

Monday, 21 April 2014

Ms. Judith Fox

National Director, Policy & Publishing
Governance Institute of Australia Limited
Level 10, 5 Hunter Street
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Via email: Judith.Fox@governanceinstitute.com.au

RE: Exposure Draft: Improving engagement between ASX-listed entities and their institutional investors - Guidelines

Dear Judith

Institutional Shareholder Services (ISS) is pleased to provide comment on the Governance Institute's (Institute) exposure draft "*Improving engagement between ASX-listed entities and their institutional investors – Guidelines*" (Guidelines). We also welcome the opportunity to provide the Institute and all interested market participants with clarity as to our engagement practices.

ISS is a leading provider of corporate governance solutions to the global financial community. More than 1,700 global clients rely on ISS' expertise in providing background research and voting recommendations to help them make more informed voting decisions. ISS issues proxy research and vote recommendations on more than 900 Australian listed companies and engages with most of the constituents of the S&P/ASX 300 Index. In addition, ISS offers a full suite of corporate governance solutions to assist institutional investors in meeting their compliance needs and fulfilling their corporate governance responsibilities.



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Submission Focus

ISS promotes the value in ongoing dialogue between listed issuers and their investors. Engagement between issuers and institutional investors is generally aimed at preserving and enhancing long-term investor value and can promote greater understanding of issuers' governance practices and philosophies. The engagement process between issuers and institutional investors should be ongoing and evolve with the circumstances and needs of the parties involved in the process.

ISS acknowledges the Institute's efforts to improve engagement through a "market-informed and consensus based approach". We appreciate the opportunity to have been a participant in the consultation process that culminated with the release of this exposure draft and a related background paper. ISS also acknowledges that the Guidelines seek to achieve a similar successful non-regulatory self-governing approach to engagement as the ASX Corporate Governance Council has achieved with its *Principles and Recommendations*, which is largely seen as the best practice for corporate governance in the market.

We are generally supportive of the Guidelines and view them as a useful frame of reference for market participants as they navigate the challenges and opportunities that engagement presents. We have limited our submission to addressing draft Guidelines 6, 7 and 16, as these have the most relevance to our role as proxy advisers.

Guideline 6: Proxy advisers explain your proxy voting and other governance guidelines

ISS has undertaken extensive efforts to make transparency a hallmark of our company. Beginning with our rigorous, inclusive and transparent policy development process – which includes an annual survey of both institutional investor clients and corporate issuers – continuing with public dissemination of our voting guidelines (http://www.issgovernance.com/policy/2014/policy_information) and accompanying webcasts, also including background research papers on evolving corporate governance practices, ISS strives to inform all market participants about the policies and corporate governance expectations that drive voting recommendations.

ISS periodically updates our Australia policy guidelines, taking into account the local market regulatory regime, disclosure practices, best practice principles, and actual market practices. In particular, our guidelines are informed by:

- Corporate legislation, including the provisions of the *Corporations Act 2001 (Cth)*;
- Regulatory guidance and rules issued by the Australian Securities and Investments Commission and by the Australian Prudential Regulation Authority;



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- Market best practice guidelines, including the ASX Corporate Governance Council's *Principles and Recommendations*, the Financial Services Council's (previously the Investment and Financial Services Association) *Blue Book*, the Australian Council of Superannuation Investors' *Governance Guidelines*;
- Ongoing feedback from investors and issuers;
- Industry group roundtables (most recently held in February 2014); and
- ISS' own policy expertise.

ISS produces its research reports and voting recommendations solely for the benefit of institutional investors who subscribe to these services, although any reporting issuer may obtain a copy of the final ISS report on their upcoming meeting upon request.

Guideline 7: Proxy advisers explain when to engage

ISS discloses to the market the periods during the year which are best for engagement and during which we have limited time for engagement. Nonetheless, we maintain a "no black out" policy even during peak AGM season, which we believe is appreciated by both issuers and institutional investors.

In 2013 we conducted an outreach program whereby we proactively invited issuers to engage and communicated our engagement principles and policy (see Appendix A).

