Governance Institute of Australia

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Manager
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The Treasury
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Dear Senator Cormann

Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014

Governance Institute of Australia (previously Chartered Secretaries Australia) is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members hold primary responsibility within listed and unlisted entities for developing governance policies, ensuring compliance with the Corporations Act and ASX Listing Rules and supporting the board on all governance matters. Their familiarity with the practical aspects of how to implement best practice governance frameworks and ensure sound reporting to members has informed the comments in this submission.

Governance Institute of Australia welcomes the opportunity to comment on the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 (the draft bill).

Executive summary

Governance Institute supports the following amendments contained in the draft bill:

- Removing the obligation to hold a general meeting on the request of 100 shareholders
- Requiring companies to include a general description of their remuneration governance framework, to the extent that it is not included elsewhere in the annual report
- Removing the requirement to disclose the value of options granted to key management personnel, replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted
- Relieving certain disclosing entities from the obligation to prepare a remuneration report
- Amendments to the test for payment of dividends (the dividends test)
- Exempting certain companies limited by guarantee from the need to appoint or maintain an auditor
- Minor technical amendment to clarify that directors may vary their financial year by up to seven days, regardless of the length of previous years.

Our detailed comments on our reasons for supporting these amendments are set out on the following pages.

Director nomination threshold

Governance Institute is of the view that there is another matter that should be subject to stakeholder consultation that affects the operation of the Corporations Act.

We refer to a proposal by Herbert Smith Freehills to introduce a minimum level of shareholder support to apply to the nomination of external director candidates to the boards of listed companies (nomination threshold). Their briefing paper is attached.

We are of the view that this proposal needs consideration by all stakeholders, as there can be differing views on it. For example, we understand that there could be concerns that the board would control the process of director nominations should such a reform be introduced. We also note the concerns that there is an increasing use of the platform of director nominations where the individual is campaigning on a specific issue with no prospect or genuine expectation of election. We also recognise that this issue is of concern to the large listed entities and not all companies.

Given that at present the Corporations Act provides for 100 members to be able to put a resolution on the agenda of the annual general meeting (AGM) and request the company to distribute a statement to all its members, which we believe is an essential component of corporate governance, we are of the view that it would be reasonable to consult with stakeholders as to whether a candidate for a board position should have a similar level of support from shareholders before nominating for that board position. That is, we are of the view that Treasury could set up a roundtable to consult with stakeholders as to whether a board candidate should be able to demonstrate a level of support from shareholders before resources of time and shareholder monies are allocated to that nomination.

We would be more than happy to meet with you to discuss our comments.

Yours sincerely

Tim Sheehy
Chief Executive

Removing the obligation to hold a general meeting on the request of 100 shareholders

Our Members strongly support the repeal of the rule allowing 100 members to requisition general meetings of companies (the 100-member rule) as set out in s 249D. Indeed, Governance Institute has been advocating for the repeal of s 249D of the Act for more than a decade.

We also continue to support the retention of the right of members with at least five per cent of the votes that may be cast at a general meeting to call a general meeting.

In 2006 we led a coalition calling for the repeal of the 100-member rule. The coalition comprised our organisation, Australian Institute of Company Directors, Business Council of Australia, Australian Shareholders' Association, Investments and Financial Services Association (now the Financial Services Council), FINSIA, Australasian Investor Relations Association and Australian Employee Ownership Association. I have attached a copy of the coalition's letter to the then Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP. The coalition also wrote to the Attorney-General of each state and territory setting out our support for the repeal of the 100-member rule.

Ongoing support for shareholder activism

It is often claimed that the repeal of the 100-member rule is intended to suppress shareholder activism. Governance Institute supports shareholder activism, which it believes is an essential component of corporate governance.

However, we are of the view that the opposition to the repeal of the 100-member rule often derives from a misunderstanding of the role of ss 249N(1)(b) and 249P(2)(b) in ensuring shareholders can bring matters to the attention of other members of the company at the annual general meeting (AGM).

