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JOINT COMMITTEE on CORPORATIONS AND SECURITIES

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SENATE

Thursday, 12 March 1998

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Members: Senator Chapman *(Chair)*

Participating members: Senators Conroy, Cooney, Gibson and Murray and Mrs Johnston, Mrs De-Anne Kelly, Mr Leo McLeay, Mr Sinclair and Mr Kelvin Thomson

Senators and members attending the hearing: Senators Chapman, Conroy, Cooney, Gibson and Murray and Mrs De-Anne Kelly, Mr Leo McLeay and Mr Kelvin Thomson

Matter referred by the Senate for inquiry into and report on:

Provisions of the Company Law Review Bill 1997

WITNESSES

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Committee met at 5.49 p.m.

CHAIR—I declare open the public hearing of the Joint Statutory Committee on Corporations and Securities on the Company Law Review Bill 1997. I welcome all of the witnesses who will be appearing before the committee this evening. We have received seven written submissions which will be considered in addition to today's evidence in preparing the committee's report.

The committee prefers to conduct its hearings in public. However, if there are any matters which witnesses wish to discuss with the committee in camera, we will consider any such request. This hearing is being held while both the Senate and the House of Representatives are sitting so, as has happened earlier in the day, committee members may have to leave the hearing from time to time if votes are required on divisions. I hope this will not unduly disrupt proceedings.

MATHESON, Mr Ian, Governor, International Corporate Governance Network, c/- Orient Capital, Level 3, 65 Walker Street, North Sydney, New South Wales 2060

CHAIR—Would you care to make an opening statement before proceeding to questions?

Mr Matheson—Yes. By way of brief explanation to the committee, I will talk about what is the International Corporate Governance Network. It was established about three years ago in part at the instigation of the Australian Investment Managers Association. It is a body that now resides in London and that has 23 countries represented on it. It principally represents the interests of investors who are investing both in their own countries and cross-border which, as the committee would appreciate, is a growing practice.

In my previous full-time executive capacity I was Executive Director of the Australian Investment Managers Association which, as members of the committee will know, was one of the previous bodies to the Investment and Financial Services Association. One of the early things I asked the members of AIMA was: what were the impediments to them as major investors in Australian companies exercising their rights as major shareholders on behalf of their clients in companies that they were investing in? I would invariably get one or more of four reasons for them not getting more involved in terms of exercising their votes over shares that they held in companies and generally playing a more active role. I would like to cite those to the committee.

The first one was uncertainty about their authority as fund managers to exercise votes over shares that they held in companies. That uncertainty came about because of the different nature of the funds that they were managing. There were an assortment of different managed funds—not just superannuation funds but unit trusts, life insurance, general insurance funds, charitable bodies, university alumni funds, et cetera—all of which, by their nature, have different voting rights and responsibilities attached to them.

To some extent, that uncertainty about the authority to vote or not has been clarified in part because AIMA developed a standard investment management agreement which dealt with the problem of trustees of superannuation funds. Previously it was uncertain as to whether they as trustees could delegate that authority to fund managers. The standard agreement, which has been supported by the ISC, certainly clarifies that position thereby making it now clear that trustees can delegate that authority to fund managers. On the collective investment side, the ASC has addressed a number of practical problems in the Corporations Law that previously restricted the rights of managers of unit trusts to voting with the full extent of their shares in companies held through unit trusts.

The second reason cited was that there was not enough time available for institutional investors to actually get a vote and their votes turned out. I will not bore the committee with the very cumbersome process and mechanics of the proxy voting process, but suffice it to say that there is a number of parties involved in the voting loop, as I like to refer to it, and certainly 14 days was not long enough—28 days is, I and institutions believe, a far more appropriate period of time for that process to occur. When you have overseas investors who are wanting to exercise votes, certainly the time frame becomes an important issue.

The third factor was the absence of common standards within the investment community

as to how they as major investors should react to corporate governance practices of companies and the absence of standards from an investor's point of view as to how investors should vote on appropriate option schemes that, as you know, are required to be approved by shareholders in company meetings. I think this third problem—the absence of industry standards—has been addressed by the Australian Investment Managers Association with the blue book, which sets out a whole series of preferred practices by an investment community as to how companies should govern themselves. Other standards have been set by the shareholders' association and others, but there is very much a commonality of standards amongst investors now that companies are well aware of.

The fourth problem was the method of voting at company meetings. A feeling was expressed by many members of AIMA and overseas institutions that just by voting a proxy before the meeting invariably meant because the resolution was passed on a show of hands at the meeting that the proxies were not actually counted. They were counted in a strict sense, but for the purposes of determining the outcome of the resolution at the meeting, the proxies are not effectively used. That is a significant disincentive to investors, both large and small, domestic and foreign, to actually exercise their right as an owner of a company. If they feel that because they cannot turn up to a meeting it is a waste of time even lodging a proxy before the meeting however small the number of shares the investor has, then that becomes a significant disincentive.

I know that this committee in its report took the view that changing the current method of voting would change the nature of the meeting. I have to say that the method of voting at company meetings in the United States, Germany and Japan is by proxy only. It has been the subject of considerable attention by the Hampel committee in the United Kingdom. As the chairman of the Board of Trade in the United Kingdom announced last week, a review of UK company law has now been embarked upon which will address in far more detail than I believe we have currently considered to date in this country the rights of shareholders.

I believe a number of these reasons for institutional investors not participating more fully in the governance of companies that they are investing in still exist. I do not believe that the bill has addressed in a number of fundamental ways these practical impediments to voting and shareholders being able to exercise their rights as shareholders more fully. Indeed, I would go as far as saying that the four reasons I have cited were sufficient for major investors to throw up their hands in the 1980s and say, 'This is all too hard for us to vote our shares.' In fact, some of those rogue companies that we all know very well probably played on this fact to do things to shareholders' funds during that period. If institutional investors as the major shareholders had played a more active part or had been able to play a more active part, then perhaps some of those things would not have occurred.

In the *Economist* magazine about midway through 1997 there was a report based on a study by two US academics that had reviewed company law in various jurisdictions around the world. The study concluded that those companies' acts in those jurisdictions that afforded greater rights to shareholders had higher market capitalisation to GDP ratios than those countries that did not afford similar rights to shareholders in other jurisdictions. I think that is a pretty powerful argument as to why the rights of shareholders should be, in a sense, sacrosanct and, if anything, improved in this country. I am not saying that Australia's current law is as bad as other countries, but it certainly falls short of other jurisdictions.

I might remind the committee of the importance of foreign portfolio investment to the Australian share market. Currently, about $80 billion is invested into Australian equities by offshore portfolio investors, which represents at any one time about 20 to 25 per cent of the market capitalisation of this market. So foreign portfolio investors are very important to this market. As you know, during the course of the 1980s, foreign portfolio investors tended to be those who were most hurt by some of the things that went on in our market during the 1980s and they left in droves. It took a long time for confidence to be re-established and for those investors to come back into this market. So confidence is an extremely important factor in attracting foreign portfolio investors into our market. Certainly, they are preserving the rights that they are used to in their own jurisdictions. I am talking primarily about the US and the UK—the two largest sources of portfolio investment into Australia.

I believe, as do many overseas investors who belong to the International Corporate Governance Network, that the bill has not gone far enough to address these various issues that go to the heart of shareholders being able to effectively exercise their rights as shareholders in companies. I think the committee should be aware that the United Kingdom government announced a review of UK company law last week and the rights of shareholders are going to form a major part of that review.

I would like to raise various issues again that, in my previous capacity as executive director of AIMA, were previously submitted to this committee when it was reviewing the second simplification bill, as it was called then. A number of other issues have arisen based on practical experience since that time that I would also like to raise with the committee.

The first one is the notification period for company meetings. The committee previously recommended that, for all company meetings, the notification period be extended from 14 days to 21 days for ordinary resolutions and there be a common notification period of 21 days for all company meetings. As I said earlier, particularly for overseas investors and institutional investors in this country, even 21 days is not long enough, and there seems to be a trend around the world where 28 days is pretty much the norm.

