Agenda paper 8.3.3.1
AASB Meeting 14 June 2019 (M171)

Australian Council of Superannuation Investors

Towards Better Corporate Accountability

April 2019

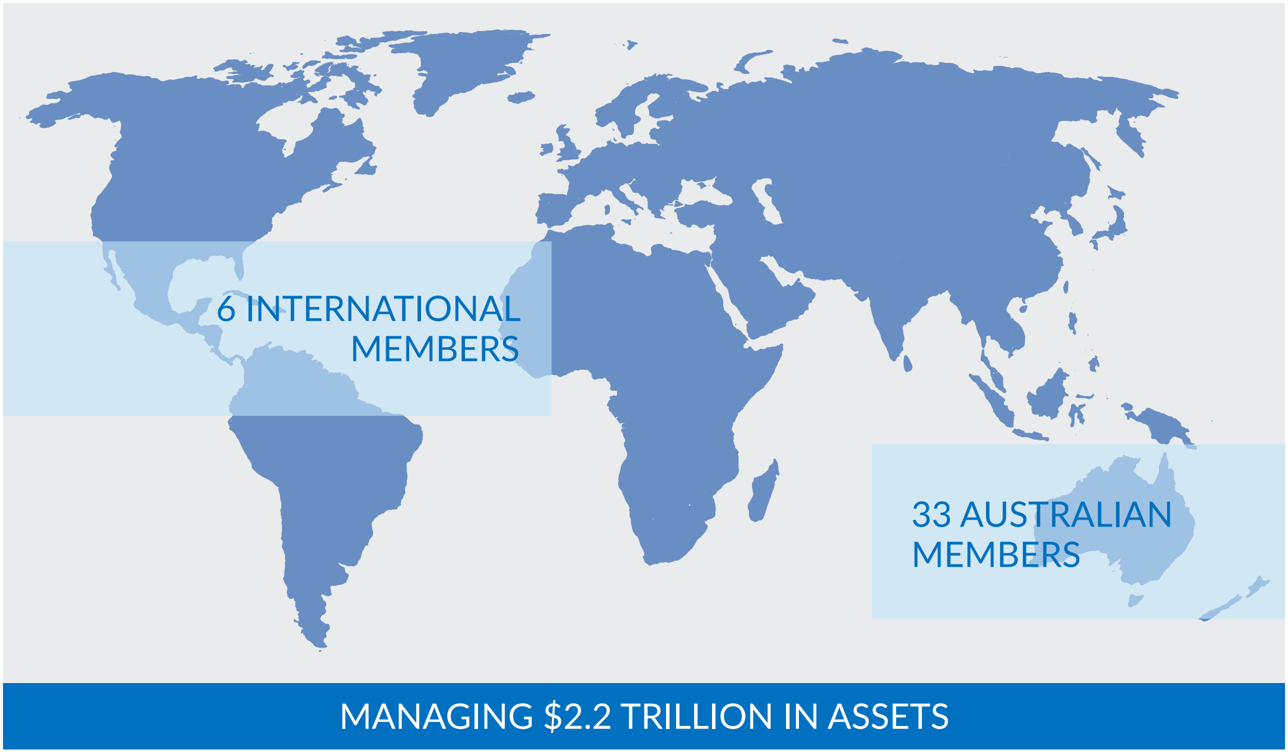
acsi

ABOUT ACSI

ACSI provides a strong, collective voice on environmental, social and governance (ESG) issues on behalf of our members.

Our members include 39 Australian and international asset owners and institutional investors. Collectively, they manage over $2.2 trillion in assets and own on average 10 per cent of every ASX200 company.

Through ACSI, our members collaborate to achieve genuine, measurable and permanent improvements in the ESG practices and performance of the companies in which they invest.



INTRODUCTION

The Australian Council of Superannuation Investors (ACSI) and our members take their responsibilities to safeguard superannuation investments seriously. We recognise that long-term, sustainable investment is underpinned by environmental, social and governance (ESG) principles.

There are too many examples in corporate Australia of poor behavior, including a failure to manage ESG risks, which have elevated public concern. Too often, investors and the wider community have borne the consequences.

The Final Report of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* outlined the need for change. It is important to keep that momentum going and now deliver better corporate accountability.