Our Members support shareholders being able to put issues on the agenda of an AGM and to instigate a debate at the meeting. This shareholder right is of particular importance to retail shareholders, who, unlike institutional investors, do not necessarily have the opportunity to meet with the company prior to the AGM.

We strongly support the retention of ss 249N(1)(b) and 249P(2)(b) that preserve the rights of shareholders (members) to use a 100-member test to put a resolution on the agenda of the AGM and request the company to distribute a statement to all its members. We believe these provisions protect the rights of small groups of members to have their concerns addressed, and that the continued support for the preservation of these rights is too often forgotten in the debate about the repeal of the 100-member rule.

Most resolutions put forward on the AGM agenda through the use of the 100 member rule in ss 249N(1)(b) and 249P(2)(b) have not been carried. However, the debate generated by such resolutions has been central to shareholder engagement with corporations, and Governance Institute strongly supports this.

We believe that it is important to confirm that the important shareholder rights set out in ss 249N(1)(b) and 249P(2)(b) will remain intact should the 100-member rule set out in s249D be repealed.

The vexatious use of the 100-member rule in s 249D with attendant costs to shareholders

Governance Institute is opposed to the vexatious use of the 100-member rule in s 249D to call an extraordinary general meeting (EGM) at substantial cost to the company, *and therefore its shareholders*, when:

a) the avenue remains open of raising the issue of concern by placing a resolution on the agenda of the AGM and having statements relating to that resolution distributed to members at the cost of the company through the utilisation of ss 249N(1)(b) and 249P(1)(b), and
b) it has been noted by those who have called an EGM that it is not expected that the resolutions put forward at the EGM will carry.

To put corporations and their shareholders, the majority of whom are not expected to support the resolutions put forward at an EGM, to the expense of the meeting, is a mischief that we believe can be prevented through the repeal of the 100-member rule in s 249D.

We note that opposition to the proposed reform fails to apprehend that it is shareholders who bear the cost of the special meeting.

Our Members query how it can be anything other than vexatious to have 100 shareholders force a company such as Telstra, for example, to call a special meeting, when 100 members of Telstra would represent approximately 0.001 per cent of the shareholders. This would enable that minority to force an EGM that has absolutely no chance of achieving anything other than costing shareholders millions of dollars.

The potential for abuse
The Parliamentary Joint Committee on Corporate and Financial Services in its report[1] on this matter clearly noted that, while there is little history of the rule being abused, its potential for abuse remains clear. Both political parties have noted that it is not necessary for parliament to wait until some quota of abuses is observed before reforming the provision. We firmly support this view.

Our Members note that their companies at various times have been approached by special interest groups threatening the use of the 100-member rule in s 249D to call an EGM unless the corporation negotiates with the special interest group on its favoured issue. From our point of view, such a threat, with its attendant costs to shareholders despite the reality that any such resolution put forward by the special interest group would not be carried at the meeting nor receive the support of the majority of shareholders, constitutes mischief.

The threat of calling an EGM by splitting 100 shares, giving people one share each, then calling a meeting between annual meetings, toys with the company's profit and, consequently, the share price and dividend stream. Thus, it is shareholder return that is being threatened when the threat to invoke s 249D (the 100 member rule) is made.

Rationale against alternative proposals
We note that various groups have proposed alternatives to the 100-member rule. For example, the Australian Shareholders' Association has called for the Corporations Act to be amended so that only 10 signatures from shareholders with marketable shares are required for shareholders to place a resolution on the agenda of an AGM.

In support of their proposal, they cite the legal regime in the United States, which allows a single shareholder who has held $2,000 continuously over 12 months to put a resolution on the agenda at an AGM, and note that this is 'easier' than their proposal of 10 shareholders holding a marketable parcel of shares.

