CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

10 September 2012

Vas Kolesnikoff
Chief Executive
Level 7,
North Tower
1-5 Railway Street
CHATSWOOD NSW 2067

Email: vaskolesnikoff@asa.asn.au

Dear Vas

Australian Shareholders' Association Corporate Governance and Proxy Voting Policies and Guidelines

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals. It is the leading independent authority on best practice in board and organisational governance and risk management. Our accredited and internationally recognised education and training offerings are focused on giving governance and risk practitioners the skills they need to improve their organisations' performance.

CSA has unrivalled depth and expertise as an independent influencer and commentator on governance and risk management thinking and behaviour in Australia. Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act), with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies.

We welcome the opportunity to comment on the *Australian Shareholders' Association (ASA) Corporate Governance and Proxy Voting Policies and Guidelines* (the policies and guidelines) and appreciate the openness to feedback shown by the ASA in seeking comment on these documents.

General comments

As a founding member of the ASX Corporate Governance Council, CSA has been a long-term champion of a flexible, principles-based approach to corporate governance as embodied in the *Corporate Governance Principles and Recommendations*. The value of the 'if not, why not' regime is that it eschews a 'one-size-fits-all' approach to corporate governance, providing rather the opportunity for listed entities to put in place governance frameworks that differ from those set out in the principles and recommendations as long as they explain to their shareholders why they have done so. It is for shareholders to test the thinking of directors — the disclosures provide the opportunity for shareholders to enter into dialogue with boards concerning their governance frameworks and practices. The principle recognise that corporate governance is a dynamic force that keeps evolving, and that governance frameworks need to accommodate the different circumstances of a wide variety of companies.

The Australian Shareholders' Association is also a long-term member of the ASX Corporate Governance Council and has been very supportive of the principles and recommendations. However, we note that the ASA policies and guidelines take a 'one-size-fits-all' approach to corporate governance. The experience of our members is that they are often applied in an inflexible manner — the antithesis of the 'if not, why not' regime — despite the ASA policies and guidelines stating that:

> The ASA believes that an 'if not, why not approach' of the ASX CGC provides the best mechanism for ensuring effective pragmatic governance of Australia's listed companies.

The inflexibility of the ASA policies and guidelines do not encourage shareholder engagement. At present, there is no capacity for the ASA to note that, while it understands that a particular company does not comply with the ASA policy, it will nonetheless support the company based on its understanding of the particular circumstances of the company or discussions with that company. Recognition of the particular circumstances of individual companies provides an opportunity for shareholder engagement, as a company needs to articulate and communicate its decision making and how it is in shareholders' best interests. In turn, such dialogue assists shareholders to understand the complexities of running an entity.

CSA urges the ASA to provide for greater flexibility in how the ASA policies and guidelines are applied. The current checklist approach does not take account of the diversity of companies in Australia and the need for corporate governance frameworks to respond to the particular circumstances of each company. CSA is firmly of the view that a flexible approach to the application of the ASA policies and guidelines will engender better shareholder engagement.

Remuneration

The ASA's policies and guidelines on remuneration, including the ten critical criteria that must be investigated and reported on by ASA monitors, are highly prescriptive.

Corporations legislation recognises the role that directors play as agents for shareholders, with their fiduciary duties to act in the best interests of the company as a whole encompassed by statute and common law. Directors have responsibility to take decisions concerning the company on a wide range of matters, and decisions on those issues are not taken in isolation. Remuneration is only one element in that range of decision making. Prescribing the remuneration frameworks that companies should implement not only isolates one element of director decision making from its broader context, but also puts the ASA in the position of acting as a remuneration consultant.

CSA is of the view that the ASA and its members seek to understand what the company is trying to achieve in the setting of its remuneration framework, and how it will benefit shareholders. A prescriptive approach to remuneration does not accommodate differing approaches to remuneration based on different circumstances, nor does it provide for opportunities for shareholder engagement.

Comments on the particular policies [numbering follows the guidelines]

2.4 Directors

CSA notes that only in exceptional circumstances will the ASA support 'election or re-election of directors who have more than five directorships of listed companies (counting a chairmanship as equivalent to three directorships)'. We note that in the policy itself, the ASA counts a chairmanship as equivalent to two directorships.