The second issue I wanted to raise was the disclosure of proxy voting results to the stock exchange. Currently, there is no requirement on the part of listed companies to disclose to the exchange the results of proxies received following the meeting. This leads to another point I want to make in a minute about the method of voting, but I would like to at this point quote from a report that was done in the United Kingdom by an organisation called the Manifest Voting Services. They did a report late last year into the level of proxy voting by UK institutions. They made some interesting observations as part of that study, such as:

> The reluctance of some, particularly FTSE 100, companies to provide information about shareholder proxy voting shows that the principle of one share-one vote is undermined by the use of the show of hands to determine shareholder resolutions. Voting outcomes should represent the views of shareholders as a body and not only of those attending the meeting. Ignoring the weight of shareholder opinion (in the form of proxy votes) may save time in shareholder meetings, but this approach goes against the principle of one share-one vote.

I think the principle of one share, one vote is one which has bipartisan support on both sides of politics and was most—

Senator MURRAY—Not multi-party?

Mr Matheson—Bipartisan, multi-party support. That principle of one share, one vote is another sacrosanct principle to investors around the world and has been the subject of many battles in many jurisdictions. Thirdly, I would suggest that perhaps the method of voting at company meetings should be changed from voting only on a show of hands to voting by a combination of postal vote and proxy voting at the meeting.

I know the committee has, again, expressed some concern as to the effect that might have on the nature of the meeting, but I would contend that the current nature of the meeting, whereby any investor who is able to turn up to a meeting is able to ask questions, can still occur under this proposed model. That would not change at all, except that at the end of the discussion on a resolution the resolution would be put and whereas the proxies received prior to the meeting are currently not counted—the resolution is passed on the show of hands—under this proposal, the proxies received before the meeting would be added together with the votes counted or represented on the floor of the meeting and aggregated, and that would be the result.

I would suggest that that would encourage far more investors to play a more active role in the companies they are investing in and for institutions to have a far greater incentive to vote shares on behalf of their many clients, and literally millions of Australians, who are investing in managed funds. I consider all these to be the practical issues associated with the voting process.

The fourth point is that currently there are institutional investors whose clients register their shares in the name of custodians. The custodians are limited to appointing no more than two proxies to a company meeting. If I could explain the impact of that: any one custodian in Australia invariably is one of the top five or six registered shareholders on any company share register. That is a phenomenon that has been compounded by the growth of superannuation. I am not saying it is a bad thing but, because of the legal definition of shareholder being the registered shareholder, as superannuation funds and other managed funds grow, because they are required by law to have their funds registered in the name of a custodian—be it Westpac custodian nominees or ANZ nominees, et cetera—those custodians and nominees are the registered holders of a greater and greater proportion of issued capital in Australian companies.

Recognising that fact, the law limits any one of those custodians, who might have literally 100 clients behind them, to being able to appoint only two proxies. If there are 100 fund managers—100 superannuation funds, let us say—behind Westpac custodian nominees, and they all want to turn up to an annual general meeting at which there are some very contentious resolutions to be put, Westpac custodian nominees is restricted to being able to appoint only two proxies at the meeting. I would suggest that the other 98 clients of that custodian are effectively being denied an opportunity to at least turn up to the meeting.

I have mentioned that the method of voting should be changed at company meetings away from a show of hands to voting by poll and postal vote only. The fifth point I raise relates to the mechanics of voting, I believe that there should be provision in this bill to provide a mandatory obligation for companies to provide a facility for electronic lodgment of proxies. The bill provides for lodgment by fax but, as the government is encouraging greater provision of electronic commerce, there seems to be a double standard in the bill—that

companies can communicate to shareholders electronically but there is no provision in the bill for shareholders to communicate electronically back to the companies. I draw the committee's attention to a growing practice in the United States whereby companies put their notice of meeting on their web page and each shareholder has a pin number that effectively allows the shareholder to vote electronically. The shareholder, at the time they send their vote off electronically, inputs their pin number so that there is some security over the votes that are cast in that way.

I would like to raise one or two other issues in relation to the bill. The first one is the disclosure of beneficial ownership of a company. While this is not directly raised in this bill, since the commencement of the first simplification bill at the end of 1995, an unintended—I suspect—consequence of that bill, which deleted the obligation on companies to keep an in-house register of shareholders, was that the Stock Exchange also dropped out a requirement in the listing rules for companies to lodge with the exchange the results of beneficial ownership traces received from custodians.

That is now no longer a requirement, so a company can trace its beneficial ownership and not have to disclose that beneficial ownership to anyone. You might ask, 'So what?' The reality is that that gives companies a significant advantage over all other parties, including the company's own shareholders, in the event of a contested proxy vote. If other parties in a contested situation, be they shareholders or other bidders for that company, are not privy to that information, that enables the company to mount a campaign that significantly disadvantages other contestants.

The last point is in relation to remuneration disclosure. I know that the committee recommended positively in this regard in its report on the bill and that the government did not accept that recommendation. Many members of the International Corporate Governance Network have expressed dismay both to me and to the government that this particular proposal was not picked up. I would like to remind the committee that, from an investor's point of view, the disclosure of remuneration details is not a voyeuristic sort of exercise. It is purely that in this country shareholders are required to vote on resolutions for the granting of options and also to approve the increases in the aggregate level of remuneration to non-executive directors.

Shareholders in this country are being asked to vote on these two remuneration related matters in the absence of complete information. I would also say to the committee that, perhaps, like parliamentarians—dare I say it—company executives and directors are being paid in many forms these days, not just in salary but in other ways like options, bonuses, long-term incentive schemes, et cetera. The reality is that some of these options schemes can add, for example, between five and 150 per cent onto the reported value of remuneration as reported in the bands in the annual report.

I believe that the remuneration disclosure and the failure of the bill to pick up on the committee's recommendation has led to much dismay in the investment community. I think it would relieve a lot of companies of a lot of agro that occurs at their annual general meetings particularly by small investors who take exception to the granting of hundreds of thousands of options, in some cases, where they are being asked to do so on the basis of incomplete information. If shareholders are being asked to make an informed determination

about whether they should approve a scheme or not, then I would suggest that they are being asked to do so currently on the basis of very incomplete information. That is all I have to say.

CHAIR—Thank you, Mr Matheson. We do have a problem in that we have allowed half an hour for your appearance before the committee. We are already to 35 minutes without questions, so I will allow one question per committee member. You have raised a number of issues as to matters that should be included in the legislation. I know it has been suggested that it may be more appropriate for those matters such as directors' remuneration, disclosure and the other matters you raised to be made matters for the listing rules for the stock exchange rather than mandated in legislation. What is your attitude to that suggestion?

Mr Matheson—From my experience, the stock exchange has a particular view about corporate governance and disclosure of corporate governance practices. I believe its response to such a suggestion would be that that is a matter that should be in the law. AIMA experienced this sort of toing-and-froing on many occasions between the exchange and policy makers. Both sides believed that it should be a matter for the other party. I believe these are all, in large part, disclosure related issues. In some cases it should only apply to listed companies, but I do believe that they are fundamental rights of shareholders that should be enshrined in law.

Senator MURRAY—I am going to have to be very short, although there is more that I would prefer to ask you. One of the key problems we have is the relationship of shareholders with their directors. If I can draw an analogy with politicians, the power brokers may appoint or preselect their candidates but it is the ordinary voter who determines whether they will hold office or not. It is not quite as sharp and clear with directors. In other words, the representivity of directors is very distant unless you are a large institutional shareholder or a large investor, in which case you would have a personal relationship. Do you feel that this bill improves the representivity of directors and improves their relationship and access to shareholders from the position as it previously was?

Mr Matheson—I do not think it has made any difference at all.

Senator MURRAY—Apart from those you have made such as the process of voting and so on, could you make any recommendations that would significantly improve it?

Mr Matheson—I think there has to be more accountability of directors to shareholders. I would suggest that there are different ways of going about that. But, at the end of the day, any discussion about rights of shareholders and standards of corporate governance becomes very academic if you cannot back it up with votes cast either at the meeting or by proxy that are going to have some effect.

Senator MURRAY—Yes, of course.

