

# Proxy Voting Policy and Application

February 2018



Improving the future prosperity of Victoria

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## Document Information

### 1.1 Document Status

The current status of this document is shown below.

Original issue date	February 2009
Current approval date	February 2018
Owner	Head of ESG
Date of next review	February 2019 (reviewed annually)
Board review required	No

### 1.2 Document History

The history of changes made to this document is shown below.

Version	Date	Summary of changes
1.0	February 2009	First Issue
2.0	March 2010	Rewrite by new Governance Manager
3.0	February 2012	Annual review. Page 4, removed names of consultants as they may change over time.
4.0	October 2012	The revisions to the policy reflect changes in the Corporations law in relation to the introduction of the two strikes rule and our experience over the past two or so years. We have also changed the formatting to reduce repetition and to make our high level principles clearer.
5.0	October 2013	Governance Manager confirms there are no changes required.
5.1	February 2014	Minor amendments following review of all policies.
6.0	August 2014	Annual review. Clarified consideration of capacity of directors, discounting of incentives and non pro rata placements.
7.0	February 2016	Annual review. Minor amendments following a review of the policy.
8.0	February 2017	Annual review. Minor amendments following a review of the policy. Clarifications made following review by Deloitte on types of contentious issues and on roles and responsibilities.
9.0	February 2018	Annual review. Minor amendments to reflect procedural updates.

## 2 Voting Process and Responsibilities

The Head of ESG manages proxy voting responsibilities with input from the Head of Equities and a Portfolio Manager from VFMC's Fundamental Equities team.

Each client of VFMC may request VFMC to provide additional analysis of specific resolutions relating to any nominated special policy matters, however VFMC retains the responsibility to vote on all resolutions in accordance with this policy.

All votes are lodged electronically, and detailed voting reports are provided to clients. Aggregate voting statistics are also disclosed on the VFMC website.

This policy will be reviewed periodically as appropriate.

### 2.1 Domestic proxy voting

VFMC does not vote on Australian shares held outside the S&P/ASX300.

The Head of ESG is responsible for all voting decisions in the S&P/ASX300. The Head of Equities and a Portfolio Manager from VFMC's Fundamental Equities team have:

- Responsibility for the final voting decision in:
  - Investment-related resolutions, including, but not limited to, acquisitions, buy-backs and ratification of placements.
- Input into the decision-making process where:
  - The Head of ESG is considering voting contrary to the advice of both proxy advisers
  - There is conjecture about issues flagged by a proxy adviser in relation to remuneration
  - The meeting is a contentious meeting or involves a contentious resolution.

Where a company meeting involves a contentious resolution, the matter is escalated to the Head of Client Services, the Chief Investment Officer and Chief Executive Officer for direction on VFMC's approach. Examples of contentious issues may include election of directors who are also directors of VFMC or of VFMC clients, non-investment related resolutions with a high media profile, or a spill resolution.

VFMC may also consider the views of external fund managers, and the outcomes of engagements undertaken either directly, collaboratively or through specialist service providers.

### 2.2 International proxy voting

Most of VFMC's international voting is conducted by an external proxy voting service provider. This provider votes in accordance with its own policy on behalf of VFMC at meetings of companies in the MSCI World Index. Voting activity is monitored by VFMC, and VFMC maintains super vote authority over these arrangements.

VFMC generally delegates voting responsibility to its external fund managers that have been appointed to manage shares outside the MSCI World Index.

## 3 Domestic Proxy Voting Principles

VFMC is a long-term shareholder of almost all companies in the S&P/ASX300. In most cases VFMC will hold shares in companies in the S&P/ASX300 long after the tenure of most directors and executives.

It is widely accepted that poor governance practices may deliver diminished investment value over the longer term. Voting rights are an asset that assists VFMC to mitigate corporate governance, agency and conflicts of interest risks that can arise where the interests of the board and management diverge from our interests as shareholders. VFMC therefore aims to vote on all resolutions at annual and extraordinary general meetings held by companies in the S&P/ASX300 in a manner that maximises shareholder value.

