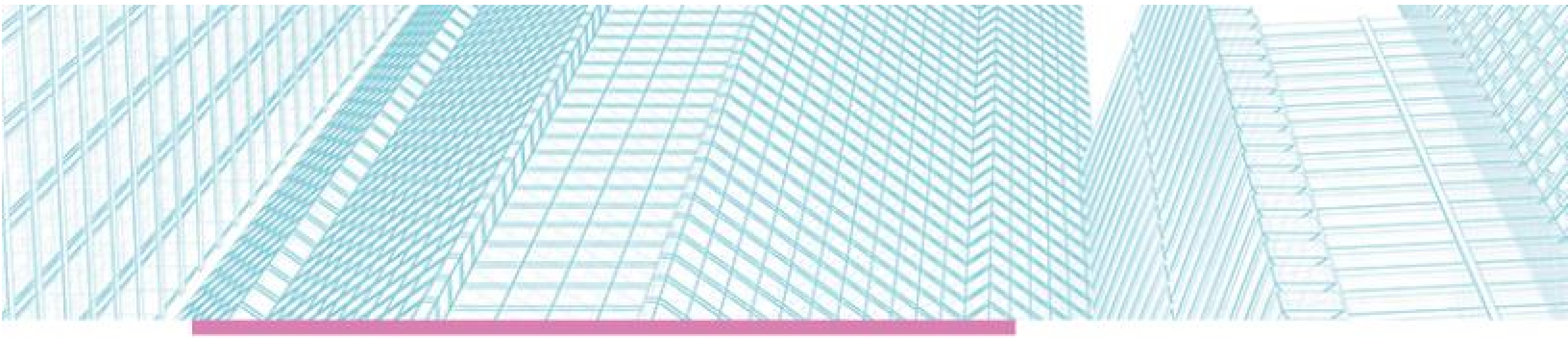
Border to Coast Pension Partnership Listed Alternatives Fund



Proxy Voting Report

Period: October 01, 2023 - December 31, 2023

Votes Cast	33	Number of meetings	5
For	27	With management	26
Withhold	0	Against management	6
Abstain	0	N/A	1
Against	6		
Other	0		
Total	**33**	**Total**	**33**

In 40% of meetings we have cast one or more votes against management recommendation.

General Highlights

Unlocking value: Corporate governance in state-owned enterprises

Working to improve corporate governance at state-owned enterprises

Many people think that corporate governance is an abstract concept and that its impact on our everyday lives is difficult to grasp. Think again. Only a few months ago, in March 2023, financial stability was tested by a crisis attributed to a large extent to poor corporate governance at US private sector banks. And the crucial importance of good governance becomes even more apparent when we look at State-Owned Enterprises (SOEs).

SOEs are amongst the largest corporations in many countries and account for a growing share of the corporate landscape. The OECD reports a staggering statistic – the ratio of SOEs in the list of top 500 global companies has tripled over the last two decades. The public sector held almost 11% of the listed companies' global market capitalization at the end of 2022. On top of that, in many countries, SOEs are the sole or main providers of essential services such as water or electricity.

Given their size and positioning in high-impact sectors, SOEs play a significant role in achieving the Sustainable Development Goals (SDGs). The consequences of poor corporate governance in SOEs will therefore extend far beyond the boardroom. The figures speak for themselves – the International Monetary Fund highlighted in a 2020 publication that the maximum annual support provided by governments to financial and nonfinancial SOEs reached 18% and 16% of GDP, respectively, with the debt of SOEs exceeding 20% in some countries.

Far from a simple matter

Good governance in SOEs is, however, far from being a simple matter. If an SOE is run well and sufficient checks and balance are in place, state control can provide stability. If not, political involvement may also have downsides. State ownership adds to the known corporate governance challenges faced by listed firms for a number of reasons. For one, as noted by the OECD, "the accountability for an SOE's performance is often dispersed across the public administration and among different state bodies with inherently different policy interests". Secondly, SOEs have the hard task of walking a fine line when balancing different – and sometimes conflicting – objectives.

Listed SOEs have the advantage of being subject to the much stricter requirements applicable to publicly listed firms, as well as monitoring from external investors. However, minority shareholders often have limited rights and therefore little power to hold management to account. Governance challenges are very present – and some argue, even exacerbated – in these firms.
Recent scandals stand testament to this. Telecoms giant Telia, which is partly-owned by the Swedish state, agreed to pay nearly USD 1 billion in 2017 to settle allegations that it paid major bribes in Uzbekistan in a case labeled as "one of the largest criminal corporate bribery and corruption resolutions ever" at the time.

Brazilian oil giant Petrobras was embroiled in the major 'lava jato' (car wash) scandal that triggered an SOE reform in the country. While Petrobras rolled out significant corporate governance improvements following the scandal, the company has recently come under intense scrutiny over proposed bylaw changes that are perceived to increase the risk of undue government interference.

OECD guidelines can help

The growing awareness of the importance of SOEs to our economies and the governance challenges that they face have prompted many countries around the world to roll out reforms. These initiatives point out the fact that there is no one-size-fits-all recipe for reform. Nonetheless, the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which are currently undergoing a review expected to be completed in 2024, are widely regarded as the golden standard for SOE reform.

The guidelines provide a multitude of tailored recommendations for SOEs, from encouraging governments to evaluate and disclose the policy rationale that motivates state ownership, to clearly identifying which part of the public administration is responsible for exercising the state ownership function. That said, the guidelines also say that:

"The state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs."

Concerning shareholder protection this includes:
1. The state and SOEs should ensure that all shareholders are treated equally;
2. SOEs should observe a high degree of transparency, including as a general rule, equal and simultaneous disclosure of information towards all shareholders;
3. SOEs should develop an active policy of communication and consultation with all shareholders;
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board elections;
5. Transactions between the state and SOEs, and between SOEs themselves, should take place on market-consistent terms.

As an investor, we use our voting rights to push for these companies to adopt good governance and sustainable corporate practices. Our votes are guided by a robust policy which sets out our approach to a wide variety of issues ranging from director elections and remuneration to capital management and shareholder rights.

We expect SOEs to have proper safeguards in place, such as the establishment of committees comprising independent members to oversee conflicts of interest, super-majorities or 'majority of minority' voting provisions, and a transparent process for board nominations. If we see that insufficient safeguards are in place, we will hold companies accountable. For example, we vote against article amendments that would lead to a negative impact on minority shareholder rights or to a deterioration in the process for director nominations. Similarly, we vote against related party transactions that are not subject to an adequate oversight process that ensures minority shareholder rights are protected. Where we conclude that a company has not ensured adequate minority shareholder protections, we will consider escalation via a vote against the most accountable board member or via engagement. Because poor corporate governance does make a difference – even in our day-to-day lives.

Market Highlights

New remuneration requirements for Australian financial institutions

In August 2021, the Australian Prudential Regulation Authority (APRA) released its final iteration of the Prudential Standard CPS 511 Remuneration (the Standard), which came into effect on January 1 2023. The Standard aims to ensure that APRA-regulated entities, such as banking, insurance, and superannuation funds/schemes, maintain appropriate remuneration incentives. The new regulation represents an important milestone in APRA's objective of improving industry practices in governance, risk culture, remuneration, and accountability.

CPS 511 was also intended to address the findings of the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission), which was initiated following a series of scandals involving several Australian financial institutions. One of the conclusions from the report was that "remuneration incentives which overemphasize short-term financial performance can drive poor customer and beneficiary outcomes and jeopardize financial soundness". The Standard addresses these findings through the implementation of three main elements, including increased oversight, balanced incentives, and appropriate consequences. Below, we highlight some of the most relevant requirements that have been introduced.

Increased oversight

CPS 511 sets out principles governing the role of the Board in overseeing an entity's remuneration incentives. More specifically, the Standard states that the Board is responsible for the remuneration framework and its effective application, consistent with the size, business mix and complexity of the entity. It also requires the establishment of a separate remuneration committee, composed solely of non-executive directors and tasked with the design, operation, and monitoring of the remuneration framework. The Board must regularly review and report on the compliance of its remuneration practices against the Standard, at least once a year.

Balanced incentives

CPS 511 requires APRA-regulated entities to maintain a remuneration framework that promotes the effective management of financial and non-financial risks. As such, the Standard requires that each component of a person's variable remuneration assigns "material weight" to non-financial measures. This is meant to replace the previously-implemented 50% cap on the use of financial performance measures, and represents the biggest change from current practices. Furthermore, entities are expected to incorporate appropriate compensation outcome adjustment tools with clearly identified triggers and the potential to reduce variable compensation to nil, depending on the severity of risk and conduct outcomes.

Appropriate consequences

The Standard states that compensation levels must be aligned with performance and risk outcomes. To achieve this, entities must incorporate clawback and malus provisions in their remuneration arrangements, and CPS 511 sets out five minimum criteria for the application of variable remuneration adjustment tools, including misconduct and significant adverse outcomes for stakeholders, among others. In addition, the Standard sets out deferral requirements for key management personnel (KMPs), to ensure that short-term rewards will not be earned at the cost of long-term outcomes. For CEOs, a minimum of 60% of the total variable remuneration must be deferred over at least six years, while for the remaining KMPs, a minimum of 40% of the total variable remuneration must be deferred over at least five years. For both groups, vesting can only start after four years.

We view the principles outlined above positively, and we believe that they are well aligned with international best practices. Additionally, several requirements go beyond current global standards, such as those surrounding variable compensation deferral and remuneration outcome adjustment provisions. Nevertheless, we also note that the "material weight" requirement for non-financial metrics can be ambiguous, as no guidance is provided on how to determine an appropriate threshold. We will monitor the implementation of this principle by corporates, to determine whether it sufficiently incentivizes the consideration of non-financial measures in performance-based compensation outcomes. We expect companies to implement material ESG metrics in their remuneration programs, and these metrics should be aligned with the company's strategic objectives, have clear targets and disclosures, and amount to a minimum weight of 10% of the relevant variable compensation plan.

During 2023, in response to the implementation of CPS 511, we saw Australian financial institutions improve their executive remuneration programs by, for example, increasing vesting periods and rebalancing the remuneration mix of executives through placing a higher emphasis on long-term incentives. However, in previous years, we already voted in favor of a high proportion of remuneration proposals at the shareholder meetings of these companies, as we determined that most of them had sound and appropriate compensation arrangements in place. Nevertheless, we welcome the improvements introduced by CPS 511, and we expect Australian financial institutions to continue putting together high-quality remuneration plans, which protect the best interests of companies' stakeholders.

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