Mr Matheson—That is the thrust of my submission. Unless you empower shareholders, large and small, domestic or foreign, with a capacity or capability to influence and make directors more accountable, then directors will continue to only appear before shareholders on that one day of the year at the annual general meeting and be completely out of touch

with investor sentiment.

Senator MURRAY—The other great aspect of accountability is the function of auditing. I mean that in the wider sense, not just in the financial statement sense and in terms of performance audits, and a broad view of how well the company is performing relative to its obligations to its shareholders. In your view, does this new bill advance the independence and vigour of the auditing and accountability process in any way, or is there no difference from the past?

Mr Matheson—I think giving shareholders a right to question the auditor at the shareholders' meeting and giving the auditor some privilege or immunity—therefore, the independence of the auditor—is definitely a positive step forward.

Senator MURRAY—What would you think of a proposition that the auditor not be appointed by management, directors or shareholders but by an outside authority, and that shareholders, managers and the board would only appoint accounting consultants, not auditors?

Mr Matheson—I think the more fundamental issue is who determines the accounting standards that are used—the practices by the company. Currently, it is the management that determine which standards it will apply to that company. That is really the issue. While there are different standards available to be used by companies, management will often use a standard that puts that company's performance in a more positive light than perhaps a more independent body or party who is choosing what standards should apply.

Mrs JOHNSTON—Clearly, it is obvious that you are not very impressed by what is in the bill; I think there were a lot of points raised that you feel are not correct. You spent a lot of time on the voting procedure. Could you add how you would see the bill being made tighter in respect of voting procedures?

Mr Matheson—Unless the whole method of voting is changed fundamentally, then everything else is secondary to that. If the committee and the government do not accept changing the method of voting, then I think there are other secondary measures that could be taken to at least make the current process more efficient. Some of those include the move to 28 days from 21 days and making the proxy voting results transparent, that is, they have to be disclosed to the exchange.

Mrs JOHNSTON—Would you see that process being very lengthy—given that a company may have a very large number of shareholders—in disclosing all the votes to the Stock Exchange?

Mr Matheson—They could just do that after the meeting.

Mrs JOHNSTON—Let us say you were looking at postal votes—you mentioned also getting postal votes in and proxy votes.

Mr Matheson—Postal votes, as is currently the case, have to be lodged with the share registry service 48 hours before the meeting. That would not change.

Mrs JOHNSTON—You would not see that changing?

Mr Matheson—No, it would just be counting, for the purposes of the final determination, those proxies—or postal votes, whatever you would like to call them—that are cast before the meeting and including them in the votes that are counted at the meeting, then everyone who is a shareholder can vote in the knowledge that their vote is actually going to count. I am reluctant to use political analogies when it comes to corporate democracy but, if I might be permitted to use one political analogy, it is like saying that if you are not in your electorate on election day then you should not be entitled to vote. If I were a constituent of yours and registered to vote in Adelaide—I am not sure which electorate you are from, Mrs Johnston—but I was in Canberra on election day and, because of that, you told me that I was not entitled to vote, can you imagine the uproar there would be?

Mrs JOHNSTON—I would absolutely be surprised, yes.

Mr Matheson—Bringing that back to a company meeting, we are saying, effectively, that just because shareholders are not at the meeting, their vote should not count. That is what happens in practice.

CHAIR—As there are no further questions, thank you, Mr Matheson, for appearing before the committee and for your answers to questions.

[6.26 p.m.]

CROSBY, Mr William Stuart, National Manager, Listings, Australian Stock Exchange Ltd, 530 Collins Street, Melbourne, Victoria 3000

HAMBLETON, Ms Deborah Gail, National Companies Counsel, Australian Stock Exchange Ltd, 530 Collins Street, Melbourne, Victoria 3000

CHAIR—I now welcome Mr Crosby and Ms Hambleton. Do you have an opening statement to supplement your submission?

Mr Crosby—Yes. We do, hopefully, have a short one. First, I would like to thank the committee for the opportunity to put our case on top of our written submissions that you have already. We would also be grateful if the committee would agree to incorporate those submissions in the record.

CHAIR—Is it the wish of the committee that the submission be incorporated in the transcript of evidence? There being no objection, it is so ordered. The submission will be included in a separate volume.

Mr Crosby—There are a couple of things I should say as a preamble. One is that Deborah will mention in a little while some matters relating to the Managed Investments Bill 1997 which are not high points of principle—unlike the issues that were being discussed earlier—but are, at a practical level, very important to us.

The Managed Investments Bill 1997 hearings of the committee were interesting in that you heard first from people who had a problem with what was presently being proposed. We were rather keen to explore following that model here but, unfortunately, it was not possible. That means, to some extent, that we are anticipating what people coming after us would say. So we may cover some redundant ground for that reason, and we apologise for that. We will certainly be about if there are things raised by subsequent speakers that you would like clarified.

What we have done is based what we are saying on the committee's previous report and on the written submissions. Indeed, the list of things grew a little as Mr Matheson made his presentation. So there are a couple of things there that we will be addressing as well. Basically, we propose to present this in two parts. I would like to talk about some high level corporate governance issues initially and deal with what we see as a couple of the more important items. These are, firstly, about the proposition that a management discussion and analysis reporting requirement be incorporated in the law and, secondly, about disclosure of directors' remuneration. Deborah will then talk about a number of the other issues, including the ones Ian Matheson raised.

Turning then to corporate governance in the round, I think it is important because all the issues, or large numbers of them, fall into the net of corporate governance. So that we understand what we are talking about, there are a couple of places that I would like to quote to you from, if I may, in that regard. One is the preliminary report of the Hampel committee on corporate governance in the UK. We understand that the final report was released late last

year, but to our knowledge no-one in Australia has a copy, so we are still relying on the preliminary report. We have not been able to get one. What that report says is this:

The single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders' investment. All boards have this responsibility and their policies, structure, composition and governing processes should reflect this.

I think it is important, because discussions of corporate governance get very process driven, that we retain our focus on what it is all about, which is that shareholders get the best possible value from the company they are investing in. That is the bottom line and, to the extent that people propose things that are going to be expensive for companies and intrude into the management's time and the management's ability to manage their companies, those things are imposed only after very careful consideration because they take management away from doing what they are meant to be doing, which is running the business of the companies, and the costs that are imposed are costs that shareholders bear at the end of the day.

There are three things that Lynn Ralph said this morning that I thought were useful in talking about corporate governance at a high level. The first thing she said was that more regulation was not necessarily better regulation. I think that is axiomatically true and something that needs to be kept at the front of everyone's mind in discussing the issues that we are discussing today. The second was when Mrs Johnston asked her about world's best practice. Ms Ralph's response was, I think, bemused. I think there is a sin that I suspect we fall into from time to time of invoking world's best practice when we cannot actually identify another argument. We say, 'What I want to do is world's best practice.' In fact, corporate governance practice around the world is extraordinarily diverse. If you look at continental Europe, German companies have a completely different structure. They have dual level boards. They have a management board and a supervisory board. The supervisory board involves all sorts of stakeholders in the business besides the owners of the business. The whole corporate governance approach is, from the very basic building blocks, quite different.

One of the big issues that people talk about in terms of Australian corporate governance is the desirability of having a non-executive chairman—an independent chairman. That would be very much an anomaly in the US, where executive chairmen or recent-past executive chairmen are very much the norm. Again, even in a basic area like that, there is not a world's best practice. The UK approach to regulation and governance generally is to have much softer deals. Issues are not resolved through black letter law as a rule. There are some counter examples like the implementation of the Cadbury recommendations through changes to the London listing rules but, at least on reading the Hampel preliminary report, there is a suggestion that they are wondering whether that was the right way to go in lots of other areas like takeovers regulation and the administration of pre-emption rights for shareholders, where shareholder approval is required for diluting issues of securities. They are dealt with in a much less formal way than the Americans would, for instance.

Hong Kong is a jurisdiction that I have experience in. Before joining the Stock Exchange, I was director of enforcement with the statutory regulator there. They introduced a corporate governance rule that required every company to have an independent director. There was one company that, until then, had had all its directors drawn from the one family

who owned most of the shares. In response to a bit of pressure from the stock exchange, they did appoint someone who did not share the same surname as all the other directors. Everyone thought that was a wonderful thing until they realised that he was married and his wife was a member of the family. It is a cheap example but it shows that world's best practice is really difficult to identify in this area. It is an area that, 10 years ago, people were not talking about in the way that we are today, and it is a debate that goes on. Obviously, the other issue there is that, if we entrench the status quo, we interfere with the capacity of Australian companies to develop in response to international developments to the extent that there is convergence towards world's best practice. It may well not be what people would identify it as today and we would interfere with that flow.

The other key issue in looking at institutionalising corporate governance practices is that, on the Australian Stock Exchange, we list companies of enormous diversity in size and nature. We have in the order of 400 mining exploration companies, most of whom would have no employees on a permanent basis besides their directors. It does not make sense to apply the elaborate corporate governance regime to them that you would apply to News Corporation or National Australia Bank or a large and diverse business.

I suppose that brings us to what has been called the box ticking approach, the approach where you say, 'Here are some corporate governance principles. Do you comply with them—yes or no?' Again, it is useful to quote from the Hampel committee report. It states:

> Box ticking takes no account of the diversity of circumstances and experience among companies, and within the same company over time. It assumes, for example, that the roles of Chairman and Chief Executive Officer should never be combined; and that there is an ideal minimum number of executive directors, and an ideal maximum notice period for an executive director. We do not think that there are universally valid answers on such points. We believe that there can be guidelines which will be appropriate in most cases; but there will be valid reasons for exceptions.

The next paragraph states:

> There is another problem with box ticking. It can be seized on as an easier option than the diligent pursuit of corporate governance objectives. It would then not be difficult for lazy or unscrupulous directors—or shareholders—to arrange matters so that the letter of every governance rule was complied with but not the substance.

Again, I think they are key issues in looking at the sort of prescription that we will be identifying in some of the proposals we believe are being put to you this evening. That concludes the general issues. I will now move on to a couple of specific issues.

The first issue I said that I would talk about was the proposal to incorporate management discussion and analysis reporting in annual reports. We think this is a bit of a furphy to some extent, because there are already detailed statutory requirements for directors' reports. They are required to report on things that have happened and on things that might affect the company in the future. Those provisions are in the Corporations Law in sections 304 and 305 at the moment. There are proposed provisions in the new bill that go very much to the same issue in clause 299.

If you take the next step and say, 'We are talking about what is actually being reported,' and if you compare Australian reporting with most jurisdictions, including jurisdictions like New Zealand and Hong Kong that say that they require management discussion and analysis

reporting, the standard of disclosure in Australia is at least as good as and probably significantly better than reporting in those jurisdictions.

There is a G100 group working on providing some informal guidance, some non-statutory guidance, on that sort of disclosure in Australia. ASX is participating, and it strongly supports that project. We would say that until that sort of self-regulatory regime, that sort of peer pressure regime, has had a chance to be tried then we would seriously question the value of introducing a statutory requirement, especially one—as was the one proposed in the committee's earlier report—that is reasonably prescriptive about the issues that must be dealt with. The issues I discussed before about description are, we would say, very relevant there.

The second issue I will address is directors' remuneration. Our position is this: that no disclosure comes without cost. We are not the ideal people to tell you the cost to a corporation of making disclosure of precise details of which directors get which remuneration. The Institute of Company Directors, or someone like that, would be much better placed than we are to explain it to you. They say that it does come at a cost and we accept what they say.

The question is: what is the benefit? Is it information that is actually of use to investors and creditors of companies, which is what annual reports are about? We really question at the margin from what we have now, which is banded disclosure, detailed disclosure of allotments of securities and other incentive arrangements to directors, whether there is value being added for investors in requiring detailed disclosure. We just do not think the case is made, so we do not support a requirement to have line by line disclosure of directors' remuneration.

Ms Hambleton—As Stuart has said, we are really addressing possible changes to the bill in light of what we anticipate is going to be raised with the committee rather than commenting on the content of the bill as it currently is. If I could reiterate what Stuart has said about cost benefit, one concern I have with these matters being raised at this late stage is the lack of consultation that is going to be available to those who do have an interest in these matters such as the companies themselves.

One of the proposals, I understand, is for a notice period for all meetings to be for 28 days. We think that is too long and we anticipate that if companies had an opportunity to comment on this they would express the same view. The law is now going to recognise notices of proxies being provided by fax and electronic means. As mentioned previously, that is going to be at the option of the company and the member to take up that option.

We think that commercial transactions have a limited window of opportunity. In a number of cases our listing rules will require approvals in order for commercial transactions to proceed. For example, listing rule 7.1 requires approval for issues of securities over 10 per cent of the company's capital. We are concerned that if you move to 28 days one issue that is going to arise for us is that companies may be seeking waivers from those sorts of rules. Alternatively, if we refuse to give a waiver, then they may be missing that window of opportunity for a commercial transaction. So we have concerns about the proposal that the notice should be extended not just from 14 to 21 but to 28 days.

Another issue we have a concern about is the proposal for a mandatory entitlement of directors to call meetings. We agreed with the government response to the committee last time, that it should be optional for companies to decide whether to provide this right or not. Meetings are expensive to call, particularly large listed companies, and there are other avenues for calling meetings if the board decides it is not appropriate to do so. Another issue is the mandatory disclosure of proxy votes. On that issue, all that we would like to say is that we think there should be an opportunity for companies to comment on that proposal before something of that nature is introduced.

Mr Matheson raised the issue of matters being put into the listing rules instead of being put into the Corporations Law. We do not see the listing rules as a repository of regulation that the government has decided not to introduce into law. We think that if the government has made a decision that regulation is not appropriate it does not mean that the interest group moves down a step and gets it into the listing rules. At each level there needs to be consideration of the cost benefit analysis in introducing regulation either through the Corporations Law or through the listing rules.

Mr Matheson mentioned the issue of disclosure of beneficial ownership notices. There was a requirement to that effect in the listing rules. We reviewed the listing rules as a whole and went through an extensive public consultation process, during which time that requirement was dropped out. We decided to focus on what was material to the market and listing rule 3.1 requires the disclosure of information that is material to the market.

Mr Matheson, when he was with AIMA, made submissions to the stock exchange that that rule should be reintroduced. We went through an extensive internal review of that—I think it was approximately a year ago—and we did not see any justification for reintroducing that level of regulation. At the time, we referred back to AIMA, and one of the points that we noted was that the Corporations Law has made the decision that materiality is at five per cent for substantial shareholding notices. While some notices under the beneficial ownership provisions may be material, that is a matter for the company to decide if it is material at a lower level to provide to ASX.

CHAIR—Generally, I think it is fair to say that your view is—and I think you stated the principle—that more regulation does not necessarily mean better regulation. The issues that have been raised as problems with this legislation in terms of additional prescriptive requirements that should be added to it you do not really regard as problems. You think they should be left either to listing rules or to company determination.

Mr Crosby—We do not believe that the cost benefit case has been made out, except in a couple of very small areas like a requirement for auditors to attend company meetings, for instance, which are fleshed out in our written submission.

CHAIR—If there are no further questions, I thank both of you for your attendance and your presentation.

[6.45 p.m.]

FRENCH, Mr Philip, Acting Senior Manager, Corporate Governance and Professional Standards, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales 2000

O'REILLY, Mr David, Member, Regulatory and Consumer Affairs Forum, Investment and Financial Services Association, Level 24, 44 Market Street, Sydney, New South Wales 2000

EASTERBROOK, Mr Sandy, Director, Corporate Governance International Pty Ltd, Level 6, 280 George Street, Sydney, New South Wales 2000

CHAIR—I welcome our new witnesses. Do you wish to make an opening statement to supplement your submission?

Mr French—Just a very brief one. First of all, apologies from Lynn Ralph and Richard Gilbert, who have been called to a rather pressing engagement.

We do not have a lot to say on this. We have made a submission which we would like to have incorporated into the record if we could.

CHAIR—There being no objection it is so ordered.

