lodgement of votes by share owners or their agents:

- voting platforms and custodians require share owners to lodge votes five days before company meetings[85]
- the Corporations Act requires share owner proxy forms to be lodged 48 hours before the company meeting.[86]

It is this issue that is regarded by most experts as the most significant environmental factor in the institutional share voting system, especially as it concerns the "quality" of the institutional share owner votes.

The reason for the gap (five days versus two days) is that the voting platform needs time to process the votes lodged by institutional share owners and to lodge these votes as a block with the company's share registry.

This length of time is needed for two reasons, administrative and commercial:

- In administrative terms there is a need to build some "fat" into the process to ensure that votes can be accurately collated and processed. Essentially, this is a risk mitigant to provide a buffer in the event that systems do not operate as they should and in the event there is a delay in lodging the votes.
- The second reason is more commercially driven and concerns the stock lending process. Votes are "pooled" to enable the custodian to maintain the lending process at a consistent level even though shares may be recalled by the share owner for voting. This issue is covered in "Stage four: votes are aggregated and lodged".

85 Note that this is the general requirement: votes may be lodged after that and will be processed on a "best endeavours" basis.

86 Section 250B(1), Corporations Act 2001 (C'th)

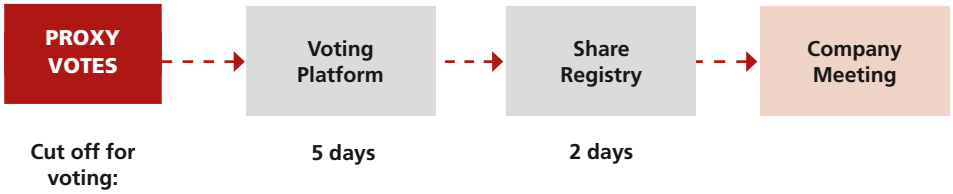


DIAGRAM 4: Voting cut off dates

Source: Mercer

For the present purpose, the reason for the time gap is less significant than the fact that it exists and is potentially a major factor in the quality of the share owner vote. Consider, for example, the situation where a managed fund has 5 million shares in a company and votes all of these shares against a resolution. Then, three days before the company meeting the managed fund reduces its shareholding to 1 million shares. What happens to the 4 million shares that are no longer owned by the managed fund? Are they counted, should they be counted, and what opportunities are offered for "playing" or manipulating the system by interested parties?

Having two different cut-offs, it is suggested, is the major cause of:

- "lost" votes, which are votes that are lodged but not counted (voted via the voting platform [or otherwise] but not counted by the registry)[87]
- double counting and over-voting, as the same votes are counted more than once or over-weighted
- empty voting[88]
- dilution or underweighting of votes.

The issue may be identified as:

- shareholding and share vote volatility in the period between the lodging of the votes with the voting platform and the lodging and counting of votes by the company registry after the Corporations Act cut-off 48 hours before the meeting
- the ability of the voting platform's/custodian's process to cope with this volatility on an overall system basis (the voting system in totality) and the varying abilities of different voting platforms and custodians to cope with this volatility.

87 See on this point the exercise conducted by AMP in which AMP estimated that about 4% votes went 'missing' or were 'lost' – reported in AMP Capital Corporate Governance Full Year Reports (December 2009) at http://www.ampcapital.com.au/about-us/corporate-responsibility/corporate-governance.asp.

88 Empty voting is when an investor has the right to vote, but has reduced or eliminated its economic exposure to the security being voted (through, for example, stock lending). See, for example, the description of this and related matters in *"Empty Voting" and Other Fault Lines Undermining Share owner Democracy: The new hunting ground for hedge funds*, Latham & Watkins LLP, 2007 at http://www.lw.com/upload/pubContent/_pdf/pub1878_1.Commentary.Empty.Voting.pdf (site accessed 30 July 2011).

The key point is that the registry may not be able to reconcile shares in the 48-hour window. By way of an illustration, an investor lodges its vote five days before the cut-off specified by the custodian through voting platform and then sells down half of its holding three days before the meeting. The registry may not be able to reconcile the votes in time and may disallow the entire holding. This issue has received sustained attention in the past few years. We have addressed this issue in more detail in the next section (Stage 4).

