

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

Updated: July 2016

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 with 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 risks¹ 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 Global Asset Management (CFSGAM) 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.

CFSGAM follows the Financial Services Council (FSC) guidelines on corporate governance and proxy voting.

This document includes environmental and social guidelines (section 5) used by CFSGAM's equity investment teams.

2. Communication

As a major investor, CFSGAM 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, CFSGAM 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 a full understanding of each other's aims and requirements.

Direct dialogue will give CFSGAM 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, CFSGAM 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 CFSGAM 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. CFSGAM has an insider trading policy in place which outlines protocols should inside information come into our possession.

3. Voting

CFSGAM 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.

CFSGAM 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 CFSGAM 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 rare occasions CFSGAM 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 nonexecutive is acceptable only if there is a clear majority of independent directors.
- **Hostile takeovers** – CFSGAM 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** – CFSGAM 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

CFSGAM is advised of corporate actions such as proxy voting by its proxy voting service providers which are Glass Lewis and Ownership Matters. The Head of each asset class or delegate 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. Information on the proxy voting process for each investment team can be found in CFSGAM's annual Proxy Voting and Engagement report which is available on our website.

In all cases CFSGAM will only vote in the best interests of its unitholders and clients. It is CFSGAM'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

CFSGAM 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.

CFSGAM is committed to integrating ESG factors into its investment decision-making, ownership and engagement policies and procedures. CFSGAM believes good management of environmental and social issues is integral to good corporate governance. CFSGAM 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.

CFSGAM'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 CFSGAM'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, CFSGAM 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 CFSGAM 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
- **CFSGAM expects all 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

- CFSGAM expects companies, especially smaller companies and companies in emerging markets, to report those key performance indicators that appropriately represent the material ESG considerations pertinent to their operations; and
- **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 or other recognised framework.

5.2 Engagement Procedures and Process

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

- **Risk** – where CFSGAM'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 CFSGAM's assessment, management is not adequately addressing ESG issues that could have a material impact on earnings and/or value
- **Process** – in keeping with CFSGAM'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** – CFSGAM takes its ownership and engagement responsibilities seriously and will engage companies on material issues. CFSGAM 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 CFSGAM's engagement, this may impact negatively on its valuation assessment and/or could result in CFSGAM 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** – CFSGAM 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** – CFSGAM 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

Most engagement activity pertaining to environmental and social issues occurs directly with management of the

company. The ESG guidelines and principles contained in this document will be used to assist decision-making and company engagement activities across all our various funds.

However, given the independent manner in which CFSGAM'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.

Detailed descriptions of each of CFSGAM's team's approach can be found in CFSGAM's annual Responsible Investment and Stewardship report or the annual Proxy Voting and Engagement report.

5.4 Reporting on Engagement Activities

Detailed descriptions of each of CFSGAM's team's approach can be found in CFSGAM's annual Responsible Investment and Stewardship report or the annual Proxy Voting and Engagement report.

6. Reporting to clients

Wherever a discrete mandate client delegates responsibility for exercising proxy votes, CFSGAM 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 CFSGAM and each discrete mandate client. However, CFSGAM 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.

7. Monitoring Proxy Voting Services

CFSGAM will regularly monitor the performance of its proxy voting advisers. This review includes; organisation, security & cyber security, compliance & risk, governance, training & competency, disaster recovery and service delivery.

8. Conflicts of Interest

Conflicts of Interest which may arise relating to proxy voting are subject to the Commonwealth Bank of Australia's (our parent company's) Conflicts of Interest Policy which is available on request. The policy requires us to maintain a conflicts of interest register including how each conflict is managed. As a fiduciary, our Global Stewardship Principles require our analysts and fund managers to put our clients' interests ahead of our own or any other third party.

We publish our full proxy voting record annually with more regular reports available to clients on request. Our annual Responsible Investment and Stewardship reports detail our work in this area and are available on our website at the following address:

http://www.firststateinvestments.com/uploadedFiles/Content/About_Us/Responsible_investment/RI_reports/FSI_RI_Report_2016_US.pdf

We utilise the services of professional proxy voting advisors (CGI Glass Lewis and Ownership Matters) to independently inform the proxy voting decisions which we take on behalf of our clients. In the event that a material conflict of interest is identified in connection with voting a proxy, we will either vote in accordance with the recommendation of the independent proxy voting advisors or abstain from voting (for example where the providers are in disagreement).

Disclaimer

This material has been prepared for the general information of clients and professional associates of Colonial First State Global Asset Management (“CFSGAM”).

This document has been prepared for general information purposes only and is intended to provide a summary of the subject matter covered. It does not purport to be comprehensive or to give advice. This is not an offer document, and does not constitute an offer, invitation, investment recommendation or inducement to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any matter contained in this document.

This document should be considered confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without the prior written consent of CFSGAM. The information contained within this document has been obtained from sources that CFSGAM believes to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy or completeness of the information.

CFSGAM and its associates, their directors, officers and employees, do not accept any liability for any loss arising whether directly or indirectly from any use of this document.

