

# Guidelines and principles for corporate engagement on governance, environment and social issues

Last updated: May 2008

## 1. Introduction

Corporate governance is concerned with the way corporate entities are governed, as distinct from the way businesses within those companies are managed on a day to day basis.

Corporate governance addresses the issues facing boards of directors, such as:

- strategy, financial policies, disclosure, legal issues and standards of corporate behaviour at the level and type of interaction with senior management
- relationships with the shareholders and other stakeholders interested in the affairs of the company (such as fund managers, creditors, debt financiers, analysts, auditors and corporate regulators)
- oversight of the company's material environmental and social risks<sup>1</sup> and the manner in which these are being monitored, disclosed and managed in the interests of shareholders and other relevant stakeholders, and
- corporate performance.

Colonial First State Asset Management (Australia) Limited (CFSAMA) is in a position to influence the environmental, social and governance (ESG) performance of companies via discussions with management or the board of directors and through the exercising of proxy votes. The exercising of the voting rights must be in the best interests of our unitholders and clients.

The scope of this document pertains primarily to the engagement of companies listed on the Australian Securities Exchange; however the principles may also be used to guide our engagement activities in other jurisdictions.

CFSAMA follows the Investment and Financial Services Association (IFSA) guidelines on corporate governance (see Appendix A). The guidelines cover four key areas: communication, voting, proxy voting policy and procedures and reporting to clients.

This document includes environmental and social guidelines (section 5) which have been developed based on Colonial First State Global Asset Management's<sup>2</sup> Responsible Investment Policy<sup>3</sup> (Annexure B) and the United Nations Principles for Responsible Investment.<sup>4</sup>

## 2. Communication

As a major investor, CFSAMA believes in having direct contact with the management and/or directors of companies into which we invest. This contact might include constructive communication about performance, corporate governance, environmental and social issues, or other matters affecting stakeholder interests and long-term shareholder value.

As a shareholder, CFSAMA is entitled to receive reports and accounts and other explanatory circulars from companies which are required by law or regulatory authorities. We also have the right to attend company meetings and raise questions about the affairs of the company. While these formal bases for communication are necessary, they may not be sufficient to allow companies and shareholders to gain full understanding of each other's aims and requirements.

Direct dialogue will give CFSAMA a better appreciation of a company's objectives, its potential problems and the quality of its management, while making the company aware of our expectations and requirements as a shareholder. In regard to environmental and social issues, CFSAMA will engage management on those matters that it believes have material impact on company earnings and value, and on best practices which the company should adopt.

As the intent of this dialogue is not to make CFSAMA an insider, in view of the insider trading provisions of the Corporations Act, care must be taken when communicating directly with the board of directors and management of companies. CFSAMA has an Insider Trading Policy in place which outlines protocols should inside information come into our possession.

## 3. Voting

CFSAMA will vote on **all** issues at company meetings where it has the authority to do so. Voting rights are a valuable asset which should be managed with the same care and diligence as any other asset. Ultimately, shareholders' ability to influence management depends on shareholders' willingness to exercise those rights.

CFSAMA generally supports boards by positive use of its voting power unless there is good reason for doing otherwise. Where a board has received steady support over a period of time, it should become a matter of concern for that board if support is not forthcoming on a particular matter. When CFSAMA intends to vote against a proposal, we may choose to make representations to a company prior to the vote so that appropriate consultation may take place with a view to achieving a satisfactory solution.

Where a satisfactory outcome cannot be achieved on an important issue, it may be desirable for the relevant fund manager or delegate to attend the relevant meeting of the company and to explain why the proposal is being opposed. In such cases a poll may be requested to ensure that the vote is duly recorded.

All votes must be made in the best interest of the unitholders and clients. It is acknowledged that our goal is to apply our corporate governance guidelines and principles in a consistent manner. However, on

### Notes:

1. Refers to issues including human capital and the alignment of people strategies with business strategies, human rights, workplace safety and relationships with important stakeholder groups such as regulators, consumer advocacy groups and non-government organisations.

2. Colonial First State Global Asset Management is a business name owned by Colonial First State Asset Management (Australia) Limited (CFSAMA).

3. More detail on Colonial First State Global Asset Management's approach can be found at [cfsam.com.au/UNPRI](http://cfsam.com.au/UNPRI).