There is some good information on these issues for other jurisdictions.[89] However, with the exception of the AMP study (which recorded a lost vote rate of 4 per cent), there is very little statistical information on this in Australia. This is a system-wide problem and not restricted to systems managed by particular custodians and registries.

Share voting: decision making and communication

This section seeks to:

- identify those factors in the institutional share voting landscape that have the greatest bearing on the communication process
- identify the key impediments to and enablers of effective communication in the share voting process.

Key factors — decision making and communication

The factors that have the greatest bearing on communication may be summarised as follows:

- *Compression:* The time available for institutions to make share voting decisions is limited by legislation and by operational needs (voting platforms/custodians). This is combined with a high-volume environment, where the time available to the decision maker per company meeting is reduced.
- *Cost and resource allocation:* There is an incentive to design a voting process and allocate resources to meet acceptable standards of cost and efficiency. Specifically, there is a need to limit the number of matters on which the share owner must actively consider and make a decision.
- *The process will provide for a graduated response to share voting:* At its most basic level a distinction is made between matters that do not require active consideration (because there is agreement between all the parties, including companies, share owners and intermediaries) or where active consideration is required.

89 See in particular C. Hansell et al, op. cit.

- The graduated response to share voting necessitates the use of filtering mechanisms and automated decision making mechanisms. For this reason share voting as an end-to-end process will be characterised by delegations (or sharing) of power from the share owner (the principal source of authority) to intermediaries and agents by:
  — the use of policy documents (share voting and governance "guidelines")
  — outsourcing part of the process.
- The model of outsourcing will influence the process and voting outcomes.
- The trend of increased voting disclosure is very likely to alter the dynamics of the system:
  — to standardise voting across the whole of a share owner's portfolio (in other words, no more "split" voting) and so reduce the autonomy of a managed fund to vote as they see fit in the interests of the share owner
  — for share owners to become more aware of the reputation risks of controversial votes and so to become more conservative and align more closely to existing policy settings or the advice of proxy advisory firms (the "safe harbour" approach).

It is worth making one or two observations on the system as a whole before we move from these key trends to communication specifically.

The first observation is that it cannot be said that there is a single "decision maker" in most institutional share voting situations. Rather, there are multiple decision makers and multiple decision-making entities across a decision-making chain (characterised by delegations of authority [in whole or part], escalation procedures and other filtering mechanisms). We know that a voting outcome will occur on behalf of the institutional share owner: either a vote will not be lodged (intentionally or unintentionally) or a vote will be lodged "for", "against" or "abstain". What we cannot state conclusively for any given scenario is who or what will determine that decision, as this will change according to a range of factors. This assessment is supported by the survey and interview components of this research project. Among other outcomes, this reveals a mismatch on who is believed to be the key decision maker (or, perhaps more accurately, at what level communication should be pitched if it is to be effective). Eighty per cent of directors believe communication should be pitched at the chair/chief executive/chief investment officer level, whereas the managed funds themselves believe effective communication should be pitched at a lower level (governance manager, or analyst portfolio managers).[90]

The institutional share owner is accountable for the decision-making chain, and will usually be responsible for the design of the chain where there are options

90 See chart 4, "Who, within Share Owners, Should Companies Try to Engage with on Significant Issues" on p 19.

available, but often large parts of that chain will operate independently from the share owner.

This leads to the second observation, which may be termed the '"area of consensus", or uncontested matters. The majority of company resolutions are not contentious and all of the participants in the decision-making chain agree on the desired voting outcome, from the company itself, to the proxy advisers and the institutional share owners.

Research often tends to focus on disputed matters, that is, what happens when there is conflict. This focus is generally warranted, as the system is designed to produce decisions and to resolve conflicts. However, this should not lead us to ignore the great sea of consensus in our focus on islands of dispute. Further, it is worth asking whether this effort to be in the "area of consensus" is always legitimate. How is consensus defined, and by whom? Does this provide an incentive to companies to "fit" their company resolutions to meet proxy advice? At what potential cost — in terms of deviation from company strategy and share owner value — might this be achieved?

In the interviews component of this research project it was clear that directors were aware of this tension between consensus and the interests of share owners. This manifested itself in the pressure to "tick the box". One director said the company had designed a remuneration system with proxy advisers at least partly in mind and commented that:

> We've had a lot of direct exposure to proxy advisers in the last 12 months … very good meetings … got 'yes' votes on all resolutions even though in the past we've had 'issues' … it is about communication and taking the time.

