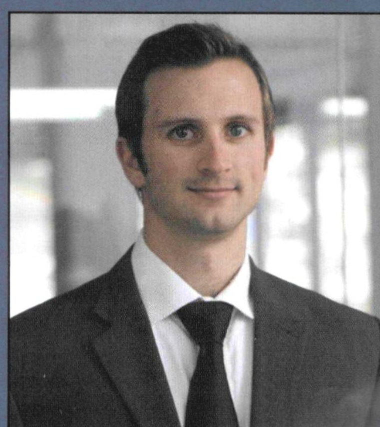
Proxy voting and disclosure

Both the UN Principles for Responsible Investing (UNPRI) and the Code for Responsible Investing in South Africa (CRISA) call for investment managers to disclose how they vote at shareholder meetings. Business Report recently reported that only 5 of the 29 South African managers that are signatories of the UNPRI currently disclose their voting. This number will surely increase with more interest from asset owners in ensuring that the investment managers that they appoint take environmental, social and governance (ESG) considerations seriously.



Bradley Preston
Portfolio Manager
Mergence Investment Managers

For this disclosure to be meaningful it is important for end investors and their representatives, in particular pension fund trustees, to understand the proxy voting process. This article explains some of the common decisions put to investors and highlights some of the issues that investors should consider when voting on them.

What is proxy voting?

Proxy voting allows shareholders to take certain decisions regarding the management of a company. Shareholders appoint a board of directors to oversee the executive management that manage the day-to-day operations of the company, but the board needs to refer certain decisions to the shareholders. These decisions are put to a vote by the shareholders at the company AGM each year. Most investment managers should have a proxy voting policy that outlines the principles that guide their proxy voting. This policy ensures the investment manager makes consistent and principled decisions when voting and also allows asset owners to understand how an investment manager may vote on their behalf.

What issues do shareholders vote on?

Taking a sample of 800 resolutions voted on over the past year for companies listed on the JSE, close to 95% of all resolutions can be divided into 10 categories.

Type of Resolution	Frequency of Occurrence
Election of directors	29%
Approval of directors' fees and remuneration	13%
Permission to issue shares or place unissued shares under board control	13%
Election of members of the audit committee	11%
Appointment of auditors and approval of auditors' remuneration	6%
Adopt new Memorandum of Incorporation	5%
General authority to repurchase shares	5%
Financial assistance	5%
Adopt Financial Statements	4%
Remuneration policy and long term incentive scheme	4%

Election of directors

The most common resolution in the proxy voting process is the election of new directors, or the re-election of current directors. These are important considerations as the board is appointed by shareholders to oversee executive management and the running of the company. One of the most effective mechanisms for shareholders to exert control over the company is by influencing the makeup of the board. King III recommends a number of best practices regarding the appointment of directors and the composition of a corporate board. One key area to consider is the presence of independent directors. The board should consist of a majority of non-executive directors and independent directors should make up the majority of the non-executive directors. The chairman of the board should also be an independent non-executive director. It is also recommended that the CEO should not be the chairman and that any past CEO should not be appointed chairman until at least three years after they have resigned as CEO.

Another common concern is the number of other boards that a director serves on. Some non-executive directors serve on a large number of boards and this can raise questions regarding their ability to perform their duties sufficiently. One way to monitor if a director has too many commitments is to monitor their attendance record at board meetings.

Directors' fees and remuneration

The King III code requires companies to put the remuneration of directors to a non-binding shareholder vote. While this vote is non-binding it is important for shareholders to express their views on executive remuneration. Best practice is for companies to present separate resolutions for the remuneration of each director and to ensure that the vote is prospective rather than retrospective. It is little use for a company to pay remuneration and then ask shareholders to approve the payments after the fact. Shareholders generally need to ensure that remuneration levels are in line with comparable companies and that annual increases are not excessive. A useful source of executive remuneration levels is the annual PWC executive remuneration report, which provides information on average remuneration across various sectors of the listed market in South Africa. This allows investors to see if the proposed remuneration is out of line with industry peers and to vote accordingly.

Issue shares

Generally a board cannot issue new shares of a company without consulting with shareholders. This provides an important protection to shareholders that management won't undertake actions that dilute current shareholders. A common request from management is to be able place a portion of the authorised but unissued shares of the company under management control so that they can issue these shares during the course of the year without having to consult shareholders. This is a resolution that often draws negative responses from shareholders as King III recommends that management rather request permission to issue shares on a case by case basis through special resolutions when they can provide investors with details of the deal that the share issue will be used for.

Election of audit committee, appointment of auditors and auditor remuneration

Shareholders rely on the auditors and audit committee of a listed company to ensure that the financial statements presented to shareholders are accurate and to guard against fraud. It is therefore very important that shareholders ensure that the auditors and audit committee are well qualified and independent of the company. King III recommends that the chairman of a company may not be eligible for appointment to the audit committee.

It is also best practice to ensure that any non-audit fees paid to the company's auditors are disclosed and that this payment is not so large as to threaten the independence of the auditors. Shareholders may also desire that audit firms are rotated after a number of years to ensure independence.

Adoption of financial statements

Technically an investor would vote against the adoption of the financial statements if they had an issue with disclosure, etc. In addition, investors may use this vote to express their concern or discontent at a range of issues.

Remuneration policy and long-term incentive scheme

This vote is probably the most complex and time consuming given that it requires the investor to understand the company remuneration policy which can often include a number of detailed incentive schemes.

It is important for investors to ensure that management incentives are aligned with shareholders and bonus payments and long-term incentives are based on well defined and stretching targets.

Conclusion

While the primary objective of an investment manager is to generate superior returns, there is growing recognition that they play a number of other important roles including active shareholding through proxy voting and engagement with management on environmental, social and governance issues. Just as trustees monitor their investment manager's performance and decisions, they too should engage with them to understand the principles behind their voting policy and how they have implemented this. The move towards better disclosure from investment managers and more educated and engaged trustees will have a positive effect on corporate governance and corporate citizenship in South Africa. ❐

Resources

There are a number of resources available that are useful and informative when considering proxy voting decisions.

PWC Executive Remuneration Report
This annual report provides information on average executive remuneration across sectors in South Africa
http://www.pwc.co.za/en/publications/executive-directors-report.jhtml

PIC proxy voting policy
As the largest asset manager in the country the PIC has a large influence over corporate governance in South Africa. The PIC discloses both their proxy voting policy and the results of their proxy voting decisions on their website.
http://196.33.27.195/wp-content/uploads/2012/04/corp_governance.pdf

Code for Responsible Investing in South Africa (CRISA)
http://www.asisa.org.za/index.php/info-centre/responsible-investment.html

United Nations Principles for Responsible Investing (UNPRI)
http://www.unpri.org/

King III Report
The King Report on good governance is the standard reference for issues of corporate governance in South Africa.
http://www.iodsa.co.za/?page=kingIII