4. <http://www.unpri.org>.

rare occasions CFSAMA may deem it to be in the best interests of unitholders and clients to exercise its proxy vote in a manner that is not consistent on certain occasions, as a degree of subjectivity may be required. For example, it may be acceptable for a non-executive director to hold six board positions and provide a meaningful contribution, while for another director six board positions may be too demanding and result in a less meaningful contribution. Following are examples of voting issues and our current position:

- **Directors/non-executive directors** – we consider independence of a non-executive director to mean that they have not been former executives of the relevant company for a minimum of five (5) years.
- **Audit and remuneration committees** – membership of an audit committee should be non-executive. Members of both committees should be listed in annual reports and identified on the notice of re-election of directors. It is preferred that only non-executive directors sit as members of the remuneration committee.
- **New directors** – there should be a formal and transparent procedure for the appointment of new directors to a board. The Chairman and a majority of the members of the Nomination Committee should be non-executive directors.
- **Number of board appointments** – non-executive directors must balance their number of board appointments with their personal ability to provide a meaningful contribution to each board. Similarly, executive directors who have outside directorships need to ensure that their contribution to their current employer is not diminished.
- **Removal of directors** – we will not support changes to company constitutions that weaken the position of non-executive directors on the board.
- **Retirement by rotation** – with the exception of the Chief Executive, we expect all directors to seek re-election, with one third seeking election each year. For directors over the age of 72, and provided that the constitution of the company permits re-election, the usual assessment criteria for selecting directors will apply.
- **Division of roles** – in most cases the role of Chairman and Chief Executive should be split. We consider that board changes involving the Chief Executive becoming Chairman or executive directors becoming non-executive is acceptable only if there is a clear majority of independent directors.
- **Hostile takeovers** – CFSAMA will meet both parties at least once before making a decision. Any decision made will be in the best interests of unit/shareholders.
- **Political donations** – CFSAMA supports the notion that companies should seek a mandate from

shareholders before making political donations. Such mandates should last for no longer than three years. Justification of political donations should be provided at the annual general meeting or in the annual report.

- **Remuneration** – we support the principle that there should be full disclosure of directors' total remuneration packages, including share options, fringe benefits and retirement benefits. We expect appropriate justification for levels of remuneration and the link of these to company objectives and performance from the Chairman of the Remuneration Committee.
- **Termination payments** – we believe that payments on termination of executive directors' contracts should not be excessive. In the case of poor performance, a statement of justification should be given. We may write to the Chairman of the Remuneration Committee to ask for details of compensation payments to departing executive directors if they are not published. Disclosure of any contingent liabilities should be made.
- **Long term incentive schemes** – we support the introduction of share-based incentive schemes as a means of aligning the longer-term interests of management and shareholders. These schemes should be subject to shareholder approval and have reasonably demanding performance targets. We prefer that no awards vest at, or below, median performance with an appropriate comparator universe.
- **Options for non-executive directors** – we are of the view that these should not be granted. We support the notion that non-executive directors can be paid in the stock of the company.
- **Environmental and social risks** – we believe that well governed companies have appropriate environmental and social risk policies and management procedures in place. As part of the governance process, we expect boards to have oversight of these risks and policies, and executive management to be able to publicly report on these risks and their management and indicate where appropriate the potential impact on company earnings.

#### 4. Proxy voting policy and procedures

CFSAMA is advised of corporate actions such as proxy voting by its custodian. The Head of each asset class or their authorised signatory is responsible for ensuring that **all** company resolutions are reviewed and an appropriate and consistent recommendation is made in line with the corporate governance guidelines and principles as outlined in this document. Each resolution is to be stated and the voting intention with supporting views is to be confirmed in writing by the Head of the asset class or their authorised signatory. In cases where the resolution may be contentious in nature, a more detailed explanation as to the reasons for the voting intention

is to be outlined. Examples of contentious issues are executive remuneration packages or the appointment of non-independent directors.

Once the proxy voting intentions have been confirmed by the Head of asset class or their authorised signatory, they must communicate the decision to the Investment Management Support unit in an agreed format by the pre-advised cut-off. The Investment Management Support unit has sole responsibility for instructing the relevant custodian of the proxy voting instruction, and whether there is any necessity for a member of the Investment team to attend the meeting and vote the shares or call a poll in person. The Investment Management Support unit will maintain records of all proxy voting decisions in a format which will allow the dissemination of this data to the relevant clients.

