Labor’s Approach To Corporate Governance Regulation – 2004 and Beyond

Introduction

Good morning.

At the outset, I’d like to thank Tim Sheehy and the Chartered Secretaries Association for giving me the opportunity to discuss “Labor’s Approach to Corporate Governance regulation in 2004 and Beyond”.

The most significant event in 2004 for corporate governance will be the passage of the CLERP 9 legislation.

However, an equally important development will be the impact of a particular resolution which was passed at the Boral AGM in October and its effect on the interpretation of the Corporations Act.

I’ll discuss both of these issues this morning.

History

Many in the business community will say that the current debate about corporate governance has resulted from the collapses of Enron and WorldCom in the US and One-Tel, HIH and Ansett in Australia.

They say that corporate governance is a fad and that it will fade as people forget about the latest scandal as share prices rise and as time moves on.

Whilst I think these scandals highlight the problems, in my view the issue runs deeper than the latest corporate scandal.

Let me see if you can guess the year in which following topics were major issues in the corporate world:

- Mismanagement at the biggest companies;
- Insider trading;
- Misstated profit & loss accountants;
- Excessive remuneration of executives;
- The need for accounting standards;
- The role of hedge funds;
- The need for independent directors;
- Shredding of internal documents;
- Directors and officers liability insurance; and
- Socially responsible investing.

1 Speech presented by Senator Stephen Conroy (Shadow Minister for Financial Services and Corporate Governance) to the Company Secretaries Association (CSA) on 24 November 2003.
Some of you might guess that these issues came to fore in the late 1980’s or even in the last few years.

In fact these issues were raised by shareholders in 1620. Many of these issues were raised in relation to the Dutch East India Company (which was established in Holland in 1602).

Centuries later, shareholders in Australia expect that CLERP 9 will address the very same issues.

Recently, the BCA, said that Labor’s CLERP 9 proposals “are a response to short-term concerns”.

Clearly, the BCA have some history to catch up on!

**Labor’s Approach**

In August last year, I released a paper called the “Directions Statement on Improving Corporate Governance”.

This paper was the first stage in implementing Labor’s corporate governance agenda through legislative change. The paper outlined Labor’s policy position on a range of corporate governance issues including executive remuneration. In October, I released a paper which sets out the second stage of Labor’s corporate governance agenda. The paper is called “Labor’s Approach to CLERP 9 – Cracking Down on Corporate Greed”.

It sets out the reforms which Labor believes should form part of the CLERP 9 Bill and is available at www.alp.org.au.

Our CLERP 9 paper proposes a range corporate governance reforms in the following areas:

- Executive remuneration;
- Composition of boards;
- Empowering shareholders;
- Analyst independence;
- Audit;
- Penalties for corporate misconduct;
- Accounting standards; and
- Whistleblowers.

Although Labor is painted as “black letter law acolytes” if you read these two papers you will see that our approach is principles based. Our reforms are based on the following principles: transparency, disclosure and accountability.

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Today, I will not discuss all of our proposed CLERP 9 reforms instead I will focus on executive remuneration and empowering shareholders.

ASIC Infringement Notice

Before discussing our reforms, I want to mention that we campaigned for, and support, many of the proposals in the original CLERP 9 policy paper including granting ASIC the power to impose financial penalties for breaches of the continuous disclosure regime.

Many in the business community such as the BCA regard this power as a threat – we see it as a mechanism to enhance the ASIC’s regulatory “tool kit”.

We believe that presently ASIC does not have sufficient regulatory tools at its disposal to effectively enforce the continuous disclosure regime as:

- criminal proceedings take considerable time; and
- ASIC’s power to suspend a company may not always be in the long term interests of the shareholders.

In March this year ASIC reached a $100,000 settlement with AMP following an investigation by ASIC in relation to AMP’s disclosures to the market during 2002.

ASIC said that if a fining regime had been in place then, a $100,00 fine would have been appropriate but as there was no power to levy a fine, AMP agreed to make a community education contribution of $100,000 as a substitute.⁴

This fining power will give ASIC the “teeth” it needs to enforce the continuous disclosure regime.

Labor will ensure that the Government is not lobbied into submission on this issue.

CLERP 9

Whilst Labor supports many of the proposals in the CLERP 9 Bill, we believe it has not gone far enough in some respects.

I am concerned that the draft CLERP 9 bill:

- fails to hold boards sufficiently accountable; and
- fails to sufficiently empower shareholders.

That’s why Labor has proposed over 30 amendments to the draft CLERP 9 bill.

⁴ ASIC Media Release, AMP agrees to $100,000 community education contribution, 27 March 2003.
I won’t discuss all of them with you today, but I will touch on our key reforms relating to:

- executive remuneration;
- audit; and
- empowering shareholders.

**Executive Remuneration**

There are still some people (and it’s not just the BCA) who are resisting increased disclosure in relation to executive pay.

