Australia

Proxy Voting Guideline Updates

2015-2016 Benchmark Policy Recommendations

Effective for Meetings on or after 1 October, 2015

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GENERAL

Alteration of the Number of Directors/Board Size in Constitution

Current Recommendation: Case-by-case

The Australian Corporations Act requires a minimum of three directors for public companies. There is no maximum limit set out in the Act, although company constitutions may set a maximum limit. ISS considers these proposals seeking to alter board size on a case-by-case basis.

All proposals to alter board size during a proxy fight or other possible contests for control should be opposed. Allowing directors to alter the terms of a contest while it is under way is not in shareholders' interests, as this tactic could be used to thwart a takeover that is in shareholders' interests.

Key Changes:

Establish a provision such that any ability for an incumbent board to invoke a "no vacancy" for new nominees may result in an “Against” recommendation on proposals seeking to alter board size.

New Recommendation: Vote case-by-case on proposals to alter the size of the board.

The Australian Corporations Act requires a minimum of three directors for public companies, and nominees are elected if they receive 50% shareholder support. There is no maximum board size limit set out in the Act, although company constitutions may set a maximum limit. Consider on a case-by-case basis the justification provided by a company to set a maximum limit on the number of directors.

Vote against proposals to alter board size which have the effect of providing the company an ability to invoke "no vacancy" for new nominees seeking election to the board. Such a limitation is not considered to be in the best interests of shareholders, as it prevents a new shareholder nominee from being added to the board unless a management nominee is voted down.

Rationale for Update:

When a company amends the constitution to set a maximum number of directors, it is possible that a candidate who received over 50% shareholder support will not be able to take up a position on the board if the incumbent board declares that there is "no vacancy".

Mergers and Acquisitions

Current Recommendation: Case-by-Case

ISS will generally recommend for mergers and acquisitions, and demergers or spinoffs, unless:

- The impact on earnings or voting rights for one class of shareholders is disproportionate to the relative contributions of the group;
- The company's structure following the acquisition or merger does not reflect good corporate governance;
- There are concerns over the process of negotiation that may have had an adverse impact on the valuation of the terms of the offer.

ISS will recommend against a transaction if the company does not provide sufficient information to make an informed voting decision.

Key Changes: Update the policy to conform to ISS' global approach on mergers and acquisitions.

New Recommendation: Vote case-by-case on mergers and acquisitions. Review and evaluate the merits and drawbacks of the proposed transaction, balancing various and sometimes countervailing factors including:

- *Valuation* - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction and strategic rationale.
- *Market reaction* - How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.
- *Strategic rationale* - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
- *Negotiations and process* - Were the terms of the transaction negotiated at arm's-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation "wins" can also signify the deal makers' competency. The comprehensiveness of the sales process (*e.g.*, abililty for alternate bidders to participate) can also affect shareholder value.
- *Conflicts of interest* - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. Consider whether these interests may have influenced these directors and officers to support or recommend the merger.
- *Governance* - Will the combined company have a better or worse governance profile than the current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

Rationale for Update:

The policy is being updated in accordance with ISS' global approach to M&A and the factors considered for these voting items.

BOARD OF DIRECTORS

Independence of Directors

Classification of Directors- Shareholder Nominees

Current Classification:

A "substantial" shareholder is a shareholder controlling 5 percent or more of the voting rights in the company. Where a person is a non-executive director of a substantial shareholder, he or she is classified as independent (unless a separate reason exists for classifying as non-independent). However, if the person is specifically designated as a representative of the substantial shareholder, he or she is classified as non-independent.

Key Changes:

- Differentiate between a shareholder nominee and a shareholder representative;
- Remove the distinction of whether the shareholder is substantial or not.

New Classification:

Non-Independent Non-Executive Director (NED)

- Designated representative of a shareholder.

Independent Non-Executive Director

- Nominee proposed for election to a board by a shareholder but otherwise not affiliated to that shareholder.

Rationale for Update:

The classification of directors is being updated to reflect the difference between a shareholder nominee and a shareholder representative. A shareholder nominee is a director (normally an NED) who was proposed to the board for election but who has no ongoing relationship or responsibility to the sponsoring investor. However, a shareholder representative is a director who has an ongoing relationship with an investor and represents the shareholder's interests on the board. This ongoing potential conflict of interest creates the independence concern, whether the shareholder is a substantial shareholder or not.

Classification of Directors- Board Tenure

Current Classification:

There is no hard and fast rule about tenure (length of time on the board) impacting independence. However, a non-executive director who has served 12 or more years may be classified as non-independent under the residual category.

Key Changes:

Clarify current policy application regarding director tenure. In practice and for data collection purposes, all non-executive directors are in fact classified as non-independent upon serving 12 years or more.

New Classification:

Non-Independent Non-Executive Director (NED)

- A director who has served for 12 or more years on the board.

Rationale for Update:

This classification change is predominantly a clarification of current practice and to enact further feedback received from institutional investors as part of ISS' shareholder outreach via policy roundtables.

The change also addresses an important consideration of institutional investors when considering the impact of excessive tenure of a director. In particular, many institutional investors consider that 12 years is an appropriate time to consider that a director's tenure may impact their independence. Note that classification of a non-executive director as non-independent upon tenure of 12 years or more will not, by itself, result in a vote recommendation against that director.

These new classifications are incorporated into a new "Classification of Directors- Australia" table, next page:

ISS Classification of Directors - Australia

Executive Director

- Employee or executive of the company.

Non-Independent Non-Executive Director (NED)

A non-executive director who is:

- classified as non-independent in the company's annual report;
- A former executive of the company or of another group member if there was less than a three year period between the cessation of employment and board service;
- A major shareholder, partner, or employee of a material adviser/supplier/customer[1];
- A founder of the company, even if no longer a substantial shareholder[2];
- A relative (or a person with close family ties) of a substantial shareholder[2] or of a current or former executive;
- A designated representative of a shareholder;
- A director who has served for 12 or more years on the board;
- A director with any material[3] relationship to the company, other than a board seat.

Independent Non-Executive Director

A non-executive director who is not classified as non-independent according to the factors above. To clarify, this may include:

- A nominee proposed for election to a board by a shareholder but otherwise not affiliated to that shareholder.

Footnotes:

[1] The materiality threshold for transactions is A$500,000 per annum for large advisers/suppliers/customers and A$50,000 per annum for small advisers/suppliers/customers. “Large” advisers include all major law, accounting, and investment banking firms. These thresholds are assessed by looking at transactions during the three most recent financial years.

[2] A substantial shareholder is a shareholder controlling 5 percent or more of the voting rights in the company.

[3]For purposes of ISS’ director independence classification, “material” will be defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one’s objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

Voting on Director Nominees in Uncontested Elections

Overboarding

Current Recommendations:

ISS will recommend for the (re)election of a board-nominated director unless:

- He or she sits on more than five other listed company boards (counting a chair as equivalent to two board positions), or is an executive director and holds more than one non-executive directorship at unrelated listed companies (recommend against, in the absence of exceptional circumstances).

Key Changes:

- Reduce the number of non-executive board appointments which are considered to constitute overboarding by a director to a total of five (5) from the previous policy of six (6). This compares with ISS European policy of a maximum of five board appointments in total for a non-executive director and current ISS US policy of a maximum of six board appointments.
- Provide a one-year transition period through the fiscal period ending 30 June 2016 to enable affected directors with six boards to be able to re-structure their portfolio of board commitments if they wish without triggering a vote recommendation against their re-election. Where there are directors with seven or more board appointments, then existing ISS policy would nevertheless warrant an “against” recommendation.

New Recommendation: Generally vote for director nominees in uncontested elections. Vote against nominees who:

Overboarding (unless exceptional circumstances exist):
- Sits on more than a total[1] of five listed boards (a chair as equivalent to two board positions); or
- An executive director who holds more than one non-executive director role with unrelated listed companies.

Rationale for Update:

The new policy is intended to align with feedback and research received from institutional investors and anecdotally from directors, regarding the ability of a director to devote sufficient time to each board commitment.

[1] A one-year transition period will apply to the fiscal year ending 30 June 2016, to allow boards and affected directors (individuals with six directorships) to manage boardroom succession issues to address overboarding concerns if they so wish.

REMUNERATION

Non-Executive Director Perks/Fringe Benefits

Current Recommendation: None.

Key Changes:

Initiate a policy which recognizes that receipt by non-executive directors of fringe benefits, in addition to their fixed directors' and committee fees, may represent poor governance practice. ISS will consider, on a case-by-case basis, fringe benefits which are

- Received during a non-executive director's tenure on a board, and
- Post-employment benefits.

New Recommendation: Vote case-by-case on:

- The remuneration report;
- Proposals to increase the non-executive directors' aggregate fee cap; and/or
- The election of the chairman of the board, chairman of the remuneration committee, or any member of the remuneration committee standing for re-election

Where a company provides fringe benefits to non-executive directors in addition to directors' board and committee fees. Fringe benefits may include payments made, or services provided without charge, by the company. Examples may include, but are not limited to, additional "travel time fees", which may be charged by the hour, in travelling to board or company meetings either domestically or overseas.

Also, vote against when post-employment fringe benefits are paid to non-executive directors, which are often represented as an entitlement per year of service on the board of the company. Unless the same or similar benefits are also offered to shareholders, such benefits are not considered good market practice, and they represent a potential conflict of interest to incentivize longevity on the board which may not be in the best interests of board succession planning or shareholders. These fringe benefits may be offered to non-executive directors as a cash payment (for example, retirement benefits) or in services provided or procured by the company.

Rationale for Update:

It is commonly considered by shareholders in the Australian market that non-executive directors should only receive remuneration as a fixed director's fee, to ensure that there is no potential conflict of interest which could impinge on a director's decision-making process while acting in the interests of shareholders. It has also been observed that some directors are beneficiaries of "fringe benefits", either during or post-employment, as a result of their roles as a director on the board of a company such as:

- retirement benefits;
- air travel benefits; or
- services without charge (which are offered to employees at discounted rates).

The provision of retirement benefits for non-executive directors has long been deemed as a poor governance practice. Only a minority of legacy retirement plans remain in existence for some long-serving directors. While cash retirement benefits have mostly been addressed and removed, there appear to be "in kind" benefits offered.

Recently, it has also been observed that some directors are benefiting from "travel time fees", representing an hourly charge in addition to the annual director's fee. These directors may receive a payment for their time whilst on a plane in international (and sometimes, domestic) travel to board meetings and company duties. This is a payment in addition to the airfare, accommodation, meals and so on, which are typically booked and paid for by the company. It is considered that on the whole, directors' fees for large and diversified companies are high enough to encompass the breadth and volume of the additional duties of directors of larger companies compared with smaller companies.

It is not intended that this policy is limited to any specific fringe benefit, such as the "travel time fees". Accordingly, ISS reviews on a case-by-case basis all additional payments and fringe benefits to non-executive directors.

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