CFSAMA will only vote in the best interests of its unitholders and clients. It is CFSAMA's duty to put any other unit/share holder relationship or interest to one side when deciding how to vote on behalf of unit-holders and clients.

## 5. Environmental, social and governance assessment and engagement

CFSAMA recognises that ESG issues impact on business value and has developed its own 'integrated' approach to responsible investment in keeping with the United Nations Principles for Responsible Investment and other emerging industry performance standards (Appendix C).

CFSAMA is committed to integrating ESG factors into its investment decision-making, ownership and engagement policies and procedures. CFSAMA believes good management of environmental and social issues is integral to good corporate governance. CFSAMA will engage with companies in which it invests, or is considering for investment, with regard to their ESG risk management policies, strategies, performance, disclosure and management capabilities.

CFSAMA's approach to environmental and social issues is based on the rigorous assessment of how ESG issues impact on company earnings and value. To achieve this, and in keeping with CFSAMA's corporate governance principles, our approach is premised on the following:

- **ESG disclosure** – encouraging the companies we invest in to disclose their material ESG risks and performance in keeping with emerging best practice
- **Engagement** – as owners, or potential owners, engage companies, and where appropriate, vote on issues where company value is at risk from ESG issues
- **Voting** – as owners, CFSAMA portfolio managers will develop their own voting positions on key environmental and social issues, and

- **Reporting** – the outcomes of engagement and voting activities to clients.

### 5.1 ESG Disclosure

To ensure CFSAMA has adequate information to assess the value at stake (risks and opportunities) we will encourage and recommend companies to disclose their material ESG risks and performance in keeping with emerging global standards. More specifically, companies are expected to report on the following aspects:

- Environmental and social risks impacting materially on earnings, including contingent liabilities
- Governance policies and procedures for assuring compliance with internal ESG policies, improving performance and mitigating risks across operations, supply chain and products and services
- CFSAMA expects all ASX/S&P 300 companies to report in keeping with these guidelines
- **ESG risks and performance** – companies are encouraged to report their ESG performance publicly on a regular basis in line with the Global Reporting Initiative's G3 Guidelines. In recommending G3 as the preferred ESG disclosure framework, CFSAMA expects companies, especially smaller companies and companies in emerging markets, to select only those key performance indicators that appropriately represent the material ESG considerations pertinent to their operations (see Appendix C)
- **Emerging markets** – for companies with operations in developing countries and/or who source products from these companies, CFSAMA expects these companies to be operating within the OECD Guidelines for Multinational Enterprises (Appendix C)
- **Climate change** – companies operating in high energy and greenhouse gas intensive sectors are expected to report their climate change risks and opportunities in line with the Global Framework for Climate Risk Disclosure (Appendix C), and
- **Sector guidelines** – should CFSAMA develop its own sector guidelines, it will make these available to companies which face material ESG issues in their operations.

### 5.2 Engagement Procedures and Process

As an owner of company shares, CFSAMA will engage companies on ESG issues in the following circumstances:

- **Risk** – where CFSAMA's assessment shows that certain ESG factors have a material impact on company earnings or value or have the potential to do so
- **Management Performance** – where, in CFSAMA's assessment, management is not adequately addressing ESG issues that could have a material impact on earnings and/or value

- **Process** – in keeping with CFSAMA’s approach, company engagement on ESG issues, when necessary, will be primarily carried out on a direct basis (e.g. by correspondence requesting information and/or clarification; meeting with management; and indirectly via its proxy voting process
- **Outcomes** – CFSAMA takes its ownership and engagement responsibilities seriously and will only engage companies on material issues. CFSAMA engages companies to achieve specific outcomes, namely ensure good ESG practices and thereby protect investor interests. In instances where management does not respond adequately to CFSAMA’s engagement, this may impact negatively on its valuation assessment and/or could result in CFSAMA divesting its ownership
- **Accountability** – given engagement is an integral part of ownership, company engagement is best carried out by the responsible portfolio managers and their investment teams
- **Themes** – CFSAMA recognises that ESG covers a wide range of issues and therefore it will concentrate its efforts on those material ESG issues in which it has a significant understanding and where it can exert influence towards achieving a specific outcome, and
- **Collaboration** – CFSAMA recognises the benefits of collaborative engagement and therefore where appropriate, may collaborate in industry initiatives and forums where appropriate.

### 5.3 Voting on Environmental and Social Issues

In keeping with CFSAMA’s approach to responsible investment (Annexure B) and governance (see section 3), sector positions will be developed on key environmental and social issues to guide engagement and voting. These positions will be developed in line with CFSAMA’s principle of acting in the best interests of unitholders and clients.