Last month, the Parliamentary Secretary to the Treasurer, Mr Ross Cameron said:5

“I don’t want to create an environment in which shareholders think their principal task is to pick over the bones of every executive's emoluments.

There is an unseemly and demeaning aspect of human nature, which is this tendency to obsess about what somebody else has that I don’t have.”

Labor believes that shareholders deserve full disclosure of executive remuneration including options.

I do not think that shareholders are showing their “unseemly and demeaning nature” by simply wanting to know how much their directors are being paid.

Also, issuing options as part of executive remuneration has the effect of diluting existing shareholders holdings.

**Loans to directors**

One of the key reforms that Labor wants to see in CLERP 9 is the prohibition of loans to directors and management by the company.

I do not believe that shareholders funds should be used by directors and executives to feather their own nest.

In December, unitholders in the Challenger Financial Services Group (“Challenger”) will be asked to approve a loan to the CEO (Mr Chris Cuffe) valued at **$21.2 million** in order for him to buy shares in the company.

My question to the Challenger unitholders is:

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Loans are not limited to the CEO and would also be available to 60 to 70 executives to buy shares in the company.

The total estimated value of the loans is $127.2 million.

As if this was not bad enough, the loans are “non-recourse”.

This means that if the value of the Challenger shares falls below the loan amount outstanding then the company (that is, the shareholders) wear the loss.

The CEO (and the executives) have all of the upside and none of the downside on the loan.

In my view, company loans to directors and management to buy shares in the company should be prohibited.

Non-recourse loans to directors and management are a green light to corporate greed.

Another key reform that Labor is proposing relates to non-executive directors.

In our view, CLERP 9 should prohibit the payment of options, bonus payments and retirement benefits (other than statutory superannuation) to non-executive directors.

We believe that remuneration for non-executives should be distinguished from remuneration for executives.

According to Corporate Governance International (CGI) the role of the non-executive director is to monitor the strategy and performance of the executive arm of the company and to safeguard the interests of shareholders generally.

Remuneration for non-executive directors should not provide any disincentive to independent action.

The ASX Corporate Governance Guidelines also say that companies should not provide options, bonus payments or retirement benefits to non-executives.

In Labor’s view, this should be a requirement in the law.

Audit

Labor will propose a number of amendments to the CLERP 9 bill specifically relating to audit.
**Firstly**, we will move an amendment which prohibits the company’s auditor from providing certain **non-audit services** which compromise the independence of the auditor such as accounting and bookkeeping services, valuation services, resolution of legal disputes, actuarial services and internal audit services.

**Secondly**, we will require auditors to specifically report to shareholders and the audit committee on **alternative treatments** of financial information that had been discussed with management, the ramifications of the use of such alternative treatments and the treatment preferred by the auditor.

This would form part of the audit opinion included in the company’s annual report.

**Thirdly**, we will require auditors to report to an appropriately composed audit committee.

**Fourthly**, we will increase the civil and criminal penalties for breach by auditors above the current $550 limit.

**Empowering Shareholders**

Another area where CLERP 9 is deficient is in relation to empowering shareholders.

I applaud the Government for adopting Labor’s policy to give shareholders a non-binding vote on executive remuneration.

The Government voted this policy down in March when we proposed it but they’ve had a change of heart.

In my view this policy will be a catalyst for greater shareholder activism and will create a cultural change in the way that the board views its relationship with its shareholders.

There are however, a number of other reforms that are needed to empower shareholders.

Labor will propose amendments to CLERP 9 which are specifically targeted at empowering shareholders. For example:

- We will require companies to put a non-binding resolution to shareholders in relation to the appointment of a director as Chair where the director is already the Chair of another company;
- We will require that directors disclose all relationships with the company and other directors (when standing for election) (not just other directorships);
• We will amend the *Corporations Act* to prohibit bundling of resolutions at the AGM in relation to certain issues such as issuing options and directors’ remuneration (in addition to guidelines on the bundling of resolutions).

• We will require trustees of super funds to vote their proxies; and

• We will require fund managers to disclose how they vote their proxies and to disclose their voting policy.

I will not discuss all of these proposals in detail today. Although, I will comment on the rationale behind our proposals to require trustees of super funds to vote and for fund managers to disclose their voting records.

Some industry participants would argue that voluntary codes of conduct in relation to institutional voting are sufficient and that we should take a ‘wait and see’ approach.

In Australia, only 14% of investors voted against resolutions on executive pay in the 2002 annual general meetings season.⁶

In Labor’s view, self-regulation has failed to produce outcomes that benefit the shareholder, the employee or the retiree.

That’s why a more robust approach is needed.

In the UK, the Institutional Shareholders Committees’ *Statement of Principles* has been criticised on the grounds that as they are not part of the law, it is impossible to overcome the web of conflicts of interest in the industry.

Similar considerations apply in Australia.