In exercising our voting rights on behalf of our clients VFMC believes that:

- *The board is the representative of shareholders and is accountable to shareholders for the company's performance.*
  - Given the importance of the board's role it should be comprised of individuals with the requisite capacity and skill-set to assist the achievement of its strategic aims. Boards should be comprised of a majority of independent directors.
- *In relation to changes to constitutions and capital structures, shareholders (and not the directors) should retain overall control of the capital structure of their company.*
  - This includes the authority to approve any division of that structure into different classes of shares. Where possible shareholders should be treated equally and dilution of existing shareholders should be limited. Any valuations should be fair and reasonable.
- *The aim of remuneration arrangements is to attract, motivate and retain the right people.*
  - Such arrangements should encourage and reward long-term outperformance, not below average performance or failure. VFMC is particularly focussed on avoiding an excessive transfer of wealth to executives and directors at the expense of shareholders. VFMC believes that how executives are remunerated is a proxy for the relationship between the board and executives and provides insight into the oversight responsibilities of the board.

VFMC will apply these underlying principles on a case-by-case basis to each proxy voting decision, taking into account the circumstances of the company and the commercial realities of voting outcomes. VFMC's overriding consideration is that shareholder rights and shareholder value is protected.

In order to identify divergences from these principles and issues for further consideration VFMC receives voting recommendations from proxy advisers. These recommendations are taken as one input into the decision-making process and highlight issues for further consideration. VFMC may also consult with external fund managers to assess the potential shareholder value impact of the vote.

## 4 Domestic Proxy Voting Application

This section provides further detail on how VFMC will, in general, apply the principles identified in Section 3 to specific resolutions within the S&P/ASX300. Where an issue arises that is outside our stated principles, VFMC's overriding consideration is to ensure that shareholder rights and value is protected.

### 4.1 Appointment of Directors

The board is the representative of shareholders and is accountable to shareholders for the company's performance. The board is responsible for appointing the CEO and overseeing their performance and the strategic direction of the company.

When considering the election or re-election of directors VFMC will consider:

- Board and/or company performance
- Governance practices
- Composition (including gender diversity and other forms of diversity) of the board and/or committees
- The capacity of individual directors given other commitments
- Remuneration practices

- The ratio of audit to non-audit fees.

Further detail regarding independence and capacity of directors is provided below.

#### 4.1.1 Independence

In general, VFMC's view is that an independent non-executive director is a director who is not a member of management, and who:

- Is not a substantial shareholder of the company (i.e. a shareholding of 5% or more of total shares in the company) or an officer of, or otherwise associated directly or indirectly with, a substantial shareholder of the company
- Has not within the last three years been employed in an executive capacity by the company or another company group member, or been a director after ceasing to hold any such employment
- Has not within the last three years been a principal or employee of a material professional adviser or a material consultant to the company, or another company group member
- Has no material contractual or related party relationship with the company or another company group member, other than as a director of the company; and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company
- Does not participate in any share option or performance-related remuneration schemes that apply to executives within the company
- Does not hold other directorships that potentially give rise to a material conflict of interest or otherwise impede the proper discharge of their director responsibilities
- Does not receive fees for services to the company that may imply significant involvement in the company's affairs or impede independence
- Is not a spouse, de facto spouse, parent, or child of other directors, senior executives or advisers to the company or its affiliate.

#### 4.1.2 Capacity

In considering any appointment to the board or the re-election of a director, an area of focus for VFMC is the capacity of the board member to be able to respond to a crisis in any or all of the companies for which they are a director. As a shareholder of almost all companies in the S&P/ASX300, VFMC views capacity as an issue of risk management and shareholder value protection. Capacity is not considered in the light of a director's ability to deal with a standard level of workflow, but rather their ability to deal with a crisis in one or more of the companies on which they are a director.

Where a director holds five or more listed board positions, VFMC will undertake further analysis and investigation to form a view about whether a director appears capacity constrained. It is VFMC's view, following extensive discussions with a wide range of directors, that a directorship may warrant a minimum commitment of one day per week.