It is important to note however, given the low probability of environmental and social issues being included on company AGM agenda’s, most engagement activity pertaining to these issues is likely to occur directly with management.

The ESG guidelines and principles contained in document will be used to assist decision-making and company engagement activities across all our various funds. However, given the independent manner in which CFSAMA’s various funds are governed and managed, it is nevertheless possible for managers to vote differently on and have different perspectives about company ESG performance.

### 5.4 Reporting on Engagement Activities

In keeping with existing practice, CFSAMA will record and report to clients and other relevant stakeholders on all material ESG engagement activities on biannual basis.

## 6. Reporting to clients

Wherever a discrete mandate client delegates responsibility for exercising proxy votes, CFSAMA will report back to the client how votes were cast on their behalf, if requested by the client.

The authority and responsibility for exercising proxy votes will be defined within the investment management agreement executed between CFSAMA and each discrete mandate client. However, CFSAMA may still receive proxy voting instructions from each discrete mandate client on a case by case basis or alternatively the discrete mandate client may instruct their custodian directly. The frequency and content of any reporting to a client is provided for in the Investment Management Agreement.

Where the client’s discrete portfolio contains Commonwealth Bank of Australia (CBA) shares, it will be explained to the client that CFSAMA is unable to vote these shares due to the nature of the ASIC exemption allowing us to purchase CBA shares for our funds. The Investment Management Support unit will provide details of the resolutions to be voted on at the meeting to the Investments team for their information only. The Investment Management Support unit will also provide details of the agenda to the Distribution team who will ensure that that any clients holding CBA shares are provided with a copy of the agenda and advised of the deadline for advising the voting instruction to apply to their holdings. The Distribution team will pass these voting instructions back to the Investment Management Support unit who will be responsible for ensuring that the relevant custodians are provided with instructions on how to exercise the proxies.

## 7. External managers

In relation to all securities in the investment mandates, the external manager is free to exercise or refrain from exercising any voting rights (or direct the Custodian to do so) as it sees fit.

For the avoidance of doubt, CFSAMA is not permitted to issue any instruction in respect of, or which in any way influences, the voting powers of the external manager and the external manager is entitled to ignore any such instruction.

## Appendix A

A summary of the Investment and Financial Services Association (IFSA) Guidelines.

### IFSA Guidelines

#### – Guideline 1: Communication

Investment managers should encourage direct contact with companies including constructive communication with both senior management and board members about performance, corporate governance and other matters affecting shareholder interests.

#### – Guideline 2: Voting

Investment managers should vote on all material issues at all Australian company meetings where they have voting authority and responsibility to do so.

#### – Guideline 3: Proxy Voting Policy and Procedures

Investment managers should have a written policy on the exercising of proxy votes that is approved by their board and formal internal procedures to ensure that policy is applied consistently.

#### – Guideline 4: Reporting to Clients

Wherever a client delegates responsibility for exercising proxy votes, the investment manager should report back to the client when votes are cast (including abstentions) on investment owned by the client. Reporting on voting should be part of the regular reporting process to each client. The investment manager should report back to clients whether or not the votes are cast. The report should include a positive statement that the investment manager has complied with its obligation to exercise voting rights in the client's interests only. If an investment manager is unable to make the statement without qualification, the report should include an explanation.

## Appendix B

### Colonial First State Global Asset Management Responsible Investment Policy Statement

#### Introduction

ESG issues are increasingly impacting on business value. Colonial First State Global Asset Management recognises this trend in business imperatives and is committed to enhancing its integration of ESG factors in investment decision-making. Such an approach is consistent with the company striving for excellence in all that it does and with being a responsible investor.

We define 'responsible investment' as the integration of ESG issues into institutional investment decision-making and ownership practices, such that medium-to-long-term returns to beneficiaries are improved.

### Our goal

Our goal is to be a leading Australian-based global fund manager and part of the global leadership group on responsible investing. We recognise that this will be a phased process and we will liaise closely with our clients and other stakeholders to ensure their interests are being addressed.