Mr French—Basically, we support the views that Mr Matheson has put this time and previously in his capacity as executive director of AIMA, one of our predecessor organisations. We believe that those changes, as previously endorsed by the joint committee, would be beneficial in terms of advancing better corporate governance in Australia. However, we do recognise that, in some cases, there are strongly held views about how far we should go in terms of putting these things into black-letter law rather than leaving it up to the marketplace, with the exception of the 28-day notice, which we do feel is quite an important issue because the law has not kept up with changes in company ownership in Australia. The law, in its present form, has been around for quite some time. The proportion of companies held by institutional investors is very large these days and likely to continue growing, and the mechanical difficulties are very real ones. They may, at some time in the future, be sold by technology, but that is not the case yet. So we feel that the 28 days would enfranchise many more shareholders than is the case at present.

As I said, we agree with the recommendations of the PJC in its report of November 1996 and as reiterated by AIMA in August of that year also. We submit them again.

CHAIR—Mr O'Reilly, do you have anything to add?

Mr O'Reilly—I would just like to take the opportunity to point out that this bill and the Managed Investments Bill 1997 are tied together in so far as the Managed Investments Bill 1997 will not commence until the provisions in this bill commence. That is because the provisions in this bill which provide for members' meetings, for audit and account requirements, and for annual returns have now been incorporated into the law properly rather than

simply through prescribed covenants. This is a much preferred course of action simply because of the power of the regulator and the breaches of these provisions which may occur. It is a much stronger approach. I would also like to take the opportunity to perhaps correct some of the misreporting in the press about some of the issues which have arisen in relation to, for example, voting requirements. If you would indulge me I would like to take it back a little bit to the Managed Investments Bill 1997. I am talking particularly about the removal or the appointment of a responsible entity.

You probably saw in the press last Friday in 'Pierpont' a statement that it would be more difficult to remove a responsible entity under the proposals than is currently the case. That is not the case. This bill defines an extraordinary resolution to be a resolution by a majority of members to both appoint and remove the responsible entity. This is a preferred approach and having it in the law in this manner in fact strengthens the position of investors. So the definitions of 'extraordinary resolution' and how they have been incorporated into the Managed Investments Bill and 'special resolution', which are both in this bill, very much enhance the protection for investors in that regard. The inclusion of the requirements for annual reports, for the auditing of accounts, in this bill are an advance in terms of the regulation of managed investments. That is why the Managed Investments Bill and this bill have been tied together as a package.

CHAIR—Mr Easterbrook, would you like to add anything?

Mr Easterbrook—First of all, I would like to make some initial comments about the stock exchanges. As a practical operator in the governance field, working 24 hours a day in there, I disagree most strongly with the comments that they have made. I think a lot of them are not only intellectually wrong but factually wrong. To take a couple of very small examples: the things that we are asking and that they asked to be added to this bill, I cannot conceive how any of them will create additional expense or distraction. They are relatively minor issues which can be implemented very easily but they are wanted by investors.

Secondly, world best practice: as I have indicated in my submission, the International Corporate Governance Network is in the process of writing some global governance guidelines. So there is in fact going to be world best practice and there is significant agreement amongst major investors around the world and people like me who consult in this area on what best practice is. As far as commercial opportunities are concerned, I am amazed at the comment that another seven days is going to deprive the companies of opportunities. If you look at the issues that come for shareholders to vote on, where there are what you might call commercial opportunities, in most cases those have been under development for months. In many cases, the documents concerned are inches thick. So another seven days is not going to make any difference at all.

If there is an odd occasion where it might, then there is a capacity for the exchange to grant a waiver and the exchange will presumably be able to do that, but they certainly will not get inundated with it. It is also simply not true to say that there is a problem with doing it because the good companies do in fact do it. I will get on to that a bit more. but I want to indicate at the beginning that I disagree very strongly on a practical basis with the exchange's position. I will come back to the exchange right at the end.

Mr Chairman, can I incorporate my submission which only reached you yesterday? I apologise for that. We were all operating under a bit of a time problem.

CHAIR—Yes. It will be incorporated in a separate volume.

Mr Easterbrook—Does the committee have a copy of the submission?

CHAIR—Yes.

Mr Easterbrook—I think the submission speaks for itself but I have brought some hard evidence which I would like the committee to look at on some of the points that we are raising. I emphasise that this is hard evidence, as opposed to general comments that have been made by other people who are opposing this.

The submission is divided up into a key background and there is a long background to all of this. Senator Chapman, you are very familiar with it all. I hope you will educate the rest of your committee who are not familiar with the background—I will not go into all of that. Suffice it to say that, when the November 1996 report came out from your committee, the investment community breathed a sigh of relief and thought, 'Oh, we are getting it down the right track.' There was then a year's hiatus and what has happened since then—again, I think a little sunlight on that is probably a good idea and I have put it out in attachment 1 and its appendix—is actually a pretty sorry tale.

The next section deals with the credentials of our organisation. We actually practice in this area. We look at what the companies do; we cover 120 companies. We actually know what we are talking about. We have got very good practical knowledge of what we are talking about, and some of that will become evident in what I am about to cover.

On the next half a page, I tried to put down what governance was all about. There is a lot of confusion about it. It is actually pretty simple, it is pretty straightforward, and it is pretty commonsense. The main point of governance is to boost the self-help of investors. It is helping investors to better monitor their investments, helping them to protect their investments, and helping them to enhance their investments. As I have said, I do not think there is any argument about the investor protection aspect of it. As far as investment enhancement is concerned, there have been a number of studies which seek to prove that—you have even got companies now accepting that. I do not know whether I can now table this package of material.

CHAIR—Yes, you can.

Mr Easterbrook—I have got four copies, and you might like to look through them as we go through. I only did four. I will take you through each one. The first one is an extract from the 1997 annual report of MMI Ltd, in which the chairman says:

> The improvement of Corporate Governance practices is not only about policing and monitoring; it is, above all, about improving the performance of the Company and enhancing shareholder value. According to a number of overseas surveys, there is increasing evidence that good governance practices really do make a difference for which investors are prepared to pay a premium.

That is on the third page of the first attachment. Have you got the front page of the annual report? I am sorry, the name of the company has not come out very well, but it has got a black cover. Then you have the first page of the chairman's message. What I have been quoting from is at the bottom of the left-hand column on the second page. Here you actually have a leader of business saying it matters.

What are we asking to be added to the bill? We are basically asking for some better tools with which investors can help protect and enhance their investments, and some mandatory transparency where the investee companies fail to embrace international best practice in financial and other disclosure. There is no doubt that what we are asking for is best practice in other markets.

Then I have asked the question, 'Why has the Australian government rejected these reforms?' Essentially, all of the reforms that were recommended by your committee, and certainly the most important, were rejected by the government. It took them ages to come up with a government response. The government response, in my assessment, is intellectually and factually barren. I think that it will be very instructive for members of the committee to actually read it. If you read it in comparison with the logic and evidence provided in the submissions that our company and AIMA produced in December 1996, I think the whole matter will speak for itself. In fact, on the third page of our submission, we were so appalled at this that we actually went into what I would call 'not our usual governance-speak. We said:

Now, however, . . . the government has decided at short notice to reject the Urgent Governance Reforms . . .

Against the background of a legislated superannuation policy which is accumulating exponentially investment funds under the supervision of TRUSTEES . . . and investment managers, it is a serious inconsistency to have legislation which effectively impairs the ability of such fiduciaries to exercise their proper role. This will be the case if the Urgent Governance Reforms . . . are not introduced into law.

This is, in fact, quite serious stuff because you have got government policy pouring money into superannuation funds, representing the moneys of millions of Australians. That money is going, in most cases, into professional investment management and you have the trustees and the managers who are responsible for those funds saying, 'In order to do our job, we want these relatively minor reforms.' Yet, apparently, they are not going to be granted.

Let us look at the reforms we are actually asking for. I should say that this is stage 2. We have had stage 1, which was the first simplification act. These were fairly simple matters which have been adopted. Then there was a second simplification bill where a number of governance proposals were submitted, on behalf of the investment community, to be added to that bill. There have been other improvements suggested, but we are happy to leave those for another time.