Guideline 16: Companies and institutional investors plan your engagements on ESG issues

Guideline 16 is consistent with the spirit of other ESG-related trends in the market, including the addition of an ESG-related recommendation (Recommendation 7.4) in the ASX Corporate Governance Council's *Principles and Recommendations*, and the pilot program of the Integrated Reporting framework at a handful of Australian listed issuers. Whilst there appears to be no consensus in the market on how to best manage ESG risks, there is a burgeoning trend of investors requesting improvements in disclosure on ESG issues. The ultimate level of disclosure on ESG-related issues is not prescribed, leaving it at the discretion of the individual issuer. At this still-nascent stage, engagement can be a useful tool by which investors and issuers can understand each other's expectations.

From the point of view of a proxy adviser, ESG-related issues manifest themselves in proxy research and recommendations primarily by way of shareholder-sponsored resolutions.

The Australian market has limited exposure to environmental and sustainability-related shareholder-sponsored resolutions—on average only one has been lodged per year over the past ten years across the constituents of the S&P/ASX 300 Index.



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The low prevalence of such proposals is due in part to the unique and significant Australian case law which has developed, under which environmental and sustainability-related issues fall under the remit of issuers' "management prerogative". The law allows the issuer to exercise ultimate discretion in addressing these issues. The result is that shareholder-sponsored resolutions on these issues may be deemed as not a "proper purpose" for shareholders to vote on, and rejected as such.

Despite this limited scope, ESG-related shareholder-sponsored resolutions that do come to a shareholder vote require additional scrutiny, which may prompt a need to engage with interested parties. In such instances, ISS endeavours to make contact with the issuer, the sponsoring shareholder and other relevant parties as appropriate in order to seek clarification on the proposals and overall to consider how responsibility is allocated within the issuer for ESG issues, and then monitored by the board.

In most instances, engagement with the interested parties was instrumental for us in reaching our final recommendation.



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Appendix A: Engagement Policy for Australia & New Zealand

Issued August 2013

Introduction

Each ISS jurisdiction has a different approach to engagement with a corporate issuer and other parties (see "What do we mean by 'engagement'" below) based on unique local market conditions. The approach to engagement for Australia & NZ follows these guidelines:

Key terms of engagement for ISS Australia and New Zealand (NZ):

- We have an open door policy to engaging with a corporate issuer which is best described as “dialogue”.
- We proactively reach out to all S&P/ASX 300 companies to set guidelines for engagement, such as providing a “engagement meeting agenda” and highlighting contentious issues for the forthcoming AGM.
- We do not have a blackout period during the annual general meeting season.
- We do not provide a copy of the draft analysis for the company to fact-check prior to publishing our report.
- We proactively reach out to all S&P/ASX 300 companies during the AGM season to clarify information set out in their meeting material.
- We proactively encourage the emerging engagement of NZX 50 issuers
- We readily correct any identified inaccuracy via an alert process.
- We include information gathered from the engagement in our published report.
- We record the information gathered during our engagements internally for use by other ISS analysts.
- We do not provide advice or direction to the corporate issuer during the engagement with regard to any matters raised by the corporate issuer; but we do explain our policy positions and market better practice on these matter.

What do we mean by "engagement"?

An engagement is a conversation – in person, over the phone, or potentially by e-mail or letter – with a corporate issuer, or with a third party about a corporate issuer. Such third parties can include dissident shareholders or shareholder proposal sponsors, or shareholders who have an opinion about a company whether or not they take any formal action. They can also include attorneys, compensation consultants, investment bankers, proxy solicitors or other advisers to a corporation or to a dissident shareholder. Some of these conversations are initiated by ISS, to seek clarification about a company action or disclosure; while others are initiated by the company or its advisers, or by a shareholder, to inquire about ISS policy, or explain a company action, or present their side of a contentious issue.



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When engagement information is included in the research report?

ISS includes an engagement summary of information garnered by the engagement in the research report irrespective of our recommendations. Clients do not always follow ISS benchmark policy, and may consider factors other than those considered by standard research analysts. ISS clients may be interested in the responsiveness of companies to requests for information, so even a company's failure to answer a request may be material to such clients. Any substantive engagement with a director should be considered material.

When is engagement information recorded internally?

In addition to the situations when engagement is communicated externally, it is recorded internally whenever the information may be useful to analysts working on future reports; to custom analysts interested in tracking engagement with clients, or with companies in client portfolios; or for the purpose of tracking how much time analysts are spending on engagement. Any engagement that is hostile or contentious is recorded in better dealing with the company in the future; but our judgment that a conversation was contentious is not included in the research report or in an engagement report sent to clients.