This document lists tangible actions designed to strengthen corporate accountability, which we will advocate for on behalf of our members and investors. Improving corporate accountability will also drive better outcomes for companies and the Australian community more broadly.

We regard this as an opportunity for businesses, boards and governments to rebuild trust with Australians and adopt long-term, sustainable practices that are underpinned by accountability to shareholders and the society on which they rely to function.

POLICY PROPOSALS	
1	Introduce a binding vote on remuneration policy every three years
2	Disclose CEO pay ratios to shareholders, along with an explanation of how the ratio supports the company's values, strategy and culture
3	Introduce annual elections for directors of listed companies
4	Give shareholders the right to bring resolutions to company meetings

ACHIEVING BETTER ACCOUNTABILITY

The Australian people have demonstrated that they will not tolerate behaviour by corporate Australia which is out of line with community expectations. The Royal Commission[1] has created the momentum for change. It is vital that we keep that momentum going and make it happen.

Stronger corporate accountability can be achieved through:

Better remuneration oversight → Disclosing CEO pay ratios → Annual Director elections → Strengthened shareholder rights

REMUNERATION

Almost six years ago, the United Kingdom (UK) Government made changes to its *Companies Act* which introduced a change to shareholder voting rights. These changes required listed companies to give shareholders a binding vote on pay policy. This meant that a company's remuneration policy would require the approval of more than 50 per cent of shareholders.[2]

This change was motivated by the hope that, strengthened in this way, shareholder voice would affect a stronger pay for performance relationship for executives.[3] The UK Secretary of State for Business Innovation and Skills said that "there is a legitimate role for high pay for exceptional talent and performance, for successful entrepreneurs and excellent managers". However, there was "frustration all-round when the people running companies are handsomely rewarded for mediocrity or failure".[4]

Similar comments were made in Australia in the Royal Commission Final Report.[5] Commissioner Hayne highlighted the connection between conduct and reward and how current remuneration structures can act to promote behaviour that is inconsistent with the interests of Australian customers and investors.

Commissioner Hayne made it clear that misconduct occurs when companies fail to manage culture, governance and remuneration – and that these three are intertwined. A poor culture where remuneration and incentives are focused on financial indicators often leads to poor customer outcomes.[6]

There is a clear need to address short-term thinking that works against the interests of investors. We should seek to establish a culture where transparency starts at the top.

We are calling for the introduction of a requirement for companies to submit their pay policies to a vote every 3 years, to supplement the existing two strikes rule. This would help to align an executive's interests with the company's values, strategy and culture, and with shareholders' interests over the long term. This would support more effective management of non-financial risk and reduce in the risk of misconduct. Pay policies can allow board discretion (and the accompanying accountability) to propose appropriate measures suitable for each company. Nonetheless, companies should include certain matters in their pay policy so that investors have the right information to assess how the policy would operate in practice.[7]

We are calling for the introduction of a requirement for companies to disclose the ratio of their CEO pay to that of their Australian workers' median, 25th and 75th percentile pay. In addition, companies should be required to explain any changes over time, along with how those ratios are consistent with the company's values, strategy and culture.

Similar measures have recently been introduced in the UK[8] and the United States (US)[9]. The US experience has shown that the new disclosures are used by a broad range of stakeholders, including investors, government, regulators, other entities and workers.

Combined, these measures will ensure investors have greater influence to prevent pay outcomes that are inconsistent with their expectations.

PROPOSAL 1

Introduce a binding vote on remuneration policy every three years

PROPOSAL 2

Implement a disclosure requirement for CEO pay ratios

[1] Governor-General of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, website, https://financialservices.royalcommission.gov.au/Pages/default.aspx, accessed 28 February 2019.

[2] The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (United Kingdom).

[3] Department for Business Innovation & Skills, Executive Pay: Shareholder voting rights consultation, March 2012.

[4] ibid, pg 5.

[5] The Commissioner, the Hon Kenneth Madison Hayne, Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019, pg 1.

[6] Hayne (2019), op cit, pg. 335.

[7] For example, explanation of how the remuneration structure links to the entity's strategy and culture, how each component of remuneration operates, mechanisms for the management of non-financial risk, performance measurement, potential minimum and maximum outcomes and provisions for recovery or withholding, the value of CEO compensation packages that result from share price changes, and whether their boards have used discretion when awarding pay packages.

[8] Companies (Miscellaneous Reporting) Regulations 2018 Regulation 17 (United Kingdom)

[9] Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act; Item 402 of Regulation S-K (United States)

ANNUAL DIRECTOR ELECTIONS

'...it is the entities, their boards and senior executives who bear primary responsibility for what has happened..."[10]

Investors need to be confident that their long-term interests are being safeguarded by directors. A well-functioning board with effective directors is critical to managing culture, social responsibility and overseeing strategy – which means that directors must be held to account. Investors should be confident that directors are efficient, skilled and prepared to challenge management.

Without boards asking the right questions, good management cannot be assured. Board efficiency, independence and performance is an issue across all sectors and not exclusive to the financial services sector.

The consequences of poor corporate governance and oversight were laid bare following the global financial crisis, which contributed to strengthened corporate government policy and practice, and again more recently in Australia following what was described by Commissioner Hayne as evidence of unchecked greed.[11]

Directors should seek out information, challenge management and take appropriate remedial action when things go wrong. The argument that directors weren't informed should not satisfy shareholders. It is a fundamental responsibility for directors to keep themselves informed of key business issues and equipped to oversee the execution of the company's strategy.

Asking companies to put directors forward for re-election annually in Australia will ensure:

- Boards are the frontline in demonstrating accountability for their companies
- Responsive and timely feedback on director performance by investors. This will boost a culture shift to further engagement with investors, and agility in responding to issues
- Careful consideration by boards and shareholders of each individual director's contribution to the board and their effectiveness.

Although reservations were expressed when annual director re-election was recommended in the UK in 2010, by 2011 88 per cent of FTSE 100 companies had adopted annual director election as best practice[12] and the 2018 UK Corporate Governance Code extends the recommendation for annual director re-election to all listed entities.[13] As is the case in other countries, if a board believes that annual elections are not appropriate for their company, they would be required to explain why.

PROPOSAL 3

Introduce annual elections for directors of listed companies

[10] Hayne (2019), op cit, pg 4.

[11] ibid, pg 138.

[12] Financial Reporting Council (United Kingdom). Developments in Corporate Governance 2011 (page 14). https://www.frc.org.uk/getattachment/cf48b625-81d0-4e4b-9982-9b79f6b529de/Developments-in-Corporate-Governance-20117.pdf

[13] UK Corporate Governance Code 2018 Provision 18. https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

SHAREHOLDER RESOLUTIONS

Effective communication between companies and investors is a cornerstone of sound corporate governance practice. Corporate governance structures and practices should protect and enhance the board's accountability to shareholders and promote transparency.

Shareholder resolutions remain an important way to focus a company on a particular issue. However, the existing process is unnecessarily complex and restricted and promotes focus on technical detail rather than the substantive issues a company might be facing.

An updated and simplified process would enable investors to propose a non-binding resolution for consideration by all of a company's shareholders at a general meeting. The voting outcome would provide valuable guidance on investors' views to directors, on a broad range of matters, including ESG risks and opportunities, without disrupting the board's role.

Strengthened rights for shareholders would ensure that:

- Shareholders have the right to propose non-binding resolutions, without the need to seek an amendment to a company's constitution, subject to appropriate support for a shareholder resolution (such as the existing 5 per cent or 100-member rule).
- Boards would have the benefit of investor views on a broad range of matters on an advisory basis, without disrupting the board's role in governing the company.

PROPOSAL 4

Give shareholders a simple process to submit non-binding resolutions to company meetings

CALL TO ACTION

While the proposals outlined in this document won't fully resolve the accountability, culture and governance concerns within corporate Australia, they will establish the foundations for a stronger, more sustainable business sector.

Australia's parliamentarians must support business policies that aren't simply good for companies today but align with sustainable practices and investor and community expectations.

We are calling on the policy makers and regulators to make a commitment to the proposals in this document:

1. **A binding vote on remuneration policy every three years**

2. **Disclosure of CEO pay ratios**

3. **Annual director elections**

4. **A simple process for shareholders to bring non-binding resolutions to company meetings**

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