Senator Murray asked some questions about audit and other areas of accounting. There have been submissions made on that and we will be pursuing those in due course with future corporate law reform. But we are saying that these ones here have been discussed and recommended and we want them added to this bill, so that they come in for the ensuing main season of 1998.

There are seven of them. The first, second, third and the seventh are issues of disclosure. We are just saying, 'We want this information.' It is information which can be provided very simply. The point is, it is not provided. The fourth, fifth and sixth are some very simple tools. They are not difficult and they are not going to cause a great hassle.

The first one is mandatory disclosure to the ASX of all information disclosed by Australian-listed companies to the American market. This is a cut-down version of the first PJC recommendation which tries to make it a little easier for the exchange.

What we are saying concerns Australian companies which are listed on the American market—and there are quite a few of them. We are saying that if these companies have made disclosures to the US market, they should also make them to the Australian market. Why should American investors get superior—because it is superior—disclosure to Australian owners of Australian companies?

It does occur in some cases and I will give you a couple of examples, one of which concerns ANZ. I expect the committee has heard of the major international investor Templeton. As one of the biggest of the international investors, it had a large holding in ANZ. I do not know whether it still has. But at the time, it asked ANZ why it did not disclose to the Australian market the information that it discloses to the American market. And the answer was: 'We're not obliged to.' I think I am correct in saying that BHP is in a similar situation. BHP does not disclose the information that it discloses to the American market. I could be wrong on that, but I think that I am right. That is the first reform that we are asking for: that Australians be treated no less badly than Americans.

CHAIR—Mr Easterbrook, I think the members of the committee have read your submission, and they are aware of the seven issues that you are raising.

Mr Easterbrook—I am just trying to give you some evidence, that is all.

CHAIR—What in fact you are doing is reinforcing the recommendations that this committee earlier made, and I think the committee understands the issues. It might be useful though, if you could deal with the government's decision not to incorporate those recommendations into the legislation and perhaps the arguments in relation to the government's decision, rather than reiterate the evidence that has already been given to us.

Mr Easterbrook—I would say that there is really no evidence at all in the government's response. For example, in relation to remuneration, it just says, 'Not appropriate'. We take the view that nothing that has been said by the government detracts from the logic of what has been put to the committee previously.

If I can go on to the second reform—which is general management discussions—I know the accounting bodies want to talk about that. But the second piece of information I have given to you is a letter from the Australian Accounting Research Foundation which says that some of the issues which we raised with them were probably better dealt with in an MD&A. The point is that the MD&A gives investors some really useful information and that is why it is wanted.

If we go to the issue of remuneration, this disclosure that is asked for is asked for, as Ian said, not for a voyeuristic reason; it is because it is actually useful information in monitoring, to see whether or not the agents of the shareholders are being paid the right amount. They might even be paid too little. It is a requirement in the UK. It is a requirement in America. It is in the AIMA blue book. The companies have been asked to provide the information. There is even a guideline on how they would like to do it. Basically, there has been no disclosure of that. We have asked it voluntarily, it has not been done. You can count on your fingers the number of companies that actually provide this information. Westpac is one; it did it recently. We are in the process of doing a remuneration study for IFSA which is looking at some these remuneration issues and it will be very interesting when that comes out. Unfortunately, it is not going to be ready until about May or June.

The next issue is the minimum 28 day notice period. The next document you have got in your list is a letter from Davis Global Advisors. I would strongly recommend you read that because he compares the international position. He says there is nothing unusual about 28 days—it is the way things are going internationally—and an extra seven days is going to make no difference at all. We are saying that we cannot see any logical difference why it would make any difference.

The next one we are asking for is that the director of an Australian listed company should be able to call a member's meeting. That is a very powerful tool when you have a minority of independent directors on a board. It will be very rarely used, but it shifts the dynamics in the board in a very subtle way. It gives those independent directors a bit more muscle because, if a majority of the non-independent directors do not listen to the independents, they can threaten to call a meeting. As I said, it is really not going to be used; it is just going to change the dynamics on the board. The reason it is not going to be used is that, if it is used wrongly by an individual director, that director might be asked to pay the cost of holding the meeting and that runs into thousands of dollars. So he is going to be extremely careful. He has got to have a really good reason to do it.

The next one is that, as the Company Law Review Bill 1997 is at the moment, it is up to the company whether shareholders can fax proxies in. We are saying that, if you are a public company, you ought to be big enough to afford a fax to let shareholders send you a fax. It is actually quite important, because the 21 days and the 28 days we have been talking about are not actually 21 and 28. They are 19 and 26 because, in most companies, you have to get your proxy in 48 hours before the meeting. If that meeting happens to be on a Monday, then you have to get it in on the Friday before, so sometimes you actually have to get it in four days before the meeting just depending on when the meeting is going to be in the week. You can also have things like Easter, holidays or whatever.

Faxing makes quite a difference because, if you can fax it, you can fax it to the company at the weekend; whereas, if it is going by mail, it does not get there. That is why we have suggested in the submission that, if it is a big problem for the small companies, you can put a capitalisation figure on it so they have to be at least a $100 million company. But if they are a $100 million company, they ought to be able to arrange for shareholders to fax proxies in to give them a bit more time. We are talking about a bit more time to get their votes in.

On the mandatory disclosure to the ASX for proxy voting results, this is something

which was not in the original recommendation. It is a very important issue because it relates to the practicality of the use of the vote. It is mandatory in the States. It has been recommended by Hampel. You have got in your evidence here the 30 January *Global Proxy Watch*, which is a two-page document that comes out every week for people in the governance industry. That indicates that Hampel has recommended that these proxy voting results should be disclosed. So it is going to come in in the UK also.

It is best practice in the AIMA blue book. There is a guideline and—again, I have put the guideline in here for you—there is an extensive explanation of why this is important. It is all logical and I strongly request that you read it. What has happened is that the companies have been asked in the guideline to do this. The next document you have is a list of about 30 companies out of the companies that we cover who report in June which have refused to do it this year. There are about 70 of those companies that report to 30 June that we cover and almost half of them have refused. About half do provide the information but about half do not. We have been asking for this information for the last four years. We have had plenty of time for the companies to get their mind around it. We are saying it should be mandated.

The next piece of information for you is: because of the importance of this issue, we wrote to each chairman on that list saying, 'Look, these are the issues. It is basically your responsibility whether this information gets released or not. These are the arguments.' After that, I have given you samples of three companies that have written back saying no. One is Coles, which I suppose is not surprising. Another one is QBE. The QBE one is very interesting. It says, 'Until this is mandated you are not going to get it.' Here is a company actually saying, 'Unless it is mandated, we are not going to provide this information.' That is very strong evidence that it needs to be mandated.

Finally, in these samples, there is an exchange of correspondence that we have had with the chairman of BHP recently on this issue. There are three letters. Again, I would request that you read those letters. BHP is not providing the information. The reasons that these companies give really do not go to the heart of the issue. What the investors want to know is what the figures actually are, because they go to a lot of trouble in many cases to vote, but they cannot be actually sure whether the votes are going in or not.

In the next page of information is the computer print-out which all companies do prior to the meeting because they might have to go to a poll. That is it there. I think, Mrs Johnson, you were saying that it was going to be terribly complicated—that is it. It is very easy. That is the list of the various resolutions in an actual company. I have taken the name of the company off because I think otherwise we ought to ask the company, but it shows the number of votes for, the number of votes against, the number open, that is, left to the proxy's discretion, the number abstained, and this 'No instruction' which I will come back to in a minute, which is a very important issue. The numbers on the left-hand side are the various resolutions. The first resolution is the resolution for the approval of the accounts. The second resolution (2a and 2b) will be the election of two directors, and then the other resolutions will be additional resolutions that shareholders were asked to vote on.