In years gone by, if investors didn’t like the way a company was being run they would sell out.

However, the old response of simply selling out – known as the “Wall Street walk” - is the easy way out.

Only dinosaurs like the Business Council of Australia (BCA) believe that selling out is the appropriate course of action in 2003.

Today, trustees of super funds (and other institutional investors) need to take an active interest in the companies that they invest in.

Because of the matters on which shareholders vote – the election of directors, certain share capital transactions, certain related party transactions – voting has a direct impact on the company’s management.

Super trustees bring pressure to bear on companies which far outweigh the pressure of individual shareholders.

To make real changes in the board rooms of Australian companies, trustees have to become more active.

In my view, to do this, legislation is required.

**Harvey Norman**

Recently some institutional shareholders have begun to take a more active approach in the companies in which they invest.

The showdown over Harvey Norman’s options policy in July is one example.

Gerry Harvey proposed to reprice options which were significantly “out-of-the-money”. However, due to pressure applied by shareholders, he was forced to withdraw the offending resolutions.

Shareholders simply would not wear a windfall to Harvey Norman executives valued at $6-$8million.

Groups like IFSA, CGI and ACSI should be commended for the stand they took against Harvey Norman in relation to this issue.

**News Corp**

Another company where IFSA, CGI, ACSI and others took a stand is News Corp.

It’s not everyday that Rupert Murdoch gets rolled but he was at the News Corp AGM in October.

Institutional investors forced Rupert to withdraw a proposal to issue more than 3 million share options to News Corp executives including Rupert himself.

Rupert’s resolutions were opposed because News Corp failed to provide any explanation of company policy on options and failed to include any performance hurdles.

One institutional investor said that voting for such a resolution would be akin to “writing a blank cheque”.

**Boral**

The Boral AGM in October is one example where institutional investors failed to take a stand.

This issue was not an issue to do with executive remuneration.
Instead, Boral proposed a resolution which launched a direct attack on shareholders rights.

I attended the Boral AGM to stand up for the rights of small shareholders. The Boral resolution which I opposed, scraps the ability of 100 shareholders to propose certain resolutions (that is special resolutions relating to the company’s constitution) for debate at the general meeting.

Now that the resolution has been passed, Boral shareholders will need to have 5% of the capital (or about $160 million worth of Boral shares), or Board approval, in order to propose this type of resolution.

Boral has effectively denied each Boral shareholder the right to join with 99 other shareholders and propose this type of resolution for debate at the company meeting.

The ability of shareholders to propose resolutions for debate is a key aspect of shareholder democracy that should be protected.

Boral’s resolution encroaches on the ability of shareholders to raise certain issues for debate and therefore their ability to hold boards accountable.

In my view, this is a direct attack on shareholders’ rights.

Accordingly, I plan to move an amendment to the Corporations Act to ensure that Boral does not set a precedent for other companies to circumvent the spirit of the Act.

**Institutions**

One of the most disappointing aspects of the Boral AGM is that Australia’s institutional investors turned a blind eye.

Despite warnings from the ACSI, the Australian Shareholders Association (ASA) and Corporate Governance International (CGI), institutions overwhelming supported a resolution which erodes shareholder democracy.

To ascertain why this occurred, I have written to IFSA asking them to clarify their position on Boral’s resolution.

**ASIC**

I have also raised Boral’s resolution with ASIC during the Senate Estimates hearings earlier this month.

Mr Rogers from ASIC said that:
“The 100 member rule can be displaced by a decision of shareholders of the company. It is not an absolute rule.”

ASIC used similar reasoning when asked about the transformation of BHP Billiton into a dual listed company and the added difficulty for shareholders to call a company meeting under a DLC structure.

Mr Rogers said that:

“The fundamental issue is that the structure that was proposed by the directors of BHP and Billiton was approved by the appropriate parties, who are the shareholders of both of those companies.”

ASIC is saying that a company can (by agreement with its shareholders) over-ride parts of the Corporations Act such as the 100 member rule in terms of both proposing resolutions and calling company meetings.

This has unprecedented implications for the interpretation of the Corporations Act.

All shareholders in Australia should be “alert and alarmed” over this development.

**Conclusion**

To conclude, whilst the most significant event in 2004 for corporate governance will be the CLERP 9 legislation – its passage will not signal the end of the corporate governance debate.

In Labor’s CLERP 9 paper, I signal three areas where corporate reform is urgently required.

Those areas are:

- Proxy solicitation and vote renting;
- Governance issues in relation to dual listed companies (DLC’s); and
- Whether appropriate safeguards are in place in light of the increased use of hedge funds by super funds and retail investors.

I look forward to discussing these issues with you in 2004 and beyond.

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7 Senate Estimates Committee Hearing with the Australian Securities and Investments Commission (ASIC), 6 November 2003.
8 Senate Estimates Committee Hearing with the Australian Securities and Investments Commission (ASIC), 6 November 2003.