The US provision can only be understood within the full context of its legal regime governing shareholder rights (which are substantially fewer than those operating in Australia). The United

[1] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Exposure Draft of the Corporations Amendment Bill (No 2) 2005*, June 2005

States also has a very stringent and detailed ‘no action’ regime which allows companies to reject proposals from shareholders for resolutions to go on the agenda at the AGM.

Under the laws in the United States, the company can disallow any proposed resolution to appoint an external board member or remove an existing board member. The company can also disallow proposals relating to the company’ ordinary business operations and also disallow any proposal relating to a part of the business that accounts for less than five per cent of assets and revenue.

Even if a shareholder is able to surmount these obstacles, there are also detailed procedural provisions relating to the ‘no action’ regime – both for the shareholder (including having to lodge the proposal *120 days prior* to the meeting materials being sent out) and the company in question.

Governance Institute is of the view that the situation for shareholders in relation to their capacity to place resolutions on the agenda at an AGM is considerably more constrained in the United States than in Australia.

The attached letter from the coalition also clearly sets out the case against a square root rule, which has been proposed in the past.

Requiring companies to include a general description of their remuneration governance framework, to the extent that it is not included elsewhere in the annual report

Governance Institute supports this amendment.

The vast majority of listed disclosing companies already provide a description of their remuneration governance framework. It is a good governance outcome for any listed entities that do not currently report on their remuneration governance framework to provide such disclosures. Indeed, we note that the ASX Corporate Governance Council’s *Corporate Governance Principles and Recommendations* require the establishment of a remuneration committee and attendant disclosures. This is effectively the same as the discussion on remuneration governance as required by this provision, which suggests there is the possibility of duplication of compliance for listed entities.

Removing the requirement to disclose the value of options granted to key management personnel, replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted

Governance Institute supports this amendment.

The current requirement to report the value of lapsed options as if they had not lapsed causes confusion for readers of the remuneration report. The amendment will remove this confusion.

Relieving certain disclosing entities from the obligation to prepare a remuneration report

Governance Institute supports this amendment.

Opportunity for wholesale review of remuneration reporting disclosures

Governance Institute recognises that the proposed amendments are part of the deregulatory measures introduced by the government, but we also note that they constitute deletions or amendments of a minor nature that do not significantly reduce red tape in relation to remuneration reporting.

A great deal of work was undertaken by stakeholders in response to a previous consultation on executive remuneration by the Corporations and Markets Advisory Committee (CAMAC)[2], in an effort to simplify the approach to remuneration reporting disclosures. Stakeholders provided significant input on how the legislative architecture could be revised to reduce the complexity of remuneration reporting.

The current legislative framework results in remuneration reports being prepared by concepts drawn from, and couched in, technical language based on accounting standards, both by virtue of s300A of the Corporations Act 2001 and the obligation to conduct an external audit of such reports. This is not conducive to communicating executive remuneration to ordinary shareholders in a readily understood and comprehensible fashion. The ongoing tension between the Corporations Act and regulations — as interpreted by those from a legal background — and the accounting standards — as interpreted by those from an accounting background — adds to the confusion. The Corporations Act and the accounting standards are meant to interact and align, but this is not always the case. There is considerable tension between lawyer and accountants as to definitions of terms, and this is exacerbated by auditors taking views based on auditing standards, where definitions can vary still further.

Governance Institute is of the view that there is an urgent need for a wholesale review of and approach to legislative requirements concerning remuneration reporting that aims to simplify reporting, in order to provide investors with the clarity they seek. This would significantly reduce red tape.

Many companies have put considerable effort into drafting their remuneration reports as clearly and simply as possible over the past few years, but due to the interaction with the accounting standards the outcome has not been as effective as hoped. This is compounded by the addition of new pieces of legislation over time, which further complicate remuneration reporting, making it extremely difficult for investors to gain a clear picture of how remuneration decisions are made and applied in entities, or to gain transparency as to how much key management personnel (KMP) are paid and how it is calculated. Governance Institute is of the view that additional disclosure obligations have not resulted in meaningful disclosure.