### Our approach

Our focus is on enhancing the investment processes that have brought us success to date and making them even more robust by formally incorporating ESG considerations. This is distinct from what many call 'socially responsible investing' or 'ethical investing' which often seeks to limit or negatively screen a universe of investments. Consistent with our business plans, Colonial First State Global Asset Management has signed the United Nations Principles for Responsible Investment. In signing the Principles, we publicly commit to adopt and implement them, consistent with our fiduciary responsibilities. We will:

- integrate ESG considerations into our investment, ownership and engagement policies and procedures
- engage with companies in which we invest, or are considering for investment, with regard to their ESG risk management strategies, performance, disclosure and management capabilities, as well as sharing with them our approach and implementation progress
- assess ESG risks at a sector and asset level, rather than excluding any specific sectors from consideration. We develop specific policies and procedures on how we approach prominent ESG issues, such as climate change and human rights
- encourage the entities in which we invest to improve and report on their ESG performance in keeping with emerging best practice
- promote responsible investment by playing an active part in relevant debates, policy consultations and in the global network of investors who face similar ESG integration challenges, and
- manage and report on our own ESG performance in keeping with emerging best practice. We will annually review our performance, with the setting of objectives and targets at the end of each calendar year, commencing in 2007. We will also submit annual reviews to the UN PRI on our progress.

Because our business covers a broad range of asset classes, investment styles and risk profiles, much of the work for this effort takes place at the investment team level. Each of these teams will maintain its own responsible investment implementation plan that is tailored to its activities and circumstances.

## Review

This is our first Responsible Investment Policy. We acknowledge that emerging best practice and global standards are evolving rapidly and therefore to ensure our approach remains relevant, we undertake to review this policy on an annual basis until further notice.

Signed:



**Warwick Negus (CEO)**

Approved 27 August 2007

## Appendix C

### CFSAMA – Preferred ESG disclosure frameworks

**1. Australian Superannuation ESG Guidelines** – contains suggestions for funds on how to incorporate ESG issues into investment processes and to facilitate the broader consideration of ESG issues across the investment industry. The guidelines also provide suggestions for fund managers and asset consultants to assist with the consideration of ESG issues, outlines the expectations that superannuation funds may have of their service providers and provides broad expectations and suggestions on ESG disclosure for listed companies.

[http://www.acsi.org.au/dsp\\_viewContent.cfm?news=1&nid=123](http://www.acsi.org.au/dsp_viewContent.cfm?news=1&nid=123)

**2. The Global Reporting Initiative (GRI)** – is a not-for-profit, worldwide, multi-stakeholder network of business, civil society, labour, investors, accountants and others that collaborate through consensus-seeking approaches to create and continuously improve a sustainability reporting framework.

The third version of the Guidelines, known as the G3 Guidelines, is the world's most widely used sustainability reporting framework. This framework sets out the principles and indicators that organisations can use to measure and report their significant economic, environmental, and social performance. The cornerstone of the framework is the Sustainability Reporting Guidelines, covering nine principles and nine standard disclosure performance indicator categories (environment, human rights, labour practices and decent work, society, product responsibility and economic).

<http://www.globalreporting.org/ReportingFramework/G3Guidelines/>

### 3. Global Framework for Climate Risk Disclosure

– is a statement of investors' expectations about the information that they need to analyse climate risk and opportunities. The Framework aims to encourage standardised climate risk disclosure so that it is easy for companies to provide and easy for investors to analyse. The Framework is not a new reporting mechanism. Instead, the investors supporting the Framework intend for companies to report through existing reporting mechanisms, including mandatory financial disclosures to securities agencies, the leading voluntary mechanisms (the Carbon Disclosure Project and the Global Reporting Initiative), and other communications with investors.

[http://www.unepfi.org/fileadmin/documents/using\\_framework.pdf](http://www.unepfi.org/fileadmin/documents/using_framework.pdf)

**4. Carbon Disclosure Project (CDP)** – is an independent not-for-profit organisation, supported by investors, that facilitates a dialogue with companies, supported by quality information regarding the implications for shareholder value and commercial operations presented by climate change. The cornerstone of the CDP is the annual survey of the world's largest corporations and which is emerging as one of the main climate change reporting frameworks.

<http://www.cdproject.net/>

### 5. OECD Guidelines for Multinational Enterprises

– are recommendations addressed by governments to multinational enterprises operating in or from adhering countries (the 30 OECD member countries plus ten non-member countries: Argentina, Brazil, Chile, Egypt, Estonia, Israel, Latvia, Lithuania, Romania and Slovenia). They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation.

<http://www.oecd.org/daf/investment/guidelines/>