On the next piece of paper we have put that into a reader-friendly form and that is how we put that in one of our reports to our subscribers. This right-hand column shows that in

this particular company 20 per cent of total capital was covered by what is called by the 'No intention'. I will explain what that is in a moment. That is actually larger than the total number votes cast in all the other categories. This 'No intention' column on the right is in fact the shares held by the custodians for which the custodians have not got votes in. If you look at the actual computer print-out, you will see opposite that 'No intention', where you have the actual number of shares, it says the number of holders. The number of holders holding 20 per cent of that company is seven. You have seven custodians holding 20 per cent of this company, who have not voted, and the total percentage of shares voted in this company is 12.1 plus 2.4. Less than 15 per cent of the total number of shares have voted in this company by proxy and 20 per cent could have been voted but were not voted.

We are saying that one of the reasons why that is not voted is quite probably that they have just not had time to get the job done. That is one of the reasons why we are saying, 'Twenty-eight days—give another seven days to get the job done. Fax proxies—it gives you a longer time to get your proxy in.' And it is why we are saying, 'Mandate the publication of this information,' because, if this comes out into the sunlight, the fund managers are going to be able to talk to their custodians and say, 'Hang on; why aren't you getting our votes in?'

There is another very significant issue about this, too: if the people that actually do vote in this company are six per cent of the company, they are actually half the people voting. So it gives minorities who do bother to vote a huge power that you would not anticipate otherwise. We are saying, 'This information needs to get out into the public arena. It is done in the United States; it is going to be done in the UK; it should be done in Australia.'

The Australian Treasurer, Peter Costello, has announced that the government's wish is that Australia should become a major financial centre. But his government is apparently not listening to what major investors are telling it that they need. In fact, if these minimal governance reforms are not adopted, Australia will significantly lag world best practice and what other governments and regulators have done or are doing.

The last bit of evidence I have given you is letters that have actually been written by some of the major American investors and advisers saying, 'Yes! This is absolutely 100 per cent right. We want this.' There is one last thing. I think that the question needs to be asked: why is the ASX opposed to these reforms? Why has it not shown similar leadership to, for example, the London Stock Exchange in revising its listing rules to require the companies to do these things, especially on the disclosure front? Why is there a difference in approach between London and the Australian Stock Exchange? I think we should ask these representatives of the exchange why that is.

CHAIR—Thank you, Mr Easterbrook, for that detailed presentation. Thanks also to IFSA for your presentation.

[7.19 p.m.]

PARKER, Mr Colin William, Director, Accounting and Audit, Australian Society of Certified Practising Accountants, 170 Queen Street, Melbourne, Victoria

SADHU, Mr Michael, Project Manager, Australian Accounting Research Foundation, 211 Hawthorn Road, Caulfield, Victoria

ROFE, Mr Alfred Edward Fulton, Chairman, Australian Shareholders Association, GPO Box 5210, Sydney, New South Wales 2001

Mr Rofe—Mr Chairman, on this occasion, I am appearing as a member of the Legislation Review Board of the Australian Accounting Research Foundation, by which this submission was prepared.

CHAIR—Do you wish to make an opening statement, Mr Parker?

Mr Parker—Yes. Firstly, I should say that, tonight, I have the pleasure to represent both the Australian Society of CPAs and the Institute of Chartered Accountants in Australia. The combined membership of both accounting bodies is over 110,000. Given the hour of the night, I shall make my opening statement very short—unlike accountants. Being the last to give testimony tonight, it is only fair that accountants should be following up at the end because that is their traditional reputation.

What concerns us most about the Company Law Review Bill 1997 is the significant step backward in not going forward with the initiative of the general discussion and analysis. We believe that that is going to significantly disadvantage investors. That is why, at the end of the day, financial reports are produced: so that investors can make informed decisions upon those financial reports.

The fact is that the general discussion and analysis provided by the Corporations Law at the current time is inadequate. It has not been revised for a number of years and lags well behind that hackneyed phrase of world's best practice. What the bill proposes is really six requirements—none of them in their own right controversial—the results of the operations for the year overall: key industry geographical segments; key strategic initiatives; major commitments; unusual items; likely developments; trends and significant events. I have to ask you: what is the harm in requiring that information to users of accounts? There is no harm. As a matter of fact, it will enhance the Australian marketplace in the world economy by requiring that information to be disclosed.

This committee previously deliberated on management discussion and analysis and did not believe that it should be changed. At the end of the day, it was the government of the day that decided to change it. Why did they decide to change it? Because of their policy in CLERP. Basically, that was to place more emphasis on self-regulation. We support self-regulation, but under broad principles. We believe that the Corporations Law should state the broad principles that were exposed and generally accepted when the corporations simplification bill was exposed.

In relation to the government's rationale for the change, it said, 'Leave it up to industry.' Industry has failed, otherwise you would see these six items being reported now. You do not see those six items being reported by all listed companies. You see it done by a fraction of listed companies, but what they are doing in any one year is that, if the results are bad, they can omit such disclosures because it is all voluntary. There is no generally accepted set of principles governing management discussion and analysis.

The submissions you have received tonight are from the users of the accounts saying that they want the information. It is the accountants that are supporting that, it is the Group of 100 that consists of the senior financial executives in Australia who are pushing for it, as are the shareholders associations and the investors. I find it quite perplexing that the ASX with its focus on disclosure would be canvassing against such an initiative by saying, 'Let the market rule,' because the market has ruled and failed.

Reference was made to the G100 working group preparing a draft best practice statement. The accounting bodies are working in with the G100, but the G100 draft was all premised around the six principles in the legislation. What that working party was going to do was flesh out those, but, no, what that working party now has to do is go back to scratch and start new rules that can be adopted as best practice. So the whole approach has changed.

There are three minor issues that we would also like to repeat for the record. We support that there be no true and fair override of accounting standards. There are pressures in the marketplace by some market participants that would like to override accounting standards by the directors using their discretion about which accounting standards to apply and which accounting standards not to apply. It is very good to see that the government has not given in to that pressure. Also, the rules in relation to redeemable preference shares are unusually prescriptive. We think that the legislation should buy out of the rules regarding redemption of preference shares.

There are two further points I would like to make. Firstly, we have a revised submission I would like recorded on the record. Secondly, to support the issue of management discussion and analysis, the Australian Society of CPAs has written a booklet which outlines all the advantages of management discussion and analysis. At the end of the day, the recommendation out of this booklet is that it should be mandatory for listed companies. It is interesting that the good Senator Gibson wrote the foreword to this book some two years ago.

Senator COONEY—He knows a lot about companies.

Mr Parker—That is right, Senator.

CHAIR—Mr Sadhu, are you adding anything to Mr Parker's comments?

Mr Sadhu—The only thing I would add is that one of the reasons we have great support for management discussion and analysis is that our evidence shows that outside the very largest companies those sorts of disclosures are not really made. The interesting fact here is that we apply the same financial reporting requirements to all listed companies regardless of size, but we find in terms of the non-audited or the non-financial narrative based information

there is extreme diversity in the types of disclosures they make. Many surveys of users have found that the non-audited and non-financial information is extremely important to users. They read it and find it useful. So to that extent the management discussion analysis can really only enhance the financial report.

The other point I would add to what Colin was saying is in relation to worlds best practice, which has been so commonly prefaced today. The introduction of MD&A would be a major plank to give us international comparability with the US, the UK and Canada. In terms of non-audited and non-financial information, we do not have a lot of comparability with those countries, yet we are spending a lot of time getting greater comparability in financial disclosures. The introduction of the MD&A would be a major step towards that end. I think they are the major points.

Mr Rofe—I think there was another point in our submission about the rule that dividends can be paid only out of profits and that that is no longer necessary. This rule was carried over from the 19th century. It was intended to protect creditors by ensuring that capital was maintained. History has shown that it does not work in practice and we now have more relevant provisions in the Corporations Law dealing with solvency. The problem with the rule is that there is uncertainty as to what profits are. Profits in a book sense really are not a very good indication of whether a company is able to pay dividend. So we would suggest that this is an historical anomaly that does not serve any useful purpose and could be left out.

There is a similar sort of thing with the rules about redeemable preference shares. The rule is that they can be deemed only out of profits or out of the proceeds of a new issue of shares. The problem there is that redeemable preference shares are quite often used as a financing device and where a company is in difficulties it could be that there are no available profits out of which to redeem the shares or it might not be feasible to make a new issue of shares.