The UK approach

Governance Institute has examined the United Kingdom (UK) approach to remuneration reporting with interest. The UK approach was aimed at the simplification of remuneration reporting, as it identified the issue of multiple figures being disclosed for each executive and how this added to the complexity and confusion, rather than providing clarity to shareholders.

In order to achieve accessibility and clarity, it was recognised by the UK Government that:

- existing legislation needed to be repealed in order to implement a new approach
- shareholders, in discussion with investor bodies, companies and remuneration experts, were better placed than public servants to develop an approach to remuneration reporting that met investor needs

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[2] In 2010, the Federal Government referred aspects of Australia's executive remuneration framework to CAMAC. The reference asked CAMAC to review the existing reporting requirements in s 300A and related regulations and asked CAMAC to identify areas where the legislation could be revised to reduce its complexity and more effectively meet the needs of shareholders and companies.

- the new requirements developed by shareholders were to replace the existing requirements.

Accordingly, in January 2012, the Secretary of State for Business in the UK announced a series of proposals relating to executive pay and its disclosure. These proposals addressed four areas of focus, one being ‘greater transparency so that what people are paid is clear and easily understood’.

The UK Department of Business Innovation and Skills (BIS) set out more detail on the proposed disclosure requirements in mid-2012, one of which was for ‘one single figure for total remuneration of each director’. As there was no agreed basis for calculating this ‘single figure’, at the request of BIS, the Financial Reporting Lab (established under the auspices of the Financial Reporting Council)[3] agreed to undertake a short-term project to obtain the views from the investment community on how a ‘single figure’ might be measured and presented, with the objective that the output would be made available to help inform BIS’s thinking in developing this disclosure requirement. The group that was formed consisted of shareholders, investor bodies, companies and remuneration experts. Importantly, the main driver was to develop remuneration reporting requirements that met investor needs — the principles of comparability and clarity underpinned the work of the group.

The Financial Reporting Lab recommended to the UK Government — and the government adopted the recommendation — a method that focuses on share awards with a link to current year performance. The new rules specify in detail how the components of pay are to be calculated and reported, which means they are comparable across companies.

The overall project to arrive at a new approach to remuneration reporting in the UK was subject to nine months’ detailed consultation. By the time the single figure was announced, all parties had had ample time to participate in the consultation process and provide their input and feedback.

Governance Institute Members do not recommend that Australia should simply import a concept from the UK, given that the UK concept had been designed to meet the needs of a particular jurisdiction. However, we note that:

- the consensus approach provided for frank and robust discussion of investor needs and how best to meet them
- the final approach to the development of a single figure has been greeted with approval by shareholders, investor bodies, companies and remuneration experts
- there is agreement that the single figure provides greater transparency to investors so that what people are paid is clear and easily understood.

On this basis, Governance Institute is of the view that Australia should explore the UK approach. This could be effected through roundtables involving shareholders, investor bodies, companies, remuneration experts, lawyers, accountants and bodies such as Governance Institute representing those involved in preparing disclosures, to tease out the issues and robustly test any suggested approaches to remuneration reporting.

A stakeholder group already exists in the form of the ASX Corporate Governance Council (the Council). Given that a fresh approach to remuneration reporting does not relate to the listing

[3] The Financial Reporting Lab was launched in 2011 to provide an environment where investors and companies could come together to develop pragmatic solutions to reporting needs. It operates as both a learning space, where companies can use the Lab to test new reporting formats with investors, and investors can indicate areas where management can add greater value through the information they provide; and also as a hub to support innovation in reporting. The Lab’s focus on gathering and sharing evidence from the market provides the broader corporate community with feedback from shareholders on the value that new reporting formats bring. It has already worked with over 50 different companies and more than 40 investors to bring insight and understanding to a number of key areas of disclosure.

rules, we are not proposing that the Council deal with this issue. However, the stakeholder bodies that constitute the Council, with their experience in rigorously developing consensus approaches to governance disclosures, could be constituted as the equivalent of a Financial Reporting Lab, with secretariat support provided by Treasury so as to facilitate practical outcomes.

Amendments to the test for payment of dividends (the dividends test)

Governance Institute welcomes the clarification of various areas of concern as to the application of the test for the payment of dividends from capital and supports the amendments contained in the draft bill.

Governance Institute is of the view that the draft bill increases the flexibility of companies to make distributions (pay dividends) and:

- addresses the concern with the issues associated with the use of 'declared' in the existing legislation
- addresses the concern that, by tying the calculation of assets and liabilities to the International Financial Reporting Standards (IFRS) in the existing legislation, companies that are not currently obliged to prepare their financial statements in accordance with IFRS are required to consider and apply IFRS before paying a dividend
- clarifies that the dividend test is a straightforward solvency test
- clarifies its application to group companies
- clarifies that a dividend paid under the new provision can be an authorised reduction of share capital that does not have to satisfy the requirements of Chapter 2J of the Act.

However, we note that such clarification is relevant only to ordinary shares. If companies have preferred shares or seek a distribution of assets (for example, a demerger) this would not be possible under the provisions of the draft bill, except out of profits. **Governance Institute recommends** that the issue of preferred shares also be addressed in the final bill, so that the legislation applies equally to ordinary and preferred shares.

Finally, we also note that there is widening gap between what constitutes a dividend in the Corporations Act and what constitutes a dividend for tax purposes. Following the amendments to s 245T in 2010, an amendment was made to the Tax Assessment Act 1936, in order to provide that a dividend paid out of an amount other than profits would, in normal circumstances, be capable of being franked.

However, Governance Institute Members are of the view that the legislation provides that the Australian Taxation Office (ATO) can disallow the franking benefit to dividends paid other than out of realised profits (such as reserves) and that any such disallowance operates against the policy objectives of the repeal of the 'profits test', which was not intended to interfere with the current imputation rules.

Governance Institute recommends that the government clarify that any dividends paid other than out of realised profits (such as reserves) also attract the franking benefit.

Exempting certain companies limited by guarantee from the need to appoint or maintain an auditor

Governance Institute supports this amendment.

This addresses the misalignment in the existing legislation whereby certain companies limited by guarantee that are not required to conduct an audit are nonetheless required to appoint or maintain an auditor.

Minor technical amendment to clarify that directors may vary their financial year by up to seven days, regardless of the length of previous years

Governance Institute supports this amendment.

Transferring the remuneration setting responsibility for the offices of the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB) to the Remuneration Tribunal

Governance Institute has no comment on this amendment.

Improving the efficiency of the Takeovers Panel, by allowing the Panel to perform Panel functions while overseas

Governance Institute has no comment on this amendment.

Transitional provisions

1549 Application of amendment relating to declaration or payment of dividends
Governance Institute notes that additional wording is required in the transitional provisions to clarify that a dividend can only be declared before it is paid, but the solvency test in such situations will be applied when the dividend is paid and in such situations the date of declaration is irrelevant.

We therefore recommend that this provision (1549) state (our suggested additional words in italics):

> This section applies if:
> 21 (a) before the commencement of this section, a company declared *or resolved to pay* a dividend; and
> 23 (b) as at the commencement of this section, the dividend has not been paid

1551 Application of amendments relating to directors' reports
Governance Institute notes that if the amendments set out in the draft bill are introduced prior to 30 June 2014, companies will be able to prepare remuneration reports in accordance with the draft bill.

However, should the amendments not be introduced until after 30 June 2014, companies will be required to wait another 12 months before they can apply the amendments to their remuneration reports.

Governance Institute therefore recommends that this provision be amended to state that 'The amendments of sections 300 and 300A made by the amending Act apply in relation to directors' reports for financial years starting on or after 1 July 2014'.