In determining the potential workload of a director, consideration will be given to the following factors, amongst other things:

- The number of board positions held
- The size and complexity of the companies, including where they are located geographically (e.g. a directorship of a small listed investment trust is likely to be viewed as requiring less time commitment)
- How often the board meets, any committees the director chairs (e.g. an audit committee role for an APRA regulated firm or for a large/complex company is likely to require additional time commitments)
- Level of attendance
- How much they are paid for their directorships for each of the companies
- Whether the director is likely to step down from any of positions in the near future
- Other non-listed board positions
- Whether the company has any contingency plans in place if a particular director is absent for a period of time

In addition, VFMC will generally not support the election of a director where:

- That individual has an executive position with another listed entity (exceptions could apply where the directorship is related to the executive position or if the director was likely to step down from their executive role in the near future)
- The director is an executive of the company in question, and there are more than two executives on the board, due to the importance of maintaining an effective separation of executives from the oversight of those executives. An exception may be made for the CEO or founder due to their importance to the company.

#### **Voting Example: Appointment of Directors**

Typically VFMC will vote **against**:

An executive director (in general, other than the CEO or founder due to their importance to the company) where:

- More than two executives sit on the board

A non-executive director (NED):

- Where they are an executive of another listed and/or a large and complex company
- Who holds five or more board positions where, following further analysis, capacity concerns remain (e.g. a director who chairs two large/complex listed companies and is a NED of another S&P/ASX 300 listed company)

## **4.2 Remuneration**

In relation to any resolution relating to remuneration VFMC will take into account the individual circumstances of the company.

### **4.2.1 Executive Remuneration**

In general, executive pay comprises fixed, short-term and long-term incentive arrangements. The aim of remuneration arrangements is to attract, motivate and retain the right people. Such arrangements should encourage and reward outperformance, not below average performance or failure.

When considering the overall quantum of executive pay VFMC will consider the performance of the company (including peer comparison), the size and complexity of the company and its operations.

### **4.3 Executive Long-Term Incentive Schemes**

One of the key aims of executive incentive arrangements is to limit the agency costs associated with the separation of shareholders as owners of listed companies and those that are delegated the authority to run the company. VFMC believes this is best achieved by aligning executive interests to shareholders.

Consistent with Australian standards, VFMC believes that granting incentives under a long-term incentive plan (LTIP) with a vesting period shorter than three years is inappropriate.

VFMC does not have a preference for particular performance metrics; it is up to each and every board to determine the appropriate performance metrics in light of its business operations, business plan and other relevant factors.

VFMC does not support cliff vesting where 100% of incentives vest based on one or more cliff-related hurdles.

Some companies seek shareholder approval for a plan so that equity grants under the plan do not count towards the “15 percent in 12 months” dilution cap. Under ASX Listing Rule 10.14 companies must seek approval for any grant of options or shares to a director (except where they are purchased on market). It is VFMC’s preference that companies seek shareholder approval for any grant of options to directors irrespective of how they are purchased.

When assessing performance criteria, established for the award of shares and/or options, these should be consistent with the company’s strategy and objective for maximising shareholder value.

VFMC will pay particular attention to disclosures by companies about how the quantum of incentives that may be issued has been determined. VFMC is generally unsupportive of companies using mechanisms to increase the incentive allocation to executives in a non-transparent way.

### Voting Example: Incentive Schemes and Plans

VFMC will vote in **favour** of resolutions in relation to incentive schemes and plans that are open to a broad range of employees and limit dilution. This is particularly the case where shareholders have the right to vote separately on the grant as it applies to directors.

VFMC will cast an **abstention** vote in relation to a grant of incentives where the grant of incentive is subject to two hurdles and one hurdle is insufficiently challenging or there is a lack of disclosure regarding the hurdle which warrants a signal being made to the company that there are aspects of the grant that we are not satisfied with.

In general, VFMC will vote **against** grants of incentives where:

- The vesting period is shorter than three years
- The performance hurdles are not sufficiently demanding
- The bulk of the incentives vest for median or sub median performance
- The size of reward is considered excessive or leads to excessive dilution
- The performance of the company does not warrant the granting of incentives on the terms disclosed
- NEDs are eligible to participate in the scheme/grant. Examples of exceptions to this include small newly established mining companies or small biotech companies who award their key staff a low base salary but grant them options with few hurdles other than exercise price issued at a discount. This may be a sensible strategy to allow a company to preserve cash in its early stages

Employee share plans that apply to Key Management Personnel (KMP) that do not include relevant hurdles.

