

Board Accountability in Australia: A Review of Director Election Practices

Market Commentary

Key Takeaways

- State Street Global Advisors believes that annual director elections improve board accountability and encourage board members to be more responsive to shareholder interests, thereby improving board quality.
- Most publicly listed companies in Australia have staggered board election cycles limiting investors' ability to hold directors directly accountable.
- Changing common practice to annual director elections would allow shareholders to hold board members accountable in a timely manner.
- Despite a heightened focus on the importance of board accountability in the Australian market, discussions around annual director elections have largely been absent from public debate.
- Director election practices in Australia will be a focus area for our Asset Stewardship efforts for the following year. In our view, the issue is best addressed at the market level. We encourage peer investors, companies and regulators to work together to promote positive market-wide progress towards adopting annual director elections.

Board Accountability: Why Annual Elections Matter

We believe that well-governed companies are better positioned to navigate challenging economic conditions while protecting shareholder interests. Therefore, we have been focusing our stewardship efforts on improving board quality in our portfolio companies, which can be further strengthened by increasing board accountability.

We believe that annual director elections improve board accountability and encourage board members to be more responsive to shareholder interests. An annual director election process allows shareholders to hold each individual director accountable annually as compared to a staggered

board structure, where individual directors stand for elections only periodically and, once elected, serve for multiple years before standing for re-election. Annual director elections provide shareholders with a more effective vote delivery mechanism by giving them the ability to express their views on each director's performance on an annual basis.

Director Terms in Australia: How Did We Get Here

While there is no legal maximum term limit for directors provided in the Corporations Act 2001, the Australian Securities Exchange (ASX) establishes listing rules on the election of directors. Listed entities are required to hold an election of directors at each general meeting where at least one director stands for election or re-election. Furthermore, directors are not allowed to hold office, without re-election, past the third annual general meeting following the director's appointment or three years, whichever is longer.¹

Although exchange listing rules set limits on the term that board members can serve before seeking re-election, **we have found** that national corporate governance codes have a strong influence in establishing best market practices with regards to the duration of director terms of office. In Australia, the *Corporate Governance Principles and Recommendations* is the national code guiding governance standards among listed entities.

Figure 1: Proportion of Listed Companies with Annual Director Elections in Australia and the United Kingdom²

Index	% of Index with Annual Director Elections
Australia	
S&P/ASX 100	4
S&P/ASX 300	2
United Kingdom	
FTSE 100	98
FTSE 350	98

Source: Bloomberg July 2018.

¹ Listing rules 14.4, 14.5, <https://asx.com.au/regulation/rules/asx-listing-rules.htm>.

² In the United States 88% of the S&P 500 and 57% of the Russell 3000 have annual director elections.

The current version of the *Corporate Governance Principles and Recommendations* does not address annual director election cycles. Towards that end, it is unsurprising that nearly all publicly listed companies in Australia have staggered director election cycles. The few Australian companies with annual director elections are mostly dual-listed companies that have integrated more frequent director term limits to meet the recommendations and/or requirements in their secondary listing country. For example, some of Australia's largest publically listed companies have a dual-listing in the United Kingdom where the local corporate governance code recommends term limits of one year. Figure 1 provides an overview of the proportion of listed companies with annual director elections in Australia compared with the United Kingdom.

Director Terms in Australia: Why Change is Needed

Most publicly listed companies in Australia have staggered board election cycles limiting investors' ability to directly hold directors accountable. As demonstrated by recent events in Australia, no matter how dissatisfied shareholders are with director performance, they have to either wait several years to hold the appropriate board members accountable or take action against the directors standing for election in a given year, which may lead to unintended consequences in the long-term. Changing common practice to annual director elections would allow shareholders the ability to hold board members accountable in a timely manner and thereby help improve the quality of board oversight.

In the United Kingdom, the Financial Reporting Council recommended the annual re-election of directors in the *UK Corporate Governance Code* as a response to the financial crisis and the subsequent recommendations in the Walker Review. In our experience, we have found that the shift to annual director elections in the United Kingdom has helped foster an engagement culture that emphasizes director's accountability to shareholders by improving company responsiveness to investor demands.

We understand that Australian companies may be reluctant to adopt annual director elections especially given that staggered board structures are currently common practice. Companies often state that multi-year terms of office enhance continuity on the board and reduce certain short-term pressures by making it more difficult for opportunistic shareholders to gain a majority control over the board. However, the "comply or explain" basis of the market corporate governance code gives companies the flexibility to choose the most appropriate director election structure for their board, while also providing investors the transparency needed to better engage with companies on this issue.

Improving Board Accountability in Australia: A Unique Opportunity for Effecting Change

While we are observing a heightened focus on the importance of board accountability in the Australian market, discussions around annual director elections have largely been absent from the conversation. There is a unique opportunity in the market to effect change.

The ASX Corporate Governance Council is finalizing revisions to the *Corporate Governance Principles and Recommendations* and could consider recommending that Australian companies adopt annual election cycles as we have suggested in our response to their recent consultation.

Director election practices in Australia will be a focus area for our Asset Stewardship efforts for the following year. We invite our peers to provide their perspectives and we call on companies to take the leadership in implementing annual director elections. In our view, the issue is best addressed at the market level. We encourage peer investors, companies and regulators to work together to promote positive market-wide progress towards adopting annual director elections. We welcome comments on our views from interested market participants.

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