There was very little evidence that directors did "fit" company resolutions. Nevertheless, there was broad recognition on the part of directors of the pressure to conform and that this may not be in the interests of share owners.

Key impediments to and enablers of effective communication in the share voting process

What we have mapped thus far is daunting in terms of effective communication; certainly at least as far as the "peak" share voting season is concerned. This section will mostly focus on the "peak" season, in part to illustrate why effective communication (or at least the foundations for effective communication) must take place outside that period.

It may be said that in the "peak" period the time for listening is almost over, and that process requirements mostly predominate over communication. Consider, for instance, what the major participants are doing at this time:

- Company/issuer: For the most part companies will be engaged in final meeting planning and execution, interacting with the registry companies and finalising arrangements with other service providers. Some companies will be seeking to execute institutional share owner voting strategies formulated by chair/board/board committee level, in conjunction with chief executive/chief financial officer/investor relations and usually in conjunction with an external communications specialist third party.
- Proxy advisory firms will be seeking to process recommendations across the ASX 200/300. Basic company research will already have been undertaken as will precedent and peer activity (for example, "How did we vote last year?", "How did we vote for similar companies and similar resolutions?") Communication will be restricted largely to contacting companies where an 'against' vote is proposed,[91] and the purpose of this communication may be to verify facts and to inform companies of proposed voting recommendations.
- Managed funds: The process here will vary considerably according to process design. If a fund manager is a source of advice for the share owner (superannuation fund or managed fund) it will generally wait passively for its opinion to be requested, usually its opinion of a proposed "against" vote. If it is a principal or is voting on behalf of share owners (delegated authority) it may be considering multiple sources of advice, policy requirements and referring to previous interactions with the company. The first model may be high volume (with multiple clients) and the second model almost certainly will, so there will be limited opportunity for real communication.
- Share owners: Superannuation funds and managed funds will be implementing processes predicated on high volume (again, across the ASX 200/300), with limited time, outsourcing, and limited escalation. Again, there is limited opportunity for real discussion.

On this basis, there are a number ways of looking at communication that are useful:

What will decision makers listen to?

Decision makers on voting matters have designed (or inherited) processes that limit the matters they have to deal with. It is likely that they will not consider matters that are a clear violation of policy, nor will they likely consider matters on which

91 Source: interviews with directors and proxy advisory firms. As noted previously, proxy advisory firms said they would inform a company of an "against" vote recommendation before the meeting (usually via contact with the company secretary), whereas directors were more generally of the view that companies were not directly or proactively informed of such recommendations.

advisers (managed funds and proxy advisory firms) are agreed. The matter would need to be in a grey area (for example, differing assessments of share owner value in a takeover situation) or require a strong advocate (for instance, a managed fund that has a strong contrary view).

Who will decision makers listen to?

If one part of the process has yielded an outcome (presumably an "against" recommendation), then who can get the attention of the decision maker on a vote? It is suggested here that this will need to be at the level of board chair, or the chair of the relevant board committee. A share owner communications firm will have less success in gaining the attention of a decision maker, even though it may have helped to design the communication process.

Does the decision maker have the power to make (reverse) the decision?

The decision maker's power to reverse the decision may be more limited than at first appears. The decision maker may be required to adhere to guidelines or precedent (for example, similar situations or peer companies) more than the process would suggest. Also, there may be a limit to the number of cases that the decision maker will allow to deviate from the norm. The disclosure of voting may also play an important part in this process, since it is the decision itself (and perhaps its divergence with the views of other players in the process) that will be publicly visible.[92]

Implications for companies

What might this mean for companies and directors, especially those seeking to communicate with institutional investors? It is suggested that the following should be considered:

- companies, directors and/or their advisers need to understand the Corporations Act and ASX Listing Rule requirements and corporate governance guidelines that apply to resolutions
- companies and/or their advisers need to understand and assess the views of proxy advisory firms and share owners
- if it is decided that communication is required, then an understanding of the process is important. An assessment should be made regarding the point in the process at which to seek to communicate; for instance, whether at the policy formulation stage, with the proxy adviser, the managed fund or the institutional share owner.