## 4.4 Termination Payments

VFMC believes termination packages for executives of greater than 12 month’s salary are inappropriate. VFMC will consider the treatment of equity incentives on termination and the link to performance and the level of board discretion applicable to such benefits.

Accordingly, VFMC will vote **against** termination payment resolutions in excess of 12 months’ salary which do not appear to provide any benefit to shareholders, and/or provide the Board with significant discretion or appear larger than the previously disclosed entitlement.

## 4.5 Non-Executive Director (NED) Remuneration

Shareholders have the right to vote on proposed increases in the aggregate NED fee pool or to approve proposals for NEDs to receive fees in the form of shares.

Remuneration for NEDs of a listed company should reflect the role that NEDs perform during the year including board and committee participation.

It is VFMC’s preference that companies:

- Do not have an active retirement benefit scheme

- Do not offer options to NEDs. The board is entrusted to put in place remuneration arrangements to attract, retain and motivate executives; however, this would be difficult if their remuneration is on a similar basis to those they are meant to oversee
- Disclose the size of any proposed aggregate NED fee cap, how much of it will be used in the subsequent year(s) and how it will be allocated to NEDs

#### **Voting Example: Aggregate NED Fee Increase**

VFMC will vote in **favour** of proposals for NEDs to receive fees in the form of shares.

VFMC will vote **against** increases in NED fee proposals where:

- The company provides retirement benefits to NEDs
- NEDs receive options and/or they are granted on terms similar to executives because of the conflict this can create. Exceptions to this may apply for small start-up companies with limited cash flow
- The fee cap increase being requested is excessive e.g. where the existing fee cap is sufficient to allow the appointment of an additional director
- In the absence of board renewal where the company's performance would not warrant an increase in the fee cap.

## **4.6 Remuneration Reports**

Companies are required to submit a remuneration report to shareholders at the AGM. The vote on this resolution is advisory only and not binding on the board. The remuneration report details the fixed pay and benefits, including short and long-term incentives payable to directors and senior management and remuneration of non-executive directors.

In considering a company's remuneration report VFMC will evaluate the report as a whole. VFMC believes that remuneration plans should reflect what is needed to attract, motivate and retain the right people.

This section on remuneration reports refers to remuneration-related issues that are not covered elsewhere in this policy.

### **4.6.1 Executive Fixed Pay**

VFMC will consider whether the fixed pay level is excessive relative to a range of peers. VFMC will also consider the rationale for any fixed pay increase. VFMC is cognisant of the compounding impact of fixed pay on other variable components of executive pay.

### **4.6.2 Executive Short-Term Incentives (STI)**

VFMC expects STI plans to relate to the key drivers of the business, outperformance of which is expected to result in increased shareholder returns. VFMC will consider:

- The key performance indicators (KPIs) for the STI
- Whether STI payments are consistent with the company's performance and what financial or non-financial hurdles are applied

Some companies resist disclosing KPIs for determining STIs on the basis that they are confidential. While this can be understood, VFMC is aware that KPIs can be disclosed retrospectively and in a manner so as not to affect commercial sensitivities.

### **4.6.3 Retention payments**

VFMC will consider the rationale for retention payments including whether the payment is in cash or equity, the company's performance, the executive's total pay compared to peers and whether these payments are subject to holding locks.

### Voting Example: Remuneration Report

If, after balancing the positive and negative features of the remuneration arrangements, VFMC believes the remuneration arrangements do not appear to be in shareholders' best interests VFMC will vote **against** the entire remuneration report.

VFMC also retains the right to cast an **abstention** vote where there are concerns regarding remuneration arrangements, which however are not sufficiently concerning to warrant voting against the whole remuneration report.

## 4.7 Two Strikes

Companies holding their AGMs since 1 July 2011 have been subject to what is known as the 'two strikes' rule. The aim of the rule is to strengthen the non-binding vote on remuneration by giving shareholders the opportunity to remove all directors if the company's remuneration report has received a 'no' vote of 25 per cent or more (known as a 'strike') at two consecutive AGMs.

VFMC approaches this rule and the resolutions attaching to it on a case-by-case basis.

If a company has received a first strike, at the next consecutive AGM the company must include in its agenda a contingent 'spill resolution' which calls for an EGM to be put to shareholders in the event that this subsequent remuneration report receives a second strike. The spill resolution will not result in directors being voted off the board. A spill resolution will be put to shareholders only to support or otherwise the holding of an EGM to consider the re-election of directors in light of the company receiving two strikes on their remuneration report.

Where an EGM is called to consider the 'spill resolution', in considering whether to support the re-election of director(s), deliberations will in all cases reflect VFMC's views with regard to the remuneration practices of the company, any improvements to remuneration structures that have occurred following at least two engagements, and what is in the best interests of shareholders.

VFMC is acutely aware of the destabilising impact that would occur if all directors available for re-election were not reappointed.

### Voting Example: Two Strikes

VFMC will consider voting in **favour** of the 'spill resolution' where:

- The company has received a first strike and VFMC did not support the remuneration report that received that strike,
- VFMC intends not supporting the subsequent and current remuneration report, and
- The company, following engagement, has not attempted to improve its remuneration structures, processes or disclosure.

Where VFMC has engaged with the company on at least two occasions and no meaningful change has been made to the remuneration structures, processes or disclosures, VFMC will consider voting **against** the Chair of the remuneration committee and possibly others on the remuneration committee. In the most egregious cases VFMC may consider not supporting the Chair of the board.

## 4.8 Changes to Capital Structure

Changes to capital structure include company share buy-backs, schemes, mergers and acquisitions and other related issues.

In considering whether to support management proposals VFMC will consider whether shareholders (and not the directors) retain overall control of the capital structure of their company, including the authority to approve any division of that structure into different classes of shares, the amount of dilution and whether any valuation is fair and reasonable.

In the absence of a compelling reason, VFMC will vote **against** advanced approval or retrospective approval of placements on the basis that dilution should be limited to 15% in a year. It is VFMC's preference that they be conducted on a pro rata basis and dilution should be limited to 15% in a year. In evaluating these proposals VFMC will consider:

- The amount of dilution
- The amount being raised
- The cost efficiency and the manner in which it is being raised
- Whether the placement is at a discount, and how significant that discount is
- The purpose of raising
- If the company could have foreseen the need for this capital raising
- To whom the placement was made.

VFMC will cast 'Take No Action' where it is ineligible to vote due to participation in a placement.

#### 4.9 Accounts

Companies are required to submit their financial statements, directors' reports and auditor reports to shareholders; however, they are not obliged under the Corporations Act to seek shareholder approval for these statements. Where shareholder approval is sought VFMC will rely on the independent auditor's assessment of the company's financial statements and whether the auditor's report has been qualified.

VFMC will vote in **favour** of such resolutions in the absence of a qualified audit report or other compelling reasons.

#### 4.10 Auditor (reappointment and new)

In considering the reappointment or appointment of an auditor VFMC will pay regard to:

- The ratio of audit to non-audit fees
- Tenure and rotation of lead auditors
- Where relevant, the rationale for changing auditors.

In the absence of a compelling reason VFMC will vote in favour of these resolutions.

#### 4.11 Constitution

These resolutions are special resolutions requiring support from 75 percent of votes cast. Issues considered include:

- Do the shareholders (and not the directors) approve any division of that structure into different classes of shares?
- Does the proposal distort the one-share, one-vote principle?
- Does the company propose to exercise the right to direct profits or allocate company assets in a non-uniform manner without shareholder consent?
- Is the company seeking to alter the constitution which will:
  - Create barriers to takeover bids for the purpose of protecting the position of management or specific shareholders
  - Reduce shareholder rights in other ways
  - Renew the "proportional takeover" clause.

Where the amendments do not limit shareholder rights VFMC will vote in favour of constitutional amendments.

#### 4.12 Shareholder Proposals

These resolutions often propose the need for additional disclosure by companies regarding environmental, social and governance aspects of a company's activities. VFMC will consider proposals of this nature on a case-by-case basis.

It is VFMC's view that day-to-day management and policy decisions should be left to management and the board. Accordingly, VFMC will vote in **favour** of shareholder proposals that do not involve shareholders impinging upon management prerogative and:

- Are likely to increase or protect shareholder value and/or,
- Promote the furtherance of appropriate shareholder rights or,
- Seek to promote director accountability.