ACSI issues updated voting guidelines

December 11, 2017

The Australian Council of Superannuation Investors (ACSI) represents 37 Australian and international asset owners and institutional investors. The Australian members include the profit-for-member superannuation funds that are jointly controlled by union and employer trustee representatives. ACSI members collectively own about 10% of each ASX 200 company.

On 29 November 2017 ACSI published the eighth edition of its Governance Guidelines. The Guidelines are updated about every 2 years. ACSI's views on executive remuneration and other governance matters continue to evolve (see our review of the last update HERE). They are an important reference for benchmarking ASX 200 board and company governance practices in addition to those of other proxy advisers (see HERE), and the ASX Corporate Governance Council Principles (see HERE).

The eighth edition of ACSI's guidelines streamlines existing principles and provides further guidance on the factors considered when determining certain voting recommendations.

The main changes are summarised below.

Core principles

The core principles underpinning the Guidelines have been refreshed to draw out the important concepts of active ownership, transparency and licence to operate.

ACSI requires better transparency on these factors to highlight both risks, suggesting that companies' pro-active responses to material ESG risks directly impact their long-term sustainability and the ability to raise capital.

The focus on these principles has been very much in evidence at all ASX 50 and most ASX 100 companies during this season's AGMs, with chairmen and CEOs being put on the spot with questions from activist shareholders. Many of these activist shareholders are served by ACSI and the other proxy advisers.

Director (re) elections

ACSI's latest guidelines provide more clarification of factors relevant to voting for both the individual director seeking (re-)election, as well as factors relevant to how that person fits within the board's overall composition.

The guideline associated with an "over-boarded" director is still prominent. But, after flexing muscle on this issue, we expect most directors are well-aware of taking on too much of a workload.

ACSI also has regard for company performance, which has become a lightning-rod for activist investors seeking wholesale board renewal.

Serial remuneration SOP vote offenders will also be singled out. Although this was part of the previous guidelines, we expect that ACSI may step up its consideration of this factor in director elections, given the fact that the board spill resolution applying to all directors on the 2nd strikes is rarely supported.

Director tenure

Where a company has long serving directors, ACSI requires boards to explain the board renewal process. This feeds into the guidelines for director re-elections – and reflecting ACSI's concerns about excessively long tenure. ACSI makes no mention of age, as you would expect. However, we have observed, with some disquiet, off-hand verbal comments from some investors and proxy advisers (not, we may add, ACSI) that some directors are too old. These ageist comments are odds with guidelines that otherwise value diversity.

Board diversity

2017 is the first year ACSI has recommended its members should vote against companies with no women on their boards. ACSI may also recommend voting against boards with less than 30% of women on a case-by-case basis, in line with evolving voting polices as updated on its website. This sounds ominous, and probably will be.

Guerdon Associates has previously noted the concerns that proxy advisers tend to publish guidelines shortly after the beginning of the season (see HERE). This timing is, effectively, after the horse has bolted with the board-approved disclosures to the ASX for release. ACSI does not do this, although it is evident that its guidelines play catch-up to its practice. (This has been particularly noticeable this year in regard to capital raisings). However, at least in respect of diversity, and women on boards, ACSI has given due warning that it may go beyond these guidelines. So, do not wait until the next guidelines are published 2 years hence. Be alert before, and during, the proxy season of refinements to ACSI views via its website.

Remuneration

ACSI has added further factors to guide companies on its expectations for the design of remuneration arrangements.

ACSI prefers companies to ensure quantum is fair and reasonable having regard to the complexity of the organisation. The emphasis on organisation complexity is a concern. The private sector is not the public service. CEO jobs are not paid on the basis of points derived from a job evaluation system. While complexity may be a related element, it is subservient to market rates associated with market supply and demand.

Another factor considered by ACSI is internal pay relativity, but not entirely in a way that a rational investor may expect. A rational investor should probably be concerned with operational risk associated with a large pay disparity between the CEO and his/her director reports. A rational investor would like to see potential successors to the CEO being groomed and taking on more responsibility. Evidence of this would be the ratio of CEO pay to his/her direct reports.

This is not, it appears, what ACSI means. ACSI suggests that boards consider internal pay relativities as a potential indicator of unfair treatment, as this will impact employee engagement. There is evidence of a relationship between fairness and employee engagement (see HERE), and it rightly an issue that board remuneration committees should monitor. However, it would be difficult to discern from statutory disclosures, so would therefore need to be the subject of voluntary disclosure. This can be a trap for the unwary, and not recommended. Nevertheless, board remuneration committees should consider it as a regular part of their annual calendar. ACSI's concerns are a fair reflection of concerns from some other proxy advisers and many investors, so chairmen should be full bottle in case of questions from ACSI, proxy advisers and investors.

Other aspects of the ACSI remuneration guidelines are unchanged from prior years.

ESG oversight

The guidelines have a new chapter on the board's oversight of ESG issues and disclosure expectations, including practical guidance by reference to four key ESG themes: climate change, labour and human rights, corporate culture, and tax transparency.

ESG reporting is rapidly evolving. Stakeholders continue to raise the bar, and ASX-listed companies are, in the main, found wanting. For example, outside of the ASX 50, few ASX-listed companies have reported sufficiently in accord with the FSB's Taskforce on Climate Related Financial Disclosure (see HERE).

Not only are there specialist ethical funds that consider these as primary criteria for investing purposes, but they are rapidly being adopted by mainstream active funds managers' considerations of risk.

Corporate culture has been a feature of ASIC and APRA reviews, past enquiries, and will again be considered in the coming Royal Commission into financial services (see HERE). We expect that over the next 2 years, voluntary disclosure will grow in respect of cultural aspects related to remuneration, whistleblowing policy, bribery and corruption, and other factors.

The ACSI guidelines refer to several other guidelines that boards would do well to review in terms of their own company's practices.

Audit firm services

ACSI wants audit firms to be rotated every 10 to 12 years. Further, where the amount paid for non-audit services is persistently higher than 50% of the total fees paid to the auditor, ACSI expects the board to explain why.

Selective placements

In line with what has already been observed this season, ACSI will generally recommend voting against capital raisings by selective placements where such placements do not adequately respect existing shareholders' interests.

Concluding comments

ACSI's guidelines have been further refined for better investor assessment of governance, environmental and social risk. They should remain a key reference for directors, and a benchmark for company self-assessment.

There are several factors assessed within these guidelines that are likely to rapidly evolve further over the next two years until ACSI publishes new guidelines. These include aspects of diversity, remuneration, capital placement, company culture and E&S.

Given that ACSI practice often precedes official changes to its policy guidelines, it is suggested that boards remain alert, engage, and be prepared to change in anticipation of the trends.