92 Equally, perhaps, a certain amount of divergence may be a good thing as it shows the institutional share owner is across the issues and of an independent mind.

Stage Four: Votes are aggregated, lodged, finalised (AGM) and disclosed

THIS STAGE IS RELATIVELY straightforward and is largely concerned with process.[93] However, there is one matter that has significance for the process overall. The stage may be described as follows:

- *Voting decision.* The voting decision is made (to vote or not to vote) by the institutional share owner or the institutional share owner's agent authorised to vote on its behalf.[94] These votes are lodged five days before the company meeting. The share owner is able to verify its votes according to voting status on the voting platform.
- *Custodian 'pools' votes.* In a step that is not visible to all of the custodian's clients, the total votes for that company are aggregated in a "pool" of votes. (Nor should that pool be transparent, for confidentiality reasons.) From that pool the votes are communicated via the voting platform to the company's share registry. These votes are lodged 48 hours before the company meeting.
- It is noteworthy that at this point the custodian takes an active role in the voting sequence. The custodian has an economic interest in this part of the process due to stock lending. (The institutional share owner may also have an economic interest in the custodian's stock lending program.) A common part of the process here is that an institutional share owner will "recall" any shares that it has out on loan — particularly when an "against" vote is decided — and will instruct its custodian that these share be recalled. Custodians will generally deal with this by redistributing shares within their total pool of votes aggregated across all clients. For example, out of a

93 Refer to diagram 3: "The Institutional Share Voting Process in Australia"

94 The share owner's agent may be a proxy advisory firm, a managed funds, or in fact the voting platform itself according to a policy with systematic default options.

million shares held in the total pool by the custodian, 100,000 will not be directed and voted and may be used for loan recall purposes.

- *Company share registry.* The voting is electronic on the platform but then the proxy forms are manually faxed to the company's share registry. The share registry (among other activities) will help the company determine the validity of proxies and will reconcile votes received with shareholdings. Votes are therefore tabulated by the share registry. How the votes are counted will depend on whether voting at the AGM is completed by a show of hands, a poll or via electronic voting.[95] The total vote is determined. An external party — often called a "vote tabulator", which may be an audit or professional services firm (generally not the company's appointed audit firm) — is usually appointed to oversee the process.
- *Disclosure.* As required by the ASX Listing Rules (rule 3.13.2), outcomes will be disclosed to the ASX.

It is important to note one other matter of genuine significance in this section, and that concerns the integrity of the voting process in Australia. The basic point is that the processes by which share voting occurs in Australia are not sufficiently robust to ensure that voting is accurate and that share owner votes are fully counted. These are matters of a technical nature that can and (in the view of this report) should be improved. The integrity of the vote is a critical issue in and of itself: however, as a number of interviewees pointed out, accuracy of voting is very likely to be of even greater importance with the "two strikes" remuneration legislation. The key issues are outlined below:

- *Time for share registry to reconcile votes:* Here is the potential for "lost", miscounted and discarded votes due to the time pressure of having a record date only 2 days prior to the meeting.[96]
- *Audit trail:* At present there is no audit trail to establish that votes have actually been voted as instructed. This is because the common method of lodging votes is still manual: the custodian or sub-custodian lodges votes with the registry company via fax. The process appears to be electronic and seamless in nature (certainly this is how it appears to the institutional investor), but there is significant disconnect between, on the one hand, the custodian and/or sub-custodian (including the voting platform) and, on the other, the registry company. Discussions with registry companies

95 See *Annual General Meetings: A guide for directors*, Australian Institute of Company Directors, 2009, paragraph 3.6.

96 These issues were considered in considerable depth by the Parliamentary Joint Committee on Corporations and Financial Services Better Share owners – *Better Company, Share owner and Engagement and Participation in Australia*, Commonwealth of Australia, 2007 and in the preceding report by IFSA (now the Financial Services Council) *Improving the Proxy Voting System in Australia*, 14 September 2007

suggest that there is electronic lodgment by institutional investors of only around 10 per cent of total votes, and the rest are lodged by fax.[97] This means institutional share owners are not able to see the entire voting chain, and they cannot be certain that their votes have been voted as instructed.

- *Electronic voting:* Electronic voting may go a long way towards fixing these problems, as it may address the time problems raised by the cut-off date and would resolve the matter of the audit trail.[98] The great majority of voting in Australian AGMs is still paper-based between custodian and the registry. The reasons for this may be summarised as follows: there is a cost involved in setting up a common system and it is not clear which party should bear the cost (the institutional investor, the company/issuer, the custodian), and there is disagreement on electronic protocols to be adopted and whether these should be based on SWIFT (and if so, who bears the cost).

These issues are important for the integrity of share owner voting in Australia and are worthy of further consideration.

97 Discussion (June 2011) with Computershare suggest that the voting breakdown is roughly as follows: 66 per cent fax (institutional share owners), 9 per cent online custodian voting and institutional share voting, 15 per cent online portal (retail), 10% scanned (retail).

98 For a discussion of electronic voting, including some international comparisons, see Richard Alcock, Andrew Daly, and Caspar Conde, *Electronic Proxy Voting in Australia*, Allens Arthur Robinson, updated February 2006. For an international perspective see *Report of Roundtable on Proxy Governance: Recommendations for providing end-to-end vote confirmation* from the University of Delaware, Alfred Lerner College of Business & Economics, August 2011

Summary of key issues and questions

Stage one: Formulating the meeting agenda

Companies / issuers

i. At this stage, from the company's point of view, communication to other participants in the share voting process is largely "on the documents", such as the annual report, financial statements, full-year presentation documents and announcements (ASX). Similarly, companies will receive communications from share owners and proxy advisory firms in the form of governance policies and statements.

ii. A company will frame its meeting resolutions on the basis of the interests of the company and its share owners. How these resolutions are received or understood by other participants in the process will be at least partly determined by the policies (or guidelines) that those participants have created or relied upon. Companies may use this policy "environment" to assess whether:
   - a resolution is likely to be considered "within" policy, a departure from policy, or a clear violation of policy
   - the company will be able to successfully communicate to institutional share owners the reason or reasons for a variation from a policy position
   - the company is willing to maintain its position.

iii. What active communication by a company there is at this point is often not directed at those who are most influential in the voting decision. For instance, investor roadshows do not usually include governance managers of share owners. Therefore, a company may believe that it is communicating actively but that communication may be bypassing a key audience.

iv. Effective communication from companies to share owners will usually not be most effective at senior points in the hierarchy (the chair, chief executive or chief investment officer of the fund) at most stages in the process. This is because the great majority of decisions are necessarily made earlier in the process and at a lower level. For example:
- outside the organisation in terms of policy (for example, industry bodies) or via service providers (engagement firms and proxy advisory firms)
- inside the organisation but at a different level (for example, governance/proxy voting managers/portfolio managers and analysts).

Further, the decision makers at the top of the hierarchy may be limited by the extent to which they may diverge from what has occurred earlier in the process (for example, as a matter of policy).

v. Direct communication from companies to share owners or proxy advisory firms on policy is not common – communication on this might be most effective at industry body level.

vi. A challenge for companies is that there is time at this early stage of the process for the directors to engage with share owners and others, but will the share owners and intermediaries retain the information until the time of the decision? There is also the question of what entity companies should talk to during this phase, if pro-active. Which participants are most likely to retain the information and act on the information in the "peak" season? Proxy advisory firms, engagement firms, institutional investors and/or others?

vii. There is an opportunity for proactively ensuring correct information is added to databases, including by the proxy advisory firms.

Share owners (superannuation funds/managed fund)

viii. From the share owners' point of view communication is also largely "on the documents" at this stage.

ix. The share owner faces the challenge of deciding whether expenditure — on internal resources and/or external service providers — is enough to enable it to:
- understand the information provided by companies, including instances where departures from policy may be in the interests of share owners
- more generally to meet the obligations of an "active owner" (advice, share voting, engagement services and internal resources).

x. It should be considered whether there are functions in the institutional share voting process that should not be outsourced if the obligations of the share owner are to be fulfilled.

Proxy advisory firms

xi. From the proxy advisory firm's point of view communication is also largely "on the documents" in the early stages (with the exception of the proxy season "previews", which are important ways of communicating governance and share voting policies to institutional investors).

xii. A challenge is whether there is a good practice (or whether one can be established) for the following:
- eliminating errors at a factual level
- implementing an error correction process
- ensuring timeliness of reports
- ensuring adequate levels of resourcing and experience.

xiii. Proxy advisory firms may face a challenge of adequate resourcing, which leads to the question of whether they are paid enough or capable of generating sufficient revenue to enable a service of high quality.

Process / knowledge gaps

xiv. Publicly available market information is needed to better understand process dynamics such as market share of participants, size of total market, potential market growth, levels of competition and barriers to entry.

xv. There is no data, other than the views of survey participants, as to the number of errors made by information sources — particularly proxy advisory firms — in reporting factual (not interpretive) information about companies. (An example of factual information would be reported net profit after tax, whereas interpretive information might be an opinion on whether a director is to be regarded as "affiliated" rather than independent.) This did not emerge as a significant theme in the interview process. *See Proxy advisory firms as an external source of advice* at p 61.

xvi. Further public information is required to better assess the proxy advisory market in terms of: subscription levels and variation (pricing differentials) across the service.

Stage two: Issuing notice to institutional share owners

Companies/issuers

xvii. A question for companies (and this relates to resources) is how proactive they should be in:
- ensuring that proxy advisory firms accurately report information about a company
- maintaining contact with engagement firms, proxy advisory firms and share owners to promote a positive company meeting environment.

xviii. Similarly, should companies or industry associations actively pursue opportunities for communication at this point with share owners and proxy advisory firms?

Process

xix. Is there sufficient time between notice of meeting and the meeting itself (currently 28 days for listed companies in the Corporations Act)[99]? If not, what should the time be and on what basis? What flow-on effects might there be in changing the time requirements?

Stage three: Making the voting decision

Companies/issuers

xx. Time is a key factor in communication. Companies that assume communicating at a sufficiently senior level is the key determinant will often be incorrect. If a matter is strategically important to a company or companies, then communication at lower levels and to different players in the process (including intermediaries and agents) will often be more effective. This includes the area of policy review (usually at industry body level).

xxi. A key question is whether companies are under pressure to "fit" their meeting resolutions — on executive remuneration, for example — to meet existing guidelines or the views of proxy advisory firms. If so, does this come at a cost in terms of deviating from the corporate strategy and/or share owner value?

Share owners (superannuation funds/managed funds)

xxii. Have guidelines become, in effect, prescriptive rules? What is the impact on Australian companies, beneficial owners (for example, superannuation members) and the broader economy? Is this impact material?

Proxy advisory firms

xxiii. We do not know what the level of communication is between the proxy advisory firm and the company at the point an "against" vote is decided on. For example, are these detailed conversations that include the potential for change, or are they just "going through the motions".

99 Section 249HA, Corporations Act 2001 (C'th)

Process

xxiv. Would increasing the time between the notice of meeting and the time of the meeting improve the process by allowing more institutional investors to be more directly involved in the decision-making process?

xxv. Due to the difference between the legal voting cut-off (48 hours) and the voting platform cut-off (five days), we do not know how many votes are lost, which may occur if there are changes in holdings up or down, or votes not exercised due to stock lending. What is the friction cost of the system as it currently operates?

xxvi. How do different voting platforms and custodians deal with the volatility of votes between the different cut-offs dates. For example, can one generalise about how the system reacts in a global sense to volatility, and what is the variability of administrative rules?

Stage four: Votes are aggregated, lodged, the vote is finalised (AGM) and disclosed

Process

xxvii. Voting is not transparent at the end point of the process (the company meeting). The shareowner cannot verify that its votes have been counted or counted correctly.

xxviii. If it is accepted that there is a need for a mechanism to improve voting transparency from the institutional investor to the registry/company, then which entity (or entities) should pay for this mechanism: the company, the institutional share owner or the custodian?

Appendix A Share voting/ governance policies and standards

Managed funds

AMP Capital Investors proxy voting policy (11 February 2011): http://www.ampcapital.com.au/about-us/corporate-responsibility/pdf/Proxy-Voting-Policy.pdf?DIRECT

BlackRock corporate governance policy: http://www.blackrockinvestments.com.au/Institutions/KnowledgeCentre/CorporateGovernancePolicy/index.htm

Colonial First State corporate governance guidelines and principles: http://www.colonialfirststate.com.au/about_us/Corporate_governance.aspx?menutabtype=aboutus

Perpetual Investment Management corporate governance and share voting policy: http://www.perpetual.com.au/pdf/27867_Proxy_voting_policy_FLYER_WL.pdf

Superannuation funds

AustralianSuper corporate governance policies: http://www.australiansuper.com/investments-and-performance/approach-and-holdings/our-investment-governance.aspx

Catholic Super approach to responsible investing: http://www.csf.com.au/responsible-investing-approach

HESTA active ownership and environmental, social and governance policies at http://www.hesta.com.au/Global-Pages/Sustainability/Investments--Corporate-Governance.html

Local Government Super: http://www.lgsuper.com.au/investments/sustainability/approach.asp

Sunsuper corporate governance statement http://www.sunsuper.com.au/Forms_and_Tools/Footer_docs/Corporate_Governance_Statement/

UniSuper investment governance policies http://www.unisuper.com.au/about-us/investment-governance

VicSuper http://www.vicsuper.com.au/www/html/2236-corporate-governance.asp?intSiteID=1

Industry bodies

Australian Council of Super Investors: http://www.acsi.org.au/

Financial Services Council (formerly IFSA) (the 'Blue Book'): http://www.fsc.org.au/standards-guidance/financial-services-council-guidance-notes.aspx

Proxy advisory firms

ISS (ProxyExchange): http://www.issgovernance.com/proxy/advisory

Glass Lewis: http://www.glasslewis.com/

SIRIS: http://www.siris.com.au/

Regulator/stock exchange

Corporate Governance Principles and Recommendations with 2010 Amendments, 2nd Edition, ASX Corporate Governance Council: http://www.asx.com.au/documents/about/cg_principles_recommendations_with_2010_amendments.pdf

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CalPERS global proxy voting policy

Canadian Coalition for Good Governance: principles for governance monitoring, voting and shareholder engagement (2010)

Council of Institutional Investors corporate governance policies

EFAMA: European Fund and Asset Management Association code for external governance (2010). Brussels

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International Corporate Governance Network: global corporate governance principles — revised (2009)

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United Nations Environmental Programme finance initiative (1991). New York

United Nations principles of responsible investment (2005). New York

Appendix B Links to voting reports

Examples of detailed reporting

AustralianSuper share voting 1 January 2011 to 31 March 2011 [online] available at: <http://www.australiansuper.com/investments-and-performance/approach-and-holdings/~/media/files/Share%20voting%20PDFs/Stock_voting_from_1_Jan_2011_to_31_Mar_2011.ashx (accessed 16 August 2011)

Care Super share voting half year to 31 December 2011 [online] available at: http://www.caresuper.com.au/documents/voting_data_dec2010.pdf (accessed 16 August 2011)

Cbus Super share voting 1 July 2010 to 31 December 2010 [online] available at: http://cbussuper.com.au/__data/assets/pdf_file/0015/23073/1012-Half-Yearly-Corp-Gov-Website-Report.pdf (accessed 16 August 2011)

HESTA share voting report 1 July to 31 December 2010 [online] available at: <http://www.hesta.com.au/Media/docs/HESTA%20Australian%20Share%20Voting%20Report%20-%201%20July%20to%2031%20December%202010-347b7a5b-a1f0-4b85-a71b-6fd45cb232f0-0.pdf (accessed 15 August 2011)

VicSuper share report 30 June 2010 to 31 December 2010 [online] available at: http://www.vicsuper.com.au/resources/documents/VS_Australian_Proxy_Voting_30062010_to_31122010.pdf (accessed 16 August 2011)

Examples of aggregate reporting

Colonial First State corporate governance update to August 2009 [online] available at: <http://www.colonialfirststate.com.au/about_us/Corporate_governance.aspx?menutabtype=aboutus> (accessed 16 August 2011)

Future Fund exercise of voting rights 2009-10 [online] available at: <http://www.futurefund.gov.au/__data/assets/pdf_file/0012/4170/Exercise_of_voting_rights_2009-10_A46725.pdf> (accessed 16 August 2011)

AMP Capital Investors corporate governance: 2010 full-year report [online] available at: <http://www.ampcapital.com.au/about-us/corporate-responsibility/pdf/corporate-governance-report.pdf?DIRECT> (accessed 16 August 2011)

UniSuper proxy voting record [online] available at: <http://www.unisuper.com.au/about-us/investment-governance/proxy-voting-record> (accessed 16 August 2011)

Appendix C
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AMP Capital corporate governance mid-year report, August 2010.

