THE COMPLEXITIES OF SHAREHOLDER VOTING

By Victoria Geddes of FIRST Advisers

There is a deeply ingrained but false belief among many listed companies that institutional investors outsource all voting decisions at shareholder meetings to their investment managers.

As a consequence, there is often no attempt to identify and engage with institutions holding stock on the register who might be directly influencing or controlling the voting process.

As the Governance Institute explained in its report "Improving engagement between ASX-listed companies and their institutional investors", the behaviour of those investors and their investment managers is actually quite complex and nuanced and this is why companies need to be much more sophisticated and strategic in their efforts at engaging with their major shareholders.

Some investment managers outsource all the shareholder's voting power to a proxy adviser while others are bound by very strict guidelines about when and how they can vote and in what circumstances they must defer to the beneficial owner of the shares. The entity which influences or exercises the vote can change from one meeting to the next.

In addition to the various voting models adopted by the Asset Owners, the Institute also identifies two groups of investment manager and describes how their relationship with the asset owner operates in relation to shareholder voting.

1. The "Active" Investment Manager
    - Controls all aspects of the mandate including voting and engagement with the Chairman of investee companies. This may be managed by the investment team or there may be a separate person/team handling governance matters.
    - Takes direction from their client as to voting and votes accordingly. This may relate only to certain situations with the default position being that they exercise control over most votes. Alternatively the client may seek their advice and recommendation but exercise their own discretion as to how the vote is managed.
    - Offshore investment managers with no Australian office will typically outsource the voting of their ASX listed stock. Voting decisions are based on the recommendations of their proxy adviser or the guidelines customized for the investor by the proxy adviser. There is little capacity to engage.
2. The "Passive" Investment Manager
    - Plays no role in engagement with companies. Will typically outsource voting to a proxy adviser or vote according to internal governance guidelines.
3. "The Asset Owner"
    - Receives reports from the manager after the event on how it has voted on the securities it owns and the reasons why it took those decisions. Does not engage at all with the company.
    - Reserves ultimate control of the voting decision under particular circumstances, such as high profile, controversial or company-specific decisions. In such cases the manager may have to consult in advance with the owner and vote as directed, or the asset owner may take back the vote and exercise it themselves. Larger asset owners may engage directly with investee companies but usually only the top 20-25 by value or those in which it has 'substantial' shareholdings. In some cases asset owners may delegate engagement to governance specialists such as ACSI or Regnan to act on their behalf.

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The role of proxy adviser is often demonised by listed companies on the receiving end of negative voting recommendations, particularly when there has been no attempt to engage with major shareholders beforehand.

The Governance Institute report confirms that it is not always clear to companies how proxy advisers apply their guidelines in their analysis of a company, nor how institutional investors apply their guidelines and proxy adviser voting recommendations in making a voting decision. An additional complication is that many of the industry or proxy adviser guidelines are not consistent, or may conflict with the ASX Corporate Governance Council's corporate governance guidelines.

However, if companies are of sufficient size to attract large, well-resourced Australian-based institutional investors, the good news is that these investors are more likely to take a case-by-case approach when exercising their vote. They will access a range of research and recommendations when deciding how to vote, including:

- Their own voting and governance guidelines
- Voting recommendations of one or more proxy advisers
- Other information considered relevant, including the recommendations of their investment manager and the particular circumstances of the company.

The Governance Institute report offers six "Principles of Engagement" to improve relations between companies and their institutional investors.

1. Institutional investors to explain how they vote and engage with companies; and companies to explain how they engage with institutional investors
2. Institutional investors and proxy advisers to explain their voting and other governance guidelines; how they apply them to voting and when they can engage with the company
3. Companies should know their significant institutional investors and institutional investors should know the significant companies in which they are invested; companies should also know who the intermediaries are (investment managers, proxy advisers etc) and engage with them.

It is also good practice for companies and institutional investors to:

4. Have a regular, efficient and meaningful engagement program.
5. Incorporate environmental, social and governance (ESG) issues in engagement.
6. Take advantage of technology to facilitate disclosure and engagement.

Governance and Small Cap Companies

The report acknowledges upfront that the guidelines are designed primarily for companies in the ASX200. However, it makes the point that it is worth the effort for smaller companies to develop a process that will facilitate engagement as they grow:

"As small companies grow, move up the index, raise capital and expand their shareholder base... they need to be in an increasingly better position to satisfy institutional investor scrutiny, in general, and to avoid a first strike on their remuneration report, in particular".

Where to from here?

Our interest in this topic is sharpened by the fact that shareholder engagement touches on two areas within our business. On the one hand we work with companies to help them implement best practice governance and to do so in a way that becomes integral to the culture of the business. We also operate an established shareholder tracking practice which identifies the beneficial owners hidden behind the registered holders of stock on company share registers. Having done this work for over a decade we know only too well that identifying who is responsible for making the investment decisions in a company's stock does not mean that you automatically know who controls the voting rights attached to that stock.

We strongly recommend that companies schedule into their calendar a plan of engagement with their major institutional shareholders, well ahead of the AGM. A key pre-requisite for this is preparing a list of those individuals who need to be contacted not only at the fund manager level but also at the beneficial owner level. Companies should also explicitly assign responsibility for these issues, whether internally or with an external provider of company secretarial or investor relations services.

FIRST Advisers has been providing register analytics, governance, investor relations and strategic communications advice to its clients for over a decade. Contact Victoria Geddes on 02 8011 0350 for more information.