So in practice in the past redeemable preference shares with, say, a par value of $1 each were issued at a premium of $99—or sometimes $999—so that they could be redeemed out of the share premium account rather than out of profits or the proceeds of a new issue of shares. If we are doing away with the share premium account and abolishing par value, then that mechanism will not be available. Therefore, this will result in issues of redeemable preference shares no longer being feasible in many cases. So again this is an historical rule which does not really serve any useful purpose. The more important question is solvency, which is now covered better in the legislation.

I have a final point if I may. Switching hats: the Shareholders Association supports these four points which have been raised by the accounting bodies, particularly the one relating to the MD&A. Most people would agree that figures by themselves tell only half the story. If you have a profit and loss account or a balance sheet, it has got a lot of figures in there. But really to understand the implications—the significance—of the figures, you really need some sort of discussion and analysis. So the MD&A is a very useful device to investors.

Indeed, surveys of shareholders have shown that one of the first things they look to is the chairman's discussion or the managing director's discussion for a description of what is

really going on rather than to the figures. As Colin Parker said, some of our leading companies already do provide this sort of discussion and analysis. All we are really asking is that the backsliders be brought up to the standard of best practice in disclosure and discussion.

CHAIR—Thank you very much, Mr Rofe. In relation to these various recommendations that you want to see made mandatory requirements in the review bill—and you say that unless they are made mandatory the companies will not comply with them voluntarily—would it not be fair to say that investors have the chance to vote with their feet or to vote with their dollars and invest their funds in those companies that voluntarily agree to provide that sort of information to the public generally but particularly to the shareholders?

Mr Parker—It sounds plausible but there are no survey results to really say that they make those decisions based upon the level of disclosures in the finance reports. They make their decisions on a wide range of issues.

Mr Easterbrook—Lots of fund managers have to invest according to agreed indices of stocks. They do not have the choice of doing that; they have to be in BHP or whatever.

CHAIR—But if they are satisfied with the stock's performance they may regard that as a higher priority than the disclosure factors perhaps and be satisfied.

Mr Parker—You would be in a better position to make your decision if the management discussion and analysis were provided. A lot of the large listed companies provide what I would class as management discussion type analysis to selected brokers and the like as part of their road shows. What we are saying is that, once a year, that information should be made available to all those shareholders along the six points that you have outlined.

Mr Rofe—I think the other point that was mentioned earlier was the flexibility there in the absence of clear guidelines, as was proposed in the MD&A provisions. When the news is good companies are keen to disclose it; when it is bad, they are not. It is a bit too late then, if you bought the shares when the good news was coming out, not to be told that next year perhaps things are not quite as good. What we are wanting is a general standard that applies in good times and bad times.

Mr Sadhu—Given that we have comparable disclosures now in relation to financial reporting in that disclosures are made in financial statements, the MD&A is really only bringing the non-audited part up to a comparable standard so that you can have comparable reporting in relation to that area as well. We now have a set of accounting standards and disclosures that are required to be made for the financial statements. The MD&A is really only looking to bring companies up to a level where they have a comparable framework to guide the disclosures that they make in the non-audited and non-financial part. At the moment it is a free for all, as we have seen. Companies are free to do what they like. So if you have a comparable framework applying to the non-audited part at least you might get some more comparable disclosures there.

Senator COONEY—I would just like Mr Rofe to expand on the issue of solvency and insolvency of a company. I was thinking of the creditors and, particularly, the copper mine

at Cobar and the meatworks at Grafton. How would you see a regime that would improve the ability of, say, the working people in those companies to know how the company is going on this issue of solvency or insolvency?

Mr Rofe—First of all, when I said ‘creditors’, I was not only thinking of trade creditors and people like that. Of course, the employees to whom wages are owed are creditors too.

Senator COONEY—Yes, that is why I took the issue up. What regime would you suggest for that? Were you saying that the present regime was all right or that it should be improved? I was not quite sure what you were saying.

Mr Rofe—I think there are two issues there. These, what I have called, outdated 19th century rules have not served to help creditors, whether they are trade creditors or employees. A solvency test is more important. There is probably a separate issue though in relation to employees. As a matter of proper commercial practice, one would have expected these companies to make sure, if they were employing the people for the next fortnight, that they would have the money to pay them. I was under the impression that there were some provisions in the legislation giving preference to employees even against a secured creditor.

Senator COONEY—I think that is correct. What I am trying to get from you is whether you think that the present regime is reasonable or that there is room for improvement as far as the solvency of companies goes, whether that issue arises for creditors, employees, shareholders or anybody else.

Mr Rofe—The present regime, dealing with the solvency test in relation to incurring liabilities, paying dividends and so forth, is a lot more effective than the old rules. In so far as the particular cases that you mention, I think one would need to look at the facts and find out exactly what went wrong there to see whether there is a deficiency in the legislation or a deficiency in those particular companies.

Mr Parker—As a follow-up point to what Ted said, the financial statements themselves will contain accounting indicators of solvency problems. Those skilled in accounting will be quite easily able to detect those early warning signs. However, for those not skilled in financial reporting matters, the management discussion and analysis, based upon the six principles previously outlined, would provide more information than the current regime. Therefore, investors and creditors would be better off at the end of the day because of those mandatory requirements. Companies will only report what is good. Under management discussion analysis, they shall also have to report the risks that they face and what is bad.

CHAIR—As there are no further questions, I thank each of you for your appearance before the committee, your presentation and your responses to questions.

[7.38 p.m.]

CROSBY, Mr Stuart, National Manager, Listings, Australian Stock Exchange Limited, 530 Collins Street, Melbourne, Victoria 3000

CHAIR—Mr Crosby, from the Stock Exchange, having been challenged to provide some information or some argument, wanted to reappear.

Mr Crosby—Thank you for the opportunity, Mr Chairman. There were some contentions made by Mr Easterbrook that I thought we should not allow to go unrefuted. He challenged the factual accuracy of three things that we said. In our submissions, he said, there were no costs to what was proposed and he said that commercial delays were not meaningful. I think that displays an incredible naivety about what costs commercial delays generate. If a company is denied access to the capital from a capital raising, for instance, by an extra 14 days—as it would be if the notice period were extended from the present 14 days to 28 days—then that is enormously significant and costly for the company concerned. The fact that they are not writing cheques about it does not mean that there are no costs. Similarly, with regard to the requirement to hold meetings, meetings are expensive. It costs money to send notice, especially if you have hundreds of thousands of shareholders, as a number of Australian listed companies now have. I think it is naive in the extreme to contend that there is no cost to the proposals that are being recommended to the committee by Mr Easterbrook.

The second thing he said was, 'Yes, there is going to be world's best practice because Mr Matheson and I are writing it down.' With respect to Mr Easterbrook and Mr Matheson, the fact that they write it down on a bit of paper does not make it world's best practice. It is not world's best practice unless it is endorsed not just by institutional investors—and I accept that Mr Easterbrook and Mr Matheson may well speak for a number of them—but by the rest of the financial markets as well. There are intermediaries concerned and there the issuers who have to report on those disclosures. I believe that the instances we gave of diversity in world practice are compelling in establishing that there is no world's best practice, and there will not be because someone writes it down on a bit of paper. It has to be what people actually do to be practice.

Mr Easterbrook also talked about US market disclosure and the fact that we do not require that every bit of paper given to anyone in the US is released into the Australian market. The reason we do that is because the Americans have a different approach to disclosure and regulation. American disclosures tend to be inordinately voluminous. We do require that anything material that is released anywhere else is released into the Australian market, and we would imagine people would draw to our attention if there were problems of material instances where relevant information or price sensitive information has been released into other markets and not released into the Australian market. Lastly, Mr Easterbrook asked why ASX is opposed to these concerns, and the answer is the answer I gave in our principal submission: we believe that the proposals they have in mind impose costs, and there is no evidence that there are concomitant benefits.

CHAIR—Thank you very much. That concludes the hearings on the Company Law Review Bill. I thank all of those witnesses still present who appeared before the committee and gave their time, their views and answered our questions. With that, we declare the hearing closed.

Committee adjourned at 7.43 p.m.