Notwithstanding this conflict between the policy and guidelines, CSA urges the ASA to recognise that the size and complexity of listed companies varies considerably, and that this will have an impact on the time required of directors. For example, there is a marked variation in what will be required of directors of a company with a market capitalisation of $20 million and one of $100 billion. Not all directorships are equivalent, and this has been recognised in the United Kingdom where a different weighting is allocated to FTSE100 companies than to companies outside that ranking in terms of the demands of a directorship.

CSA is also of the view that reference could be made to the need to encourage diversity on boards. For example, it may be beneficial for a female executive to sit on a board of an unrelated entity as a non-executive director, as this widens the pool of directors. The ASX Corporate Governance Council guidelines provide for an 'if not, why not' explanation in such circumstances, but the ASA policies and guidelines do not. The ASA guidelines note that the ASA will only contemplate approval of an executive to be appointed to an unrelated entity as a non-executive director in exceptional circumstances. CSA does not believe that encouraging diversity on boards should be considered as an exceptional circumstance.

3.2 Raising additional equity

Mid to small caps have limited access to venture capital and debt funding, particularly at early stages in their life cycle. They need to raise funds in a cost-effective manner while balancing shareholder rights. ASX has recently recognised this, and amended the Listing Rules to provide for companies outside the S&P/ASX 300 with a market capitalisation of $300 million or less to raise an additional ten per cent of capital, subject to shareholder approval by special resolution and disclosure obligations being met.

The ASA policies and guidelines recognise that placements may be reasonable, but do not accommodate a range of reasons why a rights issue may not be appropriate. A rights issue is an expensive means of raising capital, yet it comes with no guarantee that demand from existing shareholders will meet the capital needs of the entity. Moreover, in small to medium-size companies, the size of the shareholder base may not make a rights issue a viable means of raising capital. Directors will consider the best interests of the company when making decisions on which form of capital raising to embark upon.

3.3 Compulsory acquisition of small holdings

CSA welcomes the ASA's support of the compulsory acquisition of small shareholdings.

4 Remuneration of non-executive directors

The policy takes no account of competition. For example, if a company is seeking to appoint an overseas director, the remuneration offered will need to be comparable to what is being paid overseas. This is one instance of how the lack of flexibility in the ASA policy for a company to explain its position can have deleterious consequences.

4.2 and 4.3 Executive remuneration and Equity-based incentive schemes

Remuneration must be linked to strategy and remuneration structures cannot sit separately from what the company is seeking to achieve. While we understand that the ten critical criteria are intended to provide guidance to ASA monitors, the effect of the prescriptive detail in the criteria and the policy is to impose a 'one-size-fits-all' approach on remuneration. Remuneration can evolve quickly and the ASA policy is not flexible to accommodate changing circumstances.

For example, the policy states that bonuses should only occur where there is strong company performance, that is, no bonuses should be paid if the company is not performing positively. It

notes that executives should not be paid bonuses when performance is strong due to factors outside of the control of the executives, but does not provide for the reverse of that which is that bonuses should not be lost when performance diminishes due to factors outside the control of executives. At such times, as recently witnessed during the global financial crisis, executives will be focused on cost savings and the long-term protection of the company. Their focus will not be solely on the short-term. This will not necessarily translate into a strong share price, but they could well have protected it from a further slide or have stabilised it, and they should be recognised for their performance in such instances.

Moreover, total shareholder return may not be the metric employed by all companies as a proxy for company performance. For example, in the property industry, returning money to shareholders may not be in their best interests as they need to maintain capital in the buildings. The mining industry is a long-term business and total shareholder return would not always equate to executive performance.

CSA also notes that the ASA policy takes no account of statutory requirements in its position that 'the structure and disclosure of executive remuneration should be clear, concise, easily understood and transparent to investors'. Remuneration reports are seen to be difficult to understand, but there is no recognition that they are governed by the provisions of the Corporations Act. Indeed, the Corporations and Markets Advisory Committee (CAMAC) was tasked by the government in 2010 to examine and make recommendations on revising the legislative framework in relation to the reporting to shareholders on remuneration as covered by s 300A in the Act. CSA is strongly of the view that reporting to shareholders on remuneration can be simplified, and we set out our recommendations in our submission to CAMAC. That simplification is yet to be undertaken. In the meantime, the length and complexity of remuneration reports is not driven by companies but by legislative requirement.