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- Australian Council for Superannuation Investors: 14 September 2007 and 15 May 2008
- Australian Custodial Services Association: 10 September 2007
- RiskMetrics Group: 14 September 2007 and 23 May 2008

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Appendix D
Glossary

Asset consultant: An organisation qualified to provide investment advice to trustees of superannuation funds or other responsible bodies.

Australian Council of Superannuation Investors (ACSI): A membership organisation that represents the interests of not-for-profit superannuation funds. Its overriding objective is to ensure that members are equipped to deal with governance risks in their investments in a practical way.

Australian Prudential Regulation Authority (APRA): The regulator of the Australian financial services industry. It oversees banks and most members of the superannuation industry. The authority is funded largely by the industries that it supervises.

Australian Securities and Investment Commission (ASIC): The regulator with responsibility for Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

Australian Securities Exchange (ASX): ASX functions as a market operator, clearing house and payments system facilitator. It also oversees compliance with its operating rules, promotes standards of corporate governance among Australia's listed companies and helps to educate retail investors.

Brokers: An organisation or person whose business is buying and selling shares and securities on behalf of others (clients), earning commission (brokerage) on trades.

Company/issuer: An entity that has share capital listed on the Australian Securities Exchange. Other participants invest in these companies by purchasing securities or shares. The company is the entity that issues the notice of meeting and sets the date for the annual general meeting.

Company engagement firm: A firm that provides clients with voting/engagement services on share voting decisions. Engagement entails monitoring corporate behaviour and seeking changes through dialogue with companies or through the use of share ownership rights, such as filing shareholder resolutions. Shareholder engagement is often employed in attempts to change a company's performance on environmental, social and governance issues.

Corporations Act: The Corporations Act 2001 (Cth).

Custodian: An organisation that is responsible for safe keeping of assets (including shares), income collection and trade settlements, independent from the asset management function. Often the custodian is the legal owner of shares and is listed as such on the company's share register.

Financial Services Council (FSC): The Financial Services Council (formerly IFSA) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks.

Industry organisations: In this context, industry organisations are bodies that represent the interests of parties involved in proxy voting.

Managed fund: An organisation that invests assets either as principal or (more usually) as an agent on behalf of third parties for a fee.

Notice of meeting: The notice of meeting for the annual general meeting.

Proxy advisory firm (or proxy adviser): An organisation that provides clients with voting advice and advice on share voting decisions.

Proxy solicitation firm: An organisation (most often engaged by a company/issuer) that will seek to influence shareholders in a company to vote a certain way on specific matters of corporate governance. Often in the US, this will extend to seeking authorisation of other shareholders to vote on their behalf in a company ballot.

Proxy voting: The delegation of voting rights from entitled voters who do not attend shareholders' meetings to delegates who vote on their behalf.

Proxy voting policy: The written policy that articulates how proxy voting decisions are to be made and executed. Proxy voting policies can include specific guidance on environmental, social, corporate governance and ethical voting decisions.

Proxy voting season: The time available for proxy voting is determined by the Corporations Act (section 250N) which requires a company to hold its annual general meeting within five months of the end of the company's financial year. In Australia, this means there is a "mini" proxy season in April-May, and a main proxy season from early October to early December in which votes must be lodged.

Proxy voting platform: An organisation that provides the operational capability to exercise proxy voting rights.

Shares: Fully paid ordinary shares in the capital of the company.

Shareholder: An investor who holds preferred or ordinary shares of a corporation.

Share registry: An organisation that coordinates the share registry function on behalf of a company/issuer. The share registry conducts various registration and record-keeping tasks associated with an investor's shareholding.

Superannuation fund: A fund set up pursuant to a federal government-regulated investment strategy designed to provide retirement income for Australians.

The definitions provided are for the purpose of understanding this report. In other contexts, these terms may be defined differently (for example, in legislation and regulations) and should not be relied on for any other purpose.

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