CSA is also concerned that the statement on the operation of the 'two-strikes' rule in the table of criteria when voting on remuneration is incorrect. The *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011*, which took effect on 1 July 2011, introduced amendments to the Corporations Act 2001 (Cth), to provide that:

- if 25 per cent of the votes cast at an annual general meeting (AGM) oppose the adoption of the remuneration report, and shareholders make comments at the AGM on the report, then in the following year the board must report in the annual report, on any proposed responses to those comments, or explain why it does not propose any response
- if 25 per cent of the votes cast at two consecutive AGMs oppose the adoption of the remuneration report, then at the second AGM the company must give shareholders the option (if 50 per cent or more of votes cast are in favour of a 'spill') to require that the entire board (except the managing director and any directors appointed since the remuneration report was approved by the board) stand for re-election at a further general meeting (the spill meeting). This meeting must take place within 90 days.

5.3 General contents of annual reports

We note that the policy and guidelines call for more disclosures in the annual report relating to matters that fall into environmental, governance and social (ESG) style of reporting. However, this requirement fails to acknowledge that many companies, particularly those companies with a large shareholder base, understand that the annual report does not meet the needs of shareholders, as it is largely a statutory-driven document, and so they also produce a non-statutory annual shareholder review, which typically covers ESG issues. The reason companies produce such a non-statutory shareholder review is that increased regulation has seen the annual report increase dramatically in length and complexity, such that it no longer meets the needs of shareholders, particularly retail shareholders. Moreover, the annual report became

increasingly legalistic as companies strove to ensure that they had met all statutory requirements. The key target audience of the non-statutory annual shareholder review is typically the retail shareholder base.

5.4 Information about directors

The ASA requires that 'information about directors provided in the annual report will include details of all associations and directorships in other listed and unlisted entities held by directors during the preceding five years'.

This requirement is not aligned with the legislative requirement, which is three years. The legislation does not require disclosure of directorships of unlisted companies.

CSA understands that the ASA is keen to understand whether a director will have the capacity to commit sufficient time to a directorship and agrees that such information should be disclosed when the director is nominated for election or re-election, but does not support the disclosure of this information on an annual basis.

CSA also disagrees with the ASA requirement that there be disclosure 'where a candidate was appointed to the board prior to an election, why it was necessary to appoint the director prior to shareholder approval'. Annual general meetings, at which time shareholder approval for director appointments is sought, are held once a year. Where a vacancy exists, the company cannot wait for months to obtain shareholder approval, nor will a director who meets the criteria for board appointment wait for such an appointment. There is an obligation on shareholders to show an interest in the companies in which they invest, and they should be aware of a board vacancy. This should not have to be explained in the annual report.

5.5 Historic data for tax purposes

Companies will include historic data for tax purposes for a period between five and ten years, but it is not appropriate to expect them to provide this data back to 1985 in the annual report.

5.6 History of financial performance

The ASA requirement that there be disclosure in the annual report of the aggregate remuneration of the five highest paid executives for a five-year period' is not aligned with the change in corporations legislation, which provides that as of financial year 2012, the 'top five' will not need to be disclosed.

6.1 Conduct of meetings

CSA understands that the ASA supports voting on a show of hands so that directors can 'take the temperature of the room' and so that retail shareholder can express a position to directors.

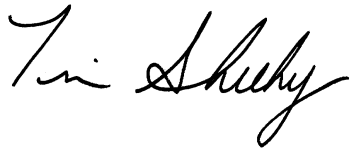
However, with the introduction of the 'two-strikes' legislation, and given the importance of ensuring that all shareholders are provided with the opportunity to vote on the resolution relating to the remuneration report, with its attendant very serious consequences, it is advisable for the vote on the remuneration-report resolution *not* to be held on a show of hands. The shareholders present at the AGM represent a tiny portion of total shareholders. Deciding the vote on the remuneration-report resolution by poll is advisable in the interests of transparency and to take account of the proxy votes that have been lodged. Otherwise the vote is potentially misleading.

CSA strongly encourages the chair to explain to shareholders why the vote is being decided by poll if the company decides this is the preferred method for the remuneration-report resolution.

6.2 Proxies

The ASA statement that default of the proxy to the chair will 'only' occur if expressly indicated on the proxy form by the shareholder does not meet the Corporations Act requirement, which is that where a proxy does not attend the general meeting or does not vote on the resolution (and the appointment specifies the way to vote on the resolution), then the directed proxy default to the chair, who is to vote as directed.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE