
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Reference: CLERP (Audit Reform and Corporate Disclosure) Bill**

TUESDAY, 9 MARCH 2004

CANBERRA

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**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Tuesday, 9 March 2004**

**Members:** Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

**Senators and members in attendance:** Senators Chapman, Conroy and Murray

**Terms of reference for the inquiry:**

To inquire into and report on:

The exposure draft bill, CLERP (Audit Reform and Corporate Disclosure) Bill, and relevant matters.

## WITNESSES

**Committee met at 4.17 p.m.**

**CHAIRMAN**—I call the committee to order. Today the Joint Committee on Corporations and Financial Services conducts its first public hearing into its inquiry into the exposure draft for the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 and related matters. The committee announced its decision to inquire into the draft bill and pursuant legislation on 14 October 2003. The inquiry was advertised widely in the national press. The committee also contacted many individuals and organisations, drawing their attention to the inquiry and inviting submissions. Submissions were lodged with the committee by 17 November 2003. To date, 58 submissions have been received. The committee expresses its gratitude to all those who have assisted it so far in its inquiry. With the introduction of the bill to parliament on 4 December 2003, the committee welcomes and is still accepting submissions. Submissions have been posted on the Parliament House web site but hard copies can be obtained from the committee's secretariat.

Before we commence taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege.

May I also state that, unless the committee should decide otherwise, this is a public hearing and as such all members of the public are welcome to attend. The committee will be holding additional public hearings for this inquiry, as determined thus far, on Thursday, 11 March in Canberra; Tuesday, 16 March in Sydney; and Thursday, 18 March in Melbourne. There will possibly be further hearings in Canberra, Sydney and Melbourne.

[4.18 p.m.]

**EASTERBROOK, Mr Alexander (Sandy) Arthur Douglas, Principal/Director, Corporate Governance International Pty Ltd**

**CHAIRMAN**—Welcome. As I have already indicated, this is a public hearing. The committee prefers that all evidence be given in public but, should you at any stage of your evidence or answers to questions wish to respond in private, you may request that of the committee and the committee will consider such a request to move in camera. We have before us the written submission from Corporate Governance International, which we have numbered 58. Do you wish to make any alterations or additions to the written submission?

**Mr Easterbrook**—No.

**CHAIRMAN**—I now invite you to make an opening statement, at the conclusion of which we will have some questions.

**Mr Easterbrook**—Thank you very much, Mr Chairman. It is actually quite a historic time for CGI. Our office is going to close tomorrow, but I hasten to say just simply because we are having our 10th birthday. As we were too busy during December to have our Christmas party, we are taking the day off. So no-one will be there to answer any queries tomorrow, but we will be back on deck thereafter on Thursday.

May I suggest that the fact that it is our 10th birthday and we have been earning our bread and butter in the governance area advising major institutional investors who have responsibility for growing the savings of millions of Australians' retirement and investment funds—we have been advising them for 10 years now on the practical governance issues in the major listed companies; we currently report on the ASX 200 companies and other entities—we may have some very unique practical experience, and the comments that we make should be regarded in that light.

You have the submission that we gave you. I received today—I will table this, but I believe that the research officer has this—support for our submission from one of our clients in London which is the largest fund manager, Hermes. It is $A100 billion worth of funds under management. It is owned by the British Telecom Pension Scheme. It is supporting the submission that we have made, and it has drawn attention in particular to two matters. The first is our suggestion that it is time to reintroduce the annual vote of shareholders to reappoint auditors, and I will talk about that again in a minute. The other is that it supports introduction of the system that the UK has for what is colloquially referred to as a non-binding vote on a remuneration report. That document will also be in front of the committee.

Our submission is divided into sections. The first section makes a number of general comments which are based on our, if I can say, 10-year experience. The first comment basically says, when you are looking at the introduction of governance reforms, you ought to take note of those that are on what we call the 'buy side' of the governance river, which are the institutions that invest in the companies, because at the end of the day governance best practice is simply a

set of principles and practices that have evolved over a period as those institutions' best mechanism for protecting the ongoing value of the funds that they have under their custody.

The second point we make is do not reinvent the wheel. Some things are already operating in much larger markets than the Australian market in the governance area. They are working perfectly well there. One good example of that is the non-binding vote in the UK. Our suggestion is that you simply pick that up and put that into the Australian Corporations Law. You can do that very simply. A set of regulations already exist in the UK. I have given you the web site hotlink connection to that so you can look at that.

I must say that we are amazed that there is all this hysteria on the business side about this non-binding vote. It is actually terribly simple. The non-binding vote is simply an incentive for boards and remuneration committees to do a better job. The only sanction of a non-binding vote is, frankly, embarrassment. If a board does such a bad job on remuneration that the shareholders throw out its remuneration report, that is a public condemnation of the directors and, because people do not like being publicly condemned, it is likely to encourage them to do a better job. That, frankly, is what has been the experience in the UK. I have tabled a comment on that from Hermes which says that the results of that are well documented in the UK. If the committee wants further information on that, I am sure I can get that for you.

The third point under 'General comments' is the best way of making these things work generally is to let the market work. So a corollary of that is that you should give investors appropriate representation on market bodies, determining bodies, so that they can have input in that way. In particular I have referred to the FRC and the proposed FRD.

The fourth comment I have made is that we are still in almost not the 20th century but the 19th century in the way that we look at some of the things in the Corporations Law. More than half the Australian market is in the hands of sophisticated institutions, yet our Corporations Law seems to still be thinking that the whole market is owned by mums and dads who do not know a thing. More than half the market is owned by extremely sophisticated institutions which are actually paid to do the job of knowing the market and the companies properly. That is what they are paid for. Secondly, increasingly the retail investors, as we can see, are also getting more and more sophisticated; and I am sure the ASA, which will be giving evidence here shortly, will speak more on that.

We are saying that concentrating reforms around the AGM and saying things have to be disclosed to the AGM or discussed at the AGM would touch only a tiny bit of the market. In particular, the issue of disclosure and discussion should be much more widespread. We now have a very good tool in email and the Internet, and that should be used.

The last comment we make is that, as CLERP 9 has had a longer gestation period than an elephant, we think these reforms have been on the agenda for a long time, everybody knows what is coming and they should be brought in for the forthcoming main Australian proxy season this year in October and November. So those are the general comments that we make.

We have made some specific comments about audit, which figures largely in CLERP 9. The first point that we make is that it is time to reintroduce the annual reappointment of the auditor. In our view, a lot of the problems we have seen in Enron type situations and in situations where

there have been complaints about audits not being done properly are due to the fact that because the auditor is entrenched in Australia—I know Enron is an overseas example, but we have other examples here similar to Enron, such as HIH—the auditor feels that it will be there anyway. That has encouraged a lot of audit firms in the past to use the audit as a loss leader to get other, more profitable work from the company, which work of course is given out by management.

Large audit firms refer to their clients as 'the companies'. In fact, their clients are not supposed to be the companies conceptually. Their clients really are the owners of the companies. So we think you should give the owners of the companies the right to confirm the appointment of the auditor each year at the AGM, as it has always been done in the UK and as it was done in Australia until changes were made in the 1980s because of Bond and the like. It is time to go back to the system that we used to have. As I have said, a large slice of the market is now in the hands of sophisticated institutions. We are not going to go back to the Bond days because the market is not shaped to enable that to happen. So the perceived ill which was the reason for the annual reappointment of auditors being removed has now passed.

**Senator CONROY**—Is that because he held the majority of the shares?

**Mr Easterbrook**—Whether or not he controlled the majority of the shares, he controlled the board.

**Senator CONROY**—An effective majority of the shares?

**Mr Easterbrook**—Yes. He had an effective control, and he was able to lean on the audit firm. If the audit firm would not do what he wanted, the auditor would be changed. That was the reason why the legislation was changed back in the 1980s: to stop that happening.

**Senator MURRAY**—And because institutions were not voting their shares.

**Senator CONROY**—No.

**Senator MURRAY**—That is a key consideration.

**Mr Easterbrook**—I think it is unlikely that will happen again. As I have said, Hermes supports the reintroduction of the annual reappointment of the auditor. It is largely symbolic, but at the same time it is a good way to remind the auditor that he is responsible to the shareholders. So that is our first point about the audit. I do not think that has been made by anyone else.

We suggest also that, if you have the annual reappointment of the auditor, that meshes neatly with the disclosure about audit fees, because the whole idea of disclosure of audit and non-audit fees is to enable the shareholders to make their own assessment as to the independence of the audit. Therefore, if they also have a vote on the auditor, that is a neat way of tying the two together.

We have also suggested that certain things relating to audit committees should be mandated. That is our second point on page 3. The Stock Exchange is rightly concerned about the costs for its smaller companies. One could say maybe you have to draw the line and say really small companies do not have to have an audit committee. We believe the concept should be: if you are

using public money, we do not care how small you are—actually, we do not cover the small companies; we go down to the ASX 200 only—you should have a proper mechanism for ensuring that your public reporting is reliable. The best way of doing that is through a properly constructed audit committee.

The third point we are making at the bottom of page 3 relates to the disclosure of audit and non-audit fees, and the quantification of each type. We agree with all that, which is what is proposed, but there is, in our experience, some different approaches by—I do not know whether it is the different audit firms or the companies but, when we ask for information about the audit and non-audit fees of the companies, sometimes some companies include audit related fees in the audit fees and sometimes they do not. To make sure you get full disclosure one way or the other we suggest that audit related fees be classified as well and how much in each be outlined. That way you will get reliable disclosure across all the companies, however they describe it.

Point 4 on page 4 is that we are concerned about two issues of independence which I do not think have been referred to before. The first one is where you have a listed subsidiary of another company. Based on the principle, again, that if you are going to use public money you should have complete independence of the audit, we think that the listed subsidiary should have a different audit firm from the parent. We do have a few listed subsidiaries in Australia, and in most cases they have the same auditor as their parent. We think there is merit in separating the two. It may make a bit of extra work for the parent because the parent auditors will then have to audit the subsidiary as well. But, in our view, that is just a cost. If you want to list the subsidiary, that is part of your cost. The public are entitled to be protected in relation to that.

Perhaps even more important is the second point, which relates to groups of companies or entities. I am disappointed that Brian Long is not going to be here because I was going to make a specific comment about Westfield. The Westfield group is not a parent and a subsidiary but three very large listed entities: Westfield Holdings Ltd; Westfield Trust, which is the Australian property trust; and Westfield America Trust, which is, as you would gather from the name, a listed American property trust. In fact, Westfield does just about all the development work, worth millions of dollars a year, for the two listed trusts. The trusts are not a subsidiary of Westfield Holdings, but at the moment the trusts have not only the same audit firm, which is Ernst and Young, but the same audit partner signatory, which is Brian Long. We think that should not be the case. We think that where companies have very material related party transactions, even if they are not associated, they should have separate auditors.

The fifth point is we think that the idea of auditors self-certifying their independence is ludicrous, that that should be the audit committee's job. The audit situation is under review because of concern about independence and the capacity of management to influence the audit firm. To have the auditor in that position, being asked to certify as to their independence, is not only akin to, as we have said in here, students setting and marking their own exams but just unfair to the audit firm because it exposes the audit firm to pressure on that point. Then we have repeated the comment about giving institutions dedicated representation on key market bodies, like the FRC and the FRD.

Going on to remuneration, our green book is our set of guidelines on remuneration that we have developed basically since we started. It is a set of guidelines we have worked out based on all the problems we have come across looking at remuneration in companies that we have

reviewed and resolutions that shareholders have been asked to vote on in the remuneration area. I table that.

Going back to the whole purpose of remuneration disclosure and the issue about the shape of the market, to put it simply, you have millions of Australians' superannuation and other investment moneys being invested compulsorily for them. They do not have a choice about it. They have to put it in there. It is taken out of their pay every week or every pay period. It is invested by professionals. Professionals are paid to invest it. They have resources to do their job properly. On the remuneration front, the whole purpose of remuneration disclosure is to enable those sophisticated experts/investors to look at the remuneration structure in the company and to compare it with other companies that they have looked at in the same industry, maybe even overseas, and see whether it makes sense. That is what it is all about. It is not about a sensation on the back page of the *Daily Telegraph*. It is so that these people who are paid to do a job can do that bit of their job which is looking at whether the remuneration structure in the company is right and, if it is not right, making representations to the company. That is what it is all about. So in this green book we have set out a series of guidelines telling the companies how they should approach this so that that information gets out publicly and these investors can do their job properly. That is, in a nutshell, what it is all about.

For that reason—this is the second point on page 5—we support the extension of mandated remuneration disclosure in CLERP 9, for example, of the essential elements in the remuneration package of a new CEO. We still have the ludicrous situation in Australia where, if a new CEO is appointed and is given an equity incentive package and the company in fact does the right thing—sometimes a company does not do the right thing and takes advantage of a loophole or an exclusion in the listing rules, and, if it does the deal carefully before the CEO is appointed, although he is obviously going to be appointed it can avoid having shareholder approval of the equity element of his package, which is required under the listing rules; but I am talking about if that loophole is not taken advantage of, which most companies do not, to their credit, although some companies do—the equity element of the package comes before shareholders normally at the next AGM after the CEO has been appointed and shareholders get to vote on it. By definition, it is part of his remuneration package. The package is explained in detail in the notice of meeting or explanatory notes, but very rarely is the equity element of the package explained. How on earth can you, as a sophisticated shareholder doing a job for the millions of Australians whose money you are investing, tell whether a bit of what is in the basket is okay when you cannot see what the rest of the basket is?

We have been advocating this for ages. It is in our green book. A few companies are now starting to actually put that information in. But most companies do not, so you are sort of making a decision blindly without that key information. It is very silly because you are going to have to show that in the next annual report. It will appear in the annual report once the new CEO has his first year's salary. But the shareholders want the information—the annual report is their information—when they are making a vote. I am going into this in a bit of detail. This is just one microcosm of the situation. That is why we support the mandated remuneration disclosure of the essential elements of the remuneration package of a new CEO. In the third point on page 5 we have commented about certain aspects of the remuneration committee that we think should be mandated.

If I can just sort of branch off here, there is a lot of confusion about the difference between Sarbanes-Oxley and the situation here in Australia and in the UK. A lot of people do not understand that there is a very basic governance situation in America which is completely different from our situation here and that in the UK, and which is, frankly, quite crazy, and that is that you cannot fire a director. Once a director of an American company is put on a board, he is there until his term expires.

Over the past few days you will have seen reports about Disney. The papers are full of this great vote against Michael Eisner. In fact, it is not against Michael Eisner. You cannot vote against him. You can do what is called withhold your vote, which just means you do not like it. But, whether you like it or not, you have got him. There are historical reasons for that going back to the 1930s. It is a bit like why we took away the annual reappointment of the auditor. They had some problems in the 1930s and there was some perceived abuses, so they sort of entrenched boards.

What is happening now is that the SEC is receiving submissions and there is a big debate going on in the US about whether that whole system ought to be changed. It will get changed, but it is going to take a long time. Because they have that totally different system in the States is why there is all this talk in the States about classified boards, which means you should have the right to vote on the board every year, and the governance people in the States are pushing that line because you cannot fire the director. But, if he comes up for re-election every year, you have the same effect. Because of that type of situation the combined chairman and CEO is sort of entrenched at the moment in the American system. Because that is a central part of the American system, and it is going to take a lot to change that, Sarbanes-Oxley is in fact saying, 'We can't touch that, but we are going to get really tough on some of the stuff around the side.'

We support the system here and in the UK because we do not have that problem. If you want to get rid of a director, you can fire him with a majority vote any time as long as you go through the procedure under our company law. That is a huge governance plus for Australia and the UK that they do not have in America. That is why we take the view that you do not need to go down the Sarbanes-Oxley route in Australia. It is nothing to do with prescription, which is what business is going on about. It is because of the different systems. If you do not understand that, you do not understand what it is really all about.

Going back to our submission, in the third point on page 5 we are saying in relation to the audit that certain things ought to be mandated about the audit committee. We are saying in here that there are certain things that ought to be mandated about the remuneration committee to make sure it does its job properly.

In the fourth point we are saying that we support strongly the concept of this non-binding vote on a remuneration report. I have already indicated what the logic for that is. I am an escaped lawyer. Lawyers get their knickers into a terrible knot about all this, saying, 'What is the legal effect of all this?' Frankly, the legal effect of it is bugger-all. It does not matter. It is nothing to do with the law. It is to do with impression. It is to do with ego. It is to do with not being embarrassed as a director of a major listed company that the community looks up to. It is a very powerful human mechanism. That is what it is all about.

So do not get sidetracked by business saying there are all these terrible problems. It is simply an incentive to make the board do a better job on remuneration. It has been introduced in the UK. It works. There are only a few examples of remuneration reports being thrown out. I see that another submission says there is only one. I am not sure that is quite right. But we all know the GlaxoSmithKline example in the UK where the remuneration report was thrown out last year. The major institutions are using this tool very carefully. They do not want to spoil a very useful tool. If you keep doing something, it is a bit like crying wolf: no-one takes any notice. But, if you do it just occasionally on the right one, it is very effective.

So we say we should adopt the UK system. I was trained in the UK. I actually had to unlearn a bit of law when I came here 33 years ago because Australia was a bit behind, but now in fact in some respects we are in front of the UK in some of our company law. But we have basically very similar systems, very similar institutions. And, despite American and UK television, we all speak the same language as well. There is a very good system working in the UK. We should pick it up and put it in. Do not muck around. Do not finetune it or anything else. They know how it works in the UK. Just pick it up and put it in here.

I have given you there the hotlink to the regulations. Have a look at those regulations. If this committee does not look at those regulations, it will not have done its job properly. You have a really good, working precedent there. Do not reinvent the wheel. Just stick it in CLERP 9.

We have said there are complaints that the non-binding vote will create all sorts of problems, and the Business Council and other establishment directors have complained about it and said there will be all these terrible problems. In fact, if you look at the evidence, that is bullshit.

**CHAIRMAN**—Mr Easterbrook, I think it might be time for us to move to questions because we are running short of time.

**Mr Easterbrook**—Sure.

**CHAIRMAN**—My first question arises from your comments regarding the non-binding vote situation in the UK. Can you just briefly explain how that differs from the non-binding vote provisions in the CLERP legislation?

**Mr Easterbrook**—I am not sure because as yet we do not have the regulations, which I understand will be the heart of what the remuneration report will be.

**Senator CONROY**—We may seek your advice a little further down the track when they are out.

**CHAIRMAN**—Secondly, you referred to listed subsidiary companies and related company transactions. You said that they should require a separate auditor and there will be a cost to the company involved in that. It is a cost to the public or the shareholders whom you are suggesting that provision would protect, isn't it? It is a cost which will ultimately be borne by the shareholders.

**Mr Easterbrook**—No, I do not agree with that. There are two separate situations we referred to. The first is where you have a listed subsidiary of a parent. The cost to the public shareholders

in the listed subsidiary will not differ. They will be paying for an audit anyway. There may be a small additional cost to the parent, which may or may not be listed. If so, our approach to that is, if it wants to have a separately listed subsidiary, that is part of the thing. But the key thing is to protect the public investors in each company, particularly in the subsidiary.

The other situation is what I referred to as my Westfield example. I do not see why it should add any cost at all because each entity will have to have an audit anyway. We think that where you have these major transactions going on between two groups it is very important that one group that pays all the money has an independent auditor of those transactions.

**Senator CONROY**—You have mentioned in your extensive opening statement a number of overseas examples. A number of organisations, such as the Business Council, seem to be complaining about the level of shareholder activism. The impression I get from the frequent media reports is that around the world this is on the rise; it is not just an odd phenomena happening here in Australia. Could you comment on Disney, which you have made a brief reference to, and Shell? I understand that overnight there has been some movement at Shell, one of the world's biggest companies. Also, Dell have just separated from their CEO. Here in Australia—thanks to the work of your organisation and others, like the Shareholders Association—I refer to Harvey Norman. We have seen a crisis in confidence in the NAB board of directors following some activities there; and Rupert Murdoch got rolled in News Corp. Is this just a local phenomenon, or is this a worldwide thing that will not go away?

**Mr Easterbrook**—The short answer is: Australia is a bit behind what is going on elsewhere. What is coming and what is here to some extent already is what is called cross-border cooperation amongst institutions. Just as a simple example, I was able to extract overnight from Hermes that support for our submission. That is partly because they know us well. They are a client. They take our reports. Particularly with electronic communication, institutions are in communication quite frequently, and I think what you will see in Australia is some local institutions and a number of the leading overseas institutions combining in appropriate cases to do something about situations that need a bit of a push.

**Senator CONROY**—In your view, is there a strong link between pay and performance in terms of executive remuneration in Australia? Has there been a disconnect, or do you think it is doing okay?

**Mr Easterbrook**—We do not have any sort of data on that. Our remuneration guidelines mainly look at structural matters. We think it is more important to get the structure right—at least that is the start. However, this year for the first time we did refer in one or two of our reports to whether the quantum itself—it was perhaps a community issue—was within acceptable bounds. Other studies are being done on the link between pay and performance. We have not done them. We say that you need to structure the pay so that executives have a serious part of their pay at risk if the performance is not right. One of the key issues, of course, is the calculation of whether the performance has been met. Sometimes we have taken issue with the method of calculation where abnormal expenses, abnormal items, have been excluded. That sometimes makes it easier to achieve performance.

**Senator CONROY**—We have seen two examples in the past 12 months—in fact, in an even shorter period—of where two CEOs of two very successful, performing companies, John

McFarlane at ANZ and Michael Chaney at Wesfarmers, have put up their hands and said: 'We will take a pay cut. We think it is getting a little out of control.' Would you like to see more of that?

**Mr Easterbrook**—I would imagine that would probably depend on the individual because, if the individual has a contractual entitlement, they are entitled to enforce that. But I do think the issue involving pay for non-performance is improving. A battle has basically been fought and won in the UK on the length of notice a CEO is entitled to. Basically what you call rolling one-year contracts are now the norm in the UK whereby if you want to get rid of a CEO you do not have to pay them more than a year; although, having said that, in some cases there are special termination arrangements which in fact extend the amount that the person gets paid. We are starting to see that rolling one-year contract concept come in here. A good example of that is in BHP. The new CEO of BHP, Chip Goodyear, is on a rolling one-year contract. The chairman of one major listed company has asked whether we could organise some publicity on that topic because he is trying to persuade his CEO to accept one.

**Senator CONROY**—Just in general terms, in your view does the CLERP 9 bill go far enough—for example, in relation to requiring shareholder approval of equity based schemes? If parliament were to pass this as it stands right now, would it be enough?

**Mr Easterbrook**—The chairman quite rightly stopped me because I was probably taking up too much time, but at the bottom of page 5 of our submission we have suggested that, if the ASX will not reinstate the listing rules which were in existence until July 2000 about shareholder votes on changes to equity schemes and also the requirement for a three-quarter majority shareholder vote approval—we think that should be reinstated; it is not clear exactly why that was removed—you should put those into CLERP 9.

**Senator CONROY**—The previous parliamentary secretary to the Treasurer, Mr Ian Campbell, said—he made a big play of this—that the government would require upfront and real-time disclosure of executive contracts. The CLERP 9 bill fails to implement this requirement. However, the ASX listing rules were changed in May last year to require disclosure of material parts of a CEO's contract. In your view, should the requirement to disclose executive contracts in real time and upfront extend beyond the CEO to other directors and senior managers?

**Mr Easterbrook**—It is a very difficult issue. I think if the current disclosure proposed in CLERP 9 is enacted we will have enhanced disclosure. We, as I understand it, will have a requirement for a new CEO's package to be disclosed, which I think is an important issue. Put it this way: I think that from our point of view the priorities are what we have put in our submission. We have now been in this business for 10 years. I have learnt what patience is all about. Maybe what we do is wait and see.

**Senator CONROY**—One step at a time. I just wanted to mention hedging schemes. You would be aware that there has been a little bit of a proliferation of them in recent times. They take away the risk element for an executive when what we are trying to do is align management and shareholder. Should directors be able to enter into these schemes? Should it be mandatory to disclose them? Should they be banned? Do you have a view on those at all?

**Mr Easterbrook**—They should certainly be disclosable because then shareholders can make up their own mind about the situation. As to whether or not you ban them, I suspect if you ban them some ingenious mind in Macquarie Bank will find another way to do it.

**Senator CONROY**—As you are aware, section 200G states that shareholder approval for retirement benefits is required only where the payout exceeds the amount prescribed by the formula. For example, an executive director or director can obtain a retirement package without shareholder approval of up to 3.5 times their average annual income if they have been with the company for 3.5 years, five times their average annual income if they have been with the company for five years and seven times their average annual income if they have been with the company for up to seven years. In your view, should these types of payments be approved by shareholders?

**Mr Easterbrook**—I think my practical answer to that is that, if disclosure of the essential elements of the remuneration package of a new CEO comes in, that again will work marvellous things on boards because they will have to confess what deal they have made with the CEO to start with. You can be sure that there will be a furore if there is a very long retirement proposal in that. I think you will find that the institutions will have some things to say about that. So, again, my inclination at this stage would be to say let's go the disclosure route and let the market apply the sanction.

**Senator CONROY**—If your annual remuneration were a million dollars and you had had 3.5 years of employment, you can receive $3.5 million under this formula without having to get approval. The maths is simple: $2 million comes to $7 million and $3 million comes to $10.5 million. Take someone like Frank Cicutto. I think he was on a salary of about $5 million with a few other bits in it. He could receive $17.5 million without shareholder approval just based on the formula in the Corporations Law right now. So the issue is: should these ones be included for a shareholder vote? That is the formula in the Corporations Law now.

**Mr Easterbrook**—I understand that. I think my answer is basically the same as the previous one. I think you would find that, if a new CEO were appointed with that type of entitlement on termination, there would be an uproar. First of all, I do not think boards would do it. Our information from the grapevine is that boards are being much more careful about the termination provisions that apply to new CEOs. I gave you the example of Chip Goodyear and BHP Billiton. If after we have the mandatory disclosure of the new CEO's package we find that a company has in fact done something like that, maybe at that stage we should decide to change the law.

**Senator CONROY**—Or the board. Hopefully both.

**Mr Easterbrook**—The board would probably get changed anyway.

**Senator CONROY**—I presume you have heard of Dick Grasso. He did pretty well from a short-term contract. I do not want to pick on Frank Cicutto because obviously he is no longer with NAB, but he had been with the company many years and, according to the formula currently in the Corporations Law, on his base salary of around $5 million he could have walked away with $35 million and this would never have had to receive shareholder approval.

**Mr Easterbrook**—Yes, but he did not. Most of his package was accrued entitlements.

**Senator CONROY**—I am not being critical of what he actually walked away with. I am talking about what is possible at the moment, what CEOs can walk away with without shareholder approval according to the formula under the law as it stands now.

**Mr Easterbrook**—I think you will find that the whole game has changed in this area. As I said, boards are being much more careful—that is the feedback we are getting—because, apart from the CEO being a bit on the nose if that comes out, it is really the board that has egg on its face. Again getting back to the remuneration report concept in the UK, the boards will not want to be criticised for making those types of outrageous arrangements. I think we need to find out whether there is a problem before we make changes.

**Senator CONROY**—The ASX corporate governance guidelines say that non-executive directors should not be provided with retirement benefits other than statutory super. Also, your own guidelines on remuneration say that NEDs should not receive options, with the only possible exception being a company in start-up mode. In light of these guidelines restricting access to options and other incentive payments to NEDs, should the law be amended?

**Mr Easterbrook**—I have not had a chance to talk about our proxy voting report, which I have also tabled, but in that we have provided a fairly detailed breakdown of the types of resolutions et cetera. If you look at that you will see that this year, in this last season, there was a big increase in the number of resolutions to raise the cap on non-executive directors' fees. That was directly related to phasing out of retirement benefits.

**Senator CONROY**—But that was something they should not have been getting. Should they realistically be compensated for something they should not have been receiving in the first place?

**Mr Easterbrook**—No, we do not agree with that. Up until quite recently, non-executive directors have been paid basically in two ways: they got an annual fee and they got a pension—a bit like executive directors getting a pension. That pension was in the form of a retirement benefit. Best practice does not like retirement benefits because it potentially impacts on a director's independence because, the longer he stays there, the more he will collect and therefore it could be an incentive for him just to toe the line even if he was not happy with what was going on. So there has been a worldwide movement towards trying to get rid of these retirement benefits and pay directors what they ought to be paid each year. Each year they used to get a fee and then a bit for their retirement, but that bit that they got for their retirement was if they stayed to the end of the relevant period.

I think the battle has been won on that and these retirement benefits are going. Some companies are doing completely the right thing and chopping them off straightaway. Last year a few companies said, human nature being what it is, 'New directors can't have it, but the old directors can.' We have been pretty critical about that. But basically I think the die is now cast that retirement benefits are not the way to go, they will not be there for the future and instead the director will get paid a whole fee during the year. We think that is the right way to go, but we think it is perfectly correct that, if you are going to give away this pension element, you need to increase the annual fee because otherwise there is actually a salary cut. So we support that—I think the ASA may want to make a comment about that later. The rough rule of thumb was that

between a 30 to 40 per cent increase in the fee was about right to compensate. Some companies asked for a big whack more than that last year and some did not.

But there is another very important element. You mentioned the word 'options'. Again, reducing governance to its most simplistic form—and it really is simple—what are the board doing in the middle between the owners and management? The answer is they are supposed to be doing a job for the owners in monitoring management strategy and performance. That is all they are there to do. If they cannot do that, they are a waste of space. The whole idea is that they really are the agents of the owners. They should represent the owners' interests. Where we are at the moment in the whole sort of panoply of governance is that in the past shareholders, for a variety of historical reasons, abdicated that control of the board and it was taken over by management, but now they are fighting to get it back. That is where it is all at. They are going to win because basically they have the money in the pocket, which makes the difference. They can decide which companies they will invest in. Over the long term, that is what will happen. It is just a question of time.

But conceptually, therefore, if that is what the board's job is, they need to be remunerated in a way which is totally different from management. They should not have the same financial interests as management. So that is why best practice says they should get a fee but they should have some of their money at risk, just like shareholders. So many companies are now introducing and have been introducing over the past few years a scheme. A very good tax-effective scheme is available now known as the NEDs scheme, under which a portion of a director's annual fee gets sacrificed and applied to buy shares in the company—normally those are bought on the market, because that avoids dilution of the existing shareholders, but it could be new shares that the company issues. Those shares are put in a box and kept in that box until the director retires or 10 years. There is a big tax advantage in that because the whole portion of the fee that is sacrificed goes to buy shares. Let us say he gets $100 and sacrifices $30 of that. The whole of that $30 goes to buy shares. It is not taxed until he retires and leaves the company, when the profit is taxed.

You have two big advantages there. One is you get the compounding advantage of not paying tax. Your full $30 goes in to buy shares. If you paid tax on that $30 at the top marginal rate, only $15 might go in. So you get the compound effect of that. Then you pay tax only at the end when you know what your profit is. A lot of the problems with all the other schemes is that people have been worried about paying tax on them whether they are going to make a profit or not. With this scheme you pay when you actually have the money in the bank at the end. Because that very good tax-effective mechanism is available in Australia, there is absolutely no excuse for directors not having this type of scheme, which achieves the objective of putting them in the same risk profile as shareholders. They have a significant amount of their money at stake in the company. When you have your own money in the company, that tends to make you concentrate on your job.

**Senator CONROY**—Thanks for explaining how directors can transfer their risk from themselves and shareholders to taxpayers. I want to have a chat about—you did mention this a little earlier in your introduction—the Business Council's opposition to a number of these propositions. I just wanted to go over with you the non-binding vote issue again and the attitude of the BCA to the executive remuneration debate. I sense that the Business Council have their heads in the sand and that they are trying to resist a worldwide phenomenon. Ultimately this

wave of shareholder activism will make the Business Council just irrelevant like dinosaurs. Could you recap your thoughts on the non-binding vote particularly?

**Mr Easterbrook**—As I said, it is a mechanism and an incentive for getting boards to do a better job, to compel them to produce a useful remuneration report which has useful information in it particularly for institutions so they can analyse the company's remuneration structure and see whether they think it makes sense in the light of competitor companies and everything else. If they are facing the prospect of a public opinion being made known on whether or not that report is acceptable to the shareholders, then that is likely to encourage them to make sure they do a good job on the remuneration side. A lot of the problems that we have had in the past few years on remuneration is, frankly, because they have not. They have not handled remuneration as well as they should have.

**CHAIRMAN**—Senator Conroy, do you have much more?

**Senator CONROY**—Fortunately we have lost a couple of witnesses tonight, so we are actually running at least two hours ahead of schedule. But thanks, Chairman.

**CHAIRMAN**—No, we have lost only one witness. We made up half an hour, which we have lost already.

**Senator CONROY**—I just wanted to go back to the concerns that you raise in your submission that some companies are not complying with section 251AA of the Corporations Act, which requires listed companies to disclose to the ASX the aggregate proxy instructions received by the company in each category of 'for', 'against', 'at proxy discretion' and 'abstain' on each resolution put to the vote at the company meeting. Could you advise the committee of your concerns and how it could be improved?

**Mr Easterbrook**—I think it is very simple. The reason this breach has occurred is that enforcement has really fallen through the gap between the ASX and the ASIC. The ASX tends to take the view that, where there are governance provisions in the Corporations Act, it is ASIC's job to enforce them. The problem is that, because ASX is the basic regulator of the listed companies, ASIC does not know about them. I have not had a chance to say much about this proxy voting report, but we regard it as a very significant report. We have raised a number of issues in there both for parliament and for the regulators.

More broadly is this issue of what we call the regulatory gap. Frankly, we are amazed that the regulation side, in which I include parliament and the regulators, not only does not do anything about it; it does not seem to be alert to it. We have the governance protection of investors partially in the listing rules and partially in our Corporations Act. Every company that is listed on the ASX has to obey the listing rules, but only Australian-incorporated companies have to obey the Corporations Act. We have a number of foreign-incorporated ASX listed companies, which do not have to comply with the governance protection in the Corporations Act because they are not governed by the Corporations Act. ResMed is a good example. It is a US company. It does not supply the remuneration disclosure in section 300A of the act because it is not subject to it. So you have this regulatory gap between certain companies. There are some companies which are listed in Australia but are not subject to our Corporations Act. We are here debating a whole lot of things for CLERP 9, but those companies will not be subject to that either. We think

something needs to be done about that. That is on page 7 of our submission. It is an important issue. Those companies also do not have to comply with 251AA, which is to provide the proxy voting disclosure, and they do not. Foreign-incorporated companies do not do it. So we do not know what the level of voting is in those.

**Senator CONROY**—I wanted to go to that point next. I understand that you are about to present a report on that matter. I wanted to hopefully draw from you your intelligence on that report, but I understand you have not released it yet and it is a commercial document. I was hoping that if we went in camera you might be able to speak to us in a confidential manner about that, if that would assist with your evidence to the committee.

**Mr Easterbrook**—Yes, I am happy to do that. It is just simply that we have put an embargo on it till Thursday and a number of journalists are presumably writing on it, and it would not be fair to them if someone were to pre-empt them; that is all.

**Senator CONROY**—Sure. I think that is a very fair request. Chairman, Mr Easterbrook has requested we go in camera briefly.

**CHAIRMAN**—How long do you need?

**Senator CONROY**—Five to 10 minutes at most. Then we will be finished. Do we need a motion? I am not sure what the procedure is.

**Mr Easterbrook**—While we are waiting, can I emphasise those points that I did not get to on page 7. In relation to that report is point 4 on page 7. We think there are some very significant things in that proxy voting report, and we draw those to your attention. We have listed on page 7 some specific things we think you need to pay attention to.

**CHAIRMAN**—Thanks. Mr Easterbrook, could you give us a brief statement outlining the reasons why you wish to move in camera?

**Senator CONROY**—This is just a formal process we have to go through.

**Mr Easterbrook**—We have issued this report to a number of journalists with an embargo date of Thursday. They are presumably working on writing about it. If it is not in camera, another journalist who might be watching this could pre-empt them; that is all. I do not think that is fair.

**CHAIRMAN**—Is it the wish of the committee that we proceed in camera?

**Senator CONROY**—It is.

**CHAIRMAN**—There being no objection, we will now proceed in camera. Could everyone other than members of the committee leave the room, please. We will call you back when we have finished our in camera session.

*The following evidence was then taken in camera but the committee and witness subsequently agreed that it could be made public—*

**Senator CONROY**—Could you advise us of what your report on proxy voting has found in terms of overall voting in this country?

**Mr Easterbrook**—I do not know whether the chairman and you have a copy of the report?

**CHAIRMAN**—Yes, we have.

**Mr Easterbrook**—The most important bits of it are pages 4, 5 and 6. They are, if you like, an executive summary. This is the fourth report of this type that we have done. We have looked at the proxy voting returns to the ASX under section 251AA, and we have made a database of all the resolutions that were voted on in 2003 amongst 161 widely held major ASX listed companies. We did similar things with the 1999 and 2000 data. For some reason we did not do it in 2001 and we did it again in 2002. Point 1 shows that the average total voting capital in widely held companies is slowly increasing. In 1999 it was 32, in 2000 it was 35, in 2002 it was 41 and last year it was 44. That is way below the UK at 55 per cent, the USA at 80 per cent and other countries—Germany is about 70 per cent. Probably the best comparison is the UK because we have very similar systems. The UK, by the way, are not happy with 55 per cent; they want to get it up.

Probably the most interesting single piece of paper in this whole report is page 24. Page 24 of the report has figures that we got from a large custodian, JP Morgan. Custodians hold shares in major listed companies for investing institutions. They hold them for a number of different investing institutions. The right-hand dark column shows the percentage of total voting capital in 2003, according to our statistics, in these major listed companies on the left. That is how much of the share capital was voted in those companies, and you can see there is quite a variation. There always is a variation, although the companies do not tend to differ that much each year.

You can compare those figures there with almost any of the figures in the next three columns. The ‘Australian Clients’ column was what JP Morgan found was the voting last year by their local institutional clients when voting was made much easier for them when the system was improved with the use of an electronic platform. Taking Amcor as an example, the total vote in Amcor was 47 per cent.

**CHAIRMAN**—That is of all shareholders?

**Mr Easterbrook**—Yes, it is 47 per cent of the total voting capital.

**CHAIRMAN**—Yes, of the shares?

**Mr Easterbrook**—Yes, of the shares. But the percentage that was voted by JP Morgan’s Australian clients was 85 per cent.

**CHAIRMAN**—Nearly double.

**Mr Easterbrook**—Yes; that related to their Australian clients. Those are Australian institutions. The next column shows the percentage that was voted by their international clients, which are offshore institutions. If you add the two together, you get 73 per cent. But, if you look

down there, you will see there is a huge difference. More or less whichever company you want to take, there is a much bigger vote by JP Morgan's clients than by all shareholders.

**CHAIRMAN**—This vote occurs as a result of JP Morgan basically trying to activate the clients?

**Mr Easterbrook**—Yes, trying to activate the clients, making it easy for them.

**CHAIRMAN**—So JP Morgan do not automatically hold the proxies?

**Mr Easterbrook**—No. They are just a conduit.

**CHAIRMAN**—They have to organise it each time.

**Mr Easterbrook**—They are the custodian. They cannot make any decisions. They execute what they are told. Under our system, the fund managers cannot, for security reasons, hold the shares themselves.

**CHAIRMAN**—But they actively seek authority to vote the shares?

**Mr Easterbrook**—Yes, and it is all centred on the introduction of one particular voting system, which I understand is called VoteX, which is an American platform. Some of our clients actually use it, and we will probably go onto it next year. We are in discussions at the moment with the owners of it. This shows what the potential is to increase. If all the other Australian custodians did the same thing, you would expect that to impact that right-hand column. Roughly two-thirds of the market is in the hands of institutions. JP Morgan are about the second biggest custodian in the Australian market. They made this big effort last year. There is a bit of a crusader in there. A chap by the name of Graeme Arnott is the person in JP Morgan who is—

**Senator CONROY**—Good man.

**Mr Easterbrook**—He is almost as keen on proxy voting as we are—it is amazing. But it has been sort of his crusade. He regards it as a competitive advantage, and here is where the market is working, because he is saying: 'Look, I can make it easier for you. Your clients are wanting you to vote, fund managers. I can do it easily for you. Come and let me be your custodian.' So this is the market working. He expects that to last for only a short time, until all the others are forced to pick it up. But this shows that there is significant potential to lift that figure if all the custodians do it, and I think from a policy point of view parliament ought to be encouraging that.

Going back to page 4, points 1 and 2 end up saying we ought to be able to get that figure of 44 per cent up. Then point 3 says that last year a few resolutions actually got withdrawn. The company pulled the resolution off the agenda, presumably because it was going to lose the vote. It is less embarrassing to pull the thing than to actually lose it. Just pausing there, that is why we say we want that loophole in 251AA plugged. We think shareholders are entitled to that information because, if the company pulls the resolution, even though it has the proxy votes on it, it does not have to disclose them under 251AA with the way that 251AA is currently drafted. We think that should be changed.

All of the rest—and there were 874 of them—went through. Point 4 says, yes, there were some against votes, and the against vote is starting to go up in some cases. Page 12 has some details on that—the top five votes against. But looking at our analysis and recommendation on those 880 resolutions—and this is more or less typical every year—we tend to have problems with about a quarter of them. At the bottom of page 4 we are at pains to point out that our instruction from our clients is that we are always to hold the bar high, because we are a sort of independent referee saying, 'Best practice would say this,' and on best practice we might say it should not go through. As a practical matter it may be perfectly valid to let it go through. So that is what we are saying at the bottom of page 4 and at the top of page 5.

But the punchline I suppose is the second paragraph at the top of page 5, where we say that in our experience:

> ... there is always a hard core of Board sponsored resolutions each year, mainly relating to remuneration, which, in CGI's view, do not merit shareholder support on any rational basis. Those certainly exceed the single digit number of withdrawn resolutions referred to in 3 above.

Six resolutions out of 880 were withdrawn, and we are saying that certainly in our view there were more than six resolutions that really ought not to have gone through. So we are saying that happened in six cases. It is not just a question of getting the vote up; it is a question of getting the educated vote up.

We then say that we really need to pick up on some things happening overseas. So we have made a number of recommendations, which are set out on pages 5 and 6. We have started off by saying: 'Let's pass the ball to the industry bodies. The institutional industry bodies should get down and do some homework on it.' But at point 5 on page 6 we say that there are certain things that parliament and the regulators should look at, and we have listed them there and they are repeated in our submission. We think you should keep pressure on the industry bodies—ACSI, ASFA and IFSA—to get on with the job, as we have said in points 1, 2, 3 and 4. You should plug the loophole in 251AA, and we would suggest that should be done in CLERP 9. It is relatively easy to make an amendment to do that.

Next, we think that due compliance by ASX listed companies with 251AA should be policed. Some companies are not following it now. We originally chose 171 companies that we reported on to do this survey on. We had to toss out 10 of them because we did not have the stats. So you should police due compliance with 251AA.

You should also do something about this regulatory gap that I have referred to whereby some of the protection is in the listing rules and some is in the Corporations Act but listed entities in Australia which are not Australian-incorporated entities are not caught by the Corporations Act reforms. You need to do something about that. These are not just the things I have been talking about. There are some other important things in the Corporations Act that these other companies are not subject to. From parliament's point of view, you need to get ASIC and ASX talking about that and doing something about it.

**Senator CONROY**—You would be aware that IFSA has produced a study that shows that fund managers vote on 92 per cent of all resolutions. Is that a credible figure, given your statistics? Why are IFSA's statistics routinely higher than CGI's?

**Mr Easterbrook**—Going back to page 4, Computershare has told us that the level of ownership of ASX 200 companies by Australian institutional investors is about 36 per cent. I think IFSA's figures—and it uses the Australian Bureau of Statistics figures—say it is 25 per cent. I think Computershare is probably more accurate. IFSA has been saying, 'Well, of the 40-odd per cent that is voting, our 25 per cent is in that figure.' It is impossible to tell, frankly, whether or not that is correct, but probably the correct figure is 36 per cent compared with 44 per cent. We know the 44 per cent figure is correct, and we think that the Computershare figure is correct—it is based on its research and the work it does on registers et cetera. That is a question that you perhaps ought to pursue with IFSA when it gives evidence.

But I again stress that two things need to be done. One is that we ought to get that level up, because 44 per cent clearly is not enough—and there are all sorts of issues. If the voting level is very low, it means that small groups of shareholders are much more influential, and that should not be the case. This 44 per cent is an average. It ranges from about 19 per cent up to about 60 per cent. In some companies the level of voting is very low. If only 19 per cent are voting in a widely held company and you have a group of shareholders who have five per cent, in reality they have 25 per cent of the vote. That is one of the reasons why we want to get this vote up: so that small interest groups cannot have the degree of leverage that they currently have.

**Senator MURRAY**—Something about voting has been taxing my mind for a long while. I believe that any institution which holds shares on behalf of someone else—however you refer to that institution, as a trust or a fund or whatever—in a broad sense does so in escrow. In those terms, I believe they have a duty to care for the interests of those who own those shares, which to me means they have to vote. A number of funds and institutions do not vote and therefore, I think, breach their duty of care. I am one of those who believe there should be a compulsory vote to ensure that the proper spread of interests is reflected.

When I put that proposition to managers and owners of the trusts, funds and institutions, they say, 'It will cost us a lot of money to do the analysis,' and I say, 'Part of the basis of holding somebody's shares for them and acting on their behalf would entitle you, in my view, to charge a small fee and to recover the costs for a proper analysis and execution of your duties'—as any trustee would in a trust situation. What is your view on compulsory voting for any circumstance where in the broader sense a share may be deemed to be held in escrow and a duty of care is to be therefore applied?

**Mr Easterbrook**—If we break that down, I agree that if you are looking after other people's money you have a duty to act in their best interests. I am not sure I would agree that it is held in escrow, but you are holding it as a fiduciary. As to the issue of compulsory voting, one of the concerns we express in our report is that there are two issues: we need to get the voting level up, but we also need to get the considered voting better. We have given you examples here. We had problems with roughly 25 per cent of the resolutions we looked at. Even though we held the bar very high, you could say that in a lot of those on a practical issue we might make a different decision. But there are some what we refer to as no-brainers. When someone within CGI says, 'Oh, here's another no-brainer,' a no-brainer is a no-brainer; yet that will still go through. We do not have stats on how many of those there are—we do not keep those—but there are certainly more than the six resolutions that were withdrawn last year that we looked at.

So we need to do two things. It is very important to not only get up the voting but also improve the quality of voting. What worries me about making voting compulsory is that you will get the level up but you will get the quality going down. At the moment we do know that the people who take those responsibilities seriously are voting. If you flood them with a whole lot of ill-considered voting, you may go the wrong way.

**Senator MURRAY**—That is why I linked a charge to the duty: because, if sufficient moneys were to come in to fund the analysts who must examine the resolutions, you would not have that effect. It seems to me that institutions and funds have exhibited an unwillingness to charge for servicing those shares they hold on behalf of investors.

**Mr Easterbrook**—It is not quite as simple as that. At the moment there is a lot of pressure on fund managers' fees, and that pressure really does not contain an element for doing what we call the ownership responsibility side of things, which is not just voting but all the other things—and I will come back to that and talk about it in a minute.

**Senator MURRAY**—Analysis, yes.

**Mr Easterbrook**—Yes. So one thing we have suggested to ACSI is that maybe the industry bodies should show some leadership here and say, 'You should separate the investment stuff from the ownership stuff and have an allocated amount to each.'

**Senator MURRAY**—Is that feasible?

**Mr Easterbrook**—I do not see why it is not feasible if they recommend that to their members and their members do that, and they require the fund managers to say, 'Okay, this much for that and this much for that.' You will end up with the same fee. The problem at the moment is that the good fund managers are doing this but the others are riding on their backs. That is a big financial problem. It is actually coming out of the good people's pockets, out of their profits. Also, because they are doing this, they are risking getting offside with some of the companies. So it is a very insidious situation. They are in fact supposed to do both. There is the pure investment bit, because there is supposed to be a bit for the long-term retirement future. We are not talking about what will be the results next month or next year. At the end of the day they will have to pay out their members. They are supposed to be looking after the investment side and the ownership responsibility side, so it is perfectly logical to say how much for this and how much for that.

A very interesting development is occurring in the UK where Hermes—it has not yet been publicly announced—have been approached by another really large pension fund. That pension fund are changing their investment managers and have decided to effectively split it this way, because they are fed up with the ownership responsibility side not being done. They have come along to Hermes and said, 'We're not going to give you any of the investment management, but will you do the ownership responsibilities bit of it and give us a quote?' This may be the start of this type of thing happening in the market.

**Senator CONROY**—Can it be demonstrated why mandating is necessary? Clearly, the fund managers do not want to do the job. They do not want to rock the boat.

**Mr Easterbrook**—No, I do not agree. It is not just voting. I refer you to appendix 5, a very important document in here entitled 'International Corporate Governance Network Statement on Institutional Shareholders Responsibilities'. One of the recommendations that we are making in this report is that the three industry bodies—ACSI, ASFA and IFSA—take this and Australianise it. You should read appendix 5. It is really very tough, and it is not just about voting. As we say, this report has a section about two important reports. There is the new Myners report, which is basically associated with how you get the mechanics improved. Then there are these new ICGN institutional shareholder responsibilities, and I will read just a short bit from it. It states:

... to ensure that investments are managed exclusively in the financial interests of their beneficiaries ...

… … …

The general objective of these activities is to stimulate the preservation and growth of the companies' long -term value.

That is out of the first section. It also says that appropriate actions to give effect to these ownership responsibilities begin with voting but may extend to up to 10 other actions—I have listed them—which are all to do with constructive engagement with the company.

**Senator CONROY**—How many pension funds are represented on that committee?

**Mr Easterbrook**—Quite a lot.

**Senator CONROY**—Directly? How many pension funds are directly represented on that committee?

**Mr Easterbrook**—On this, I would have to go and check; I do not know.

**Senator CONROY**—A single digit starting with 1. Only PIRC are on there, Sandy.

**Mr Easterbrook**—No. This committee is actually chaired by the legal counsel of ABP—

**Senator CONROY**—The trustees of pension funds as opposed to the managers of pension funds?

**Mr Easterbrook**—Yes.

**Senator CONROY**—There is a difference.

**Mr Easterbrook**—The ICGN basically is controlled by the pension funds rather than the fund managers.

**Senator CONROY**—It is funny that I cannot find any pension funds who will tell me that; but that is one we can argue about later.

**Mr Easterbrook**—This appendix 5 is really taking the challenge up to particularly the fund managers very seriously because it has a whole section also on the conflict of interest situation,

which is another huge can of worms. So I would recommend, Senator Murray, that you look very carefully at appendix 5.

I was in Amsterdam last July when this was being debated. The way the ICGN works is that the various committees work during the year and they do a report which is then debated at the AGM when everyone gets together. The embryonic sort of statement was circulated prior to the AGM and then was debated at the AGM, which is right at the end of the conference. It was quite fascinating because a couple of large fund managers got up while this was being debated and basically said, if you understood the language, 'This is far too tough.' The pension fund representatives got up and said, 'Well, this is what we want.'

**Senator MURRAY**—I cannot find anyone who disagrees with your core propositions that, firstly, there should be the highest level of voting possible and, secondly, the voting should be of a high quality. Everybody agrees. The question is how you achieve that. If you have voting a dominant financial interest of anywhere between five per cent and 15 per cent and the non-dominant financial interest that bothers to vote is only one per cent and that is a very high-quality vote, it is worthless. You have to get in a sufficient number of votes as well as votes of sufficiently good quality. I would suggest to you that before quality the first priority is numbers—as shocking as that may sound—because it does provide a countervailing interest to the dominant financial interest which can direct or skew a company in the manner in which we are afraid.

It is a bit like the debate over our own democracy: whether or not compulsory voting is right. I am inclined to think that, providing you do not put any impediments to charging a fee so that you can afford the quality, if you mandate to some extent, in some way, at least some form of voting, you will not achieve the outcome that we are searching for. However, others argue that we are already getting there, that the numbers voting and the quality of voting are improving, and you do not need to act legislatively. That is why I am very interested in your reaction, given the depth of your experience and your understanding of international comparisons.

**Mr Easterbrook**—Things are improving, and the real reason they are improving is that the fund managers' clients are taking a much closer interest. Frankly, I think that is the way to go. If you want to mandate anything, mandate an obligation to carry out all the ownership responsibilities competently and faithfully.

**Senator MURRAY**—How would you describe those ownership responsibilities?

**Mr Easterbrook**—I suggest you take a look at appendix 5. That is what the ICGN suggests.

**Senator MURRAY**—Are you suggesting that we just draw those 10 points out of there?

**Mr Easterbrook**—You could do that. We have deliberately led a bit with our chin on this because one inference of this report is that we are being somewhat critical of some members of our client base—the fund managers. Not all fund managers are our clients, but most of the big ones are.

**Senator CONROY**—Would it be fair to say that they are passionately opposed to a proposal to mandate disclosure of how they vote? I use the word 'passionately'—

**Mr Easterbrook**—I can understand what they are talking about because in many cases the most effective way of getting things improved is through not just the vote but the other things you do with the company. That is why I think appendix 5 is very important: because it is saying there are all these other things as well. If you hone in solely on voting, you may get everyone concentrating in that area and not doing the other things which are equally important. From our perspective, we think disclosure is the way to go with CLERP 9, which is the way that you are going generally. We need to improve the mechanics on the electronic side, and we need to get better disclosure of that and to get that out in the public arena. As this report itself states, the industry needs to pull up its socks.

**Senator MURRAY**—Perhaps that is why there is a little disjunction between the two of us as we discuss this. I do not see that the core of CLERP 9 should be disclosure, although I think disclosure is an important part. I think the core of CLERP 9 should be the exposition of corporate democracy, because I think that provides you with the relevant checks and balances—and I deliberately use the comparison with a political democracy, a democracy of the people. Within that, the vote is one of the most important pillars. The vote in corporate life is far better than it was, but it is still not strong enough. If you are to achieve corporate democracy, I think you need to expand the vote. Disclosure, accountability, separation of powers and all those other things are part of the architecture.

**Mr Easterbrook**—I have two responses to make to that. One is that I think we still need to be a bit patient. I am concerned that, if you bring in mandatory voting, it will not improve things. We are seeing some improvement. We are seeing the clients of the fund managers getting much more interested in this area and requiring things to happen; so the market is starting to work there. That is the first point. If you rush in with hobnailed boots, I think you might tread on some very delicate flowers that are coming up—if I can put it that way.

**Senator CONROY**—It has been five years.

**Mr Easterbrook**—You have to be patient in this game. We have been in it for 10 years; I have learned a bit about patience.

**Senator CONROY**—It has been five years. It has moved about only three or four per cent, on your own figures, in five years.

**Mr Easterbrook**—Yes, I know. But the fact is that the quality as well as the quantity need to be improved. There is one other thing I would say. If you are going to mandate voting—and we recommend that it not be done at this stage because we think it is happening naturally and we should let it happen naturally—you must mandate well-considered voting, not just voting; otherwise people just tick boxes, and that would be disastrous.

**Senator CONROY**—But surely, given your description of all these flowers that are blooming and that people are paying more attention, that could not possibly happen.

**Mr Easterbrook**—I am concerned that, if you so change the rules of the game at the moment, you might have that effect. At the moment the trustees are getting their minds around this and many of them are saying, 'What should we be doing in this situation?' So they are still adjusting to it. The big ones have themselves organised; it is the next layer that need to be given time to

get organised. That is our advice. But, for goodness sake, if you are going to mandate voting, it must be expressed in such a way that it puts a legal obligation on them to have well-considered voting. Ticking boxes is actually dangerous.

**Senator MURRAY**—I accept that.

**CHAIRMAN**—As there are no further questions, we thank you for your attendance and your evidence, Mr Easterbrook.

**Mr Easterbrook**—Just before I leave, I again draw your attention to the last dot point on page 6, which refers to proxy solicitation and 'vote renting'. I think that is a major issue, and in appendix 6 I have given you the figures on Coles Myer.

**CHAIRMAN**—Thank you very much and thank you for your time with us this afternoon.

[5.59 p.m.]

**WILSON, Mr Stuart, Chief Executive Officer, Australian Shareholders Association Ltd**

**CHAIRMAN**—Welcome. The committee prefers that all evidence be given in public but, if at any stage of your evidence or answers to questions you wish to respond in private, you may request that the committee move in camera and we will consider such a request. We have before us the written submission from the Australian Shareholders Association, which we have numbered 22. Do you wish to make any alterations or additions to the written submission?

**Mr Wilson**—No.

**CHAIRMAN**—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

**Mr Wilson**—Thank you. At the outset I would like to make it very clear that the ASA supports very strongly the CLERP 9 suggestions. Perhaps I could go through some of those that we have most interest in. Also, from time to time I might mention some of the things that we think would strengthen CLERP 9.

In relation to audit reform, the ASA has long held the view that non-audit services should be not undertaken by audit firms. We feel that this clearly compromises auditor independence. Whenever a shareholder reads an annual report, typically the first thing that they do is look at the auditor's statement. So, before they ask themselves whether the figures in the annual report are good or bad, they want to know whether they are reliable. The provision of non-audit services via the auditor we feel compromises the integrity of the audit for two reasons. Firstly, in a financial sense, we have seen research that suggests that audit firms use a discount to the cost of the audit in order to obtain the additional higher profit margin non-audit services. Following on from that, because there has been that reduced fee for the audit, there seems to be a tendency for audit firms to perhaps use more junior staff or perhaps not be so rigorous in testing—although I have to admit that there is no actual evidence of that; it is really just anecdotal.

Just in recent times, with the National Australia Bank where the SEC in the US have requested additional information, because of the provision of non-audit services by the audit firm, it was pointed out by the National Australia Bank that this is not in contravention of the Corporations Act. But, in terms of governance, seeing the US ahead of Australia is really quite disturbing for the Australian shareholder. We would want to see at least the banning of non-audit services that are proscribed in the US legislation, such as internal audit, actuarial services, bookkeeping, valuation, legal services and management functions—senior executive secondment and the like. In addition, we feel that the use of the auditor for taxation advice and strategic taxation planning needs to be explicitly mentioned as a service that should be banned, and I think that the HIH Royal Commission pointed to that as well.

Going on to remuneration, like Sandy Easterbrook before me, we endorse the non-binding vote on executive remuneration, on the remuneration report. We have seen the UK experience of the non-binding vote. We have heard the concerns of the BCA and a number of other groups.

These really have not played out in the UK, and we do not expect that to occur here in Australia either. It will be interesting to see in May at GlaxoSmithKline's annual general meeting just how seriously they have taken the vote on the remuneration report and what they have done about it in order to retain investor confidence.

We also agree with the expansion of the definition of the term 'officer' under CLERP 9, and we feel that this will shed greater light on executive largesse in Australia. We endorse ASIC's powers to fine, as per our submission. We particularly endorse the shareholder participation initiatives in CLERP 9. This is a very important aspect for the ASA operationally. The profile of investors in Australia is largely at the retail shareholder end, and operationally it is very hard to get them to vote their shares. We feel that having a corporate proxy representative where an individual can appoint the ASA as their proxy will result in a vast increase in the level of voting activity by retail shareholders in Australia, and hopefully we will be able to take advantage of that at the ASA.

One of the things that have not been included in CLERP 9 is the requirement for listed trusts to hold annual information meetings. There is a separation of requirements between listed companies and listed trusts, property trusts and the like, where they do not have to hold an annual meeting to answer questions and be held accountable by their shareholders. Because of the structure of the trusts, there are a larger proportion of individual investors investing in property trusts because of the higher distribution yields; so we get constant requests from individuals to encourage listed trusts to have these information meetings. Some of the larger ones do. The turnout is very large, and it is very well participated in by the unit holders.

I will mention a couple of things about Labor's approach that we took particular interest in. One of those was a fund's requirement to vote and the fund manager's disclosure of their voting at annual general meetings. We are seeing a greater level of institutional participation at annual general meetings. We are seeing the larger investment companies actually disclosing their voting over the course of the prior year. I have just received quite a comprehensive report for AMP on, in particular, the more controversial aspects that they have voted on. So I am not sure whether legislating is the best way to go there, seeing that we are seeing movement and we expect that to continue over the course of this reporting season.

One thing that we do endorse is the disclosure of analysts briefings in the US. Analysts briefings are usually webcast, and we feel that they should be at least publicly available to, if not participated in by, the retail shareholders. The other thing that we endorse in Labor's approach is the banning of retirement benefits to non-executive directors. That has been discussed at length over the past few years. The last time I checked with the relevant bodies—the ASA, the IFSA, the AICD and the ASX Corporate Governance Council—they all believed that it is not a good idea to pay non-executive directors retirement benefits. So I do not think you would find anyone arguing that this could be repealed. Finally, I would like to say that it would be great to get the legislation up and running as quickly as possible, particularly for this reporting season.

**Senator CONROY**—We are very keen to facilitate that. I will defer to Andrew, as he missed out on questioning the last witness at length.

**Senator MURRAY**—I want to start with the mandatory voting issue. It seems that those who support compulsory voting have a number of options to consider, either determining what types

of institutions should have to vote or determining what broad class of things they should vote on. We have had one division suggested between investment decisions and ownership obligations. A third option is a limited list of things that are regarded as being the most important to be voted on. For instance, you might consider that, with the election of directors, you would really want someone who has a fiduciary duty or an escrow responsibility arising from their management of shares on behalf of others. There might be a few things that you would regard as being very important. What do you think are the most important things that institutions, funds or trustees should be voting on with respect to the resolutions that come to AGMs?

**Mr Wilson**—If I were a unit holder in a fund, I would expect the fund manager, first, to vote on any corporate action, such as a merger, a scheme of arrangement or the like. I think that would be the most important one. Voting on election of directors is also extremely important, as is voting on any proposals to increase the amount of equity in the company, either by ratification of placements or by executive and employee equity plans. I think also there will probably be a number of proposed changes to constitutions that would have serious implications, and they would have to be dealt with as well. So off the top of my head I think those four things would be the most important.

**Senator MURRAY**—There are many arguments put against mandatory or compulsory voting, as you are well aware. One of them is that the sheer volume of resolutions, many of them being machinery and technical resolutions, if we can put it that way, would just swamp institutions. Other people counter that there are software systems you can get to deal with that and so on. If the legislature were to dip its toe in the field of mandatory voting, would your preference be to limit it to being the institution which should vote or to the subject matter on which there should be a vote?

**Mr Wilson**—That is a good question. If we were going down this path of mandatory voting, I would say it would be the institution rather than the type of resolution. I guess I fear that clever structuring of resolutions to avoid any mandatory voting might ensue if you list the type of resolutions that one must vote on.

**Senator MURRAY**—But that would raise market concerns, wouldn't it, because people would identify companies that are into that type of thing? It would be pretty obvious, wouldn't it?

**Senator CONROY**—That is what is happening now on the floor of AGMs. Certain issues are not allowed to be raised. There is now the Boral precedent whereby they have repealed important sections of the Corporations Law by contracting out of it. I would like to think the market was concerned, but I am sure Mr Wilson shares my concern about the lack of concern of the market about some of those issues.

**Mr Wilson**—Yes. I think Sandy raised an issue where, if you appoint a CEO but the day beforehand you give him his options plan, you do not need to vote and shareholders do not get to vote on it. This happened four or five times last year, and, yes, it still goes on. Yes, there may be a small amount of market concern. There is a lot from the ASA but very little from elsewhere.

**Senator MURRAY**—I am becoming attracted to having in the electoral law on donations and also in the Corporations Law a general anti-avoidance provision—in other words, pretty well

following the tax act—that says, if the intention is to avoid compliance with the law, the anti-avoidance provisions kick in, which, as you know, is the strength of that provision in tax. How would you feel about a general catch-all device like that in the Corporations Law for regulators to use? It would catch this sort of day-before business with CEO appointments and so on.

**Mr Wilson**—If it could be caught and there were the resources there to implement the oversight of those sorts of resolutions, I would not have a problem with it.

**Senator MURRAY**—Talk to me briefly about binding and non-binding votes by shareholders on remuneration. The difficulty for me is where the board and management coalesce, which is where you have the executive director. Where there is a management person whose remuneration is established by the board and they are not a director, I have no quarrel with the board having the ability to sign that off. In fact, often it is not the board, as you know; it is a management committee. But where a director, whether executive or not, is to be remunerated by the board—even if it is a remuneration committee appointed by the board, it is still effectively a subsidiary of the board—surely with that conflict of interest the best protection for the shareholder is to have a binding vote on those matters. Why should it be a non-binding vote when there can be a direct conflict of interest with people determining their own remuneration?

**Mr Wilson**—Firstly, with executive directors I think there already is a binding vote on the largest part of their remuneration.

**Senator MURRAY**—Namely, the options and so on.

**Mr Wilson**—Yes, their equity component.

**Senator MURRAY**—So why not take it the extra yard?

**Mr Wilson**—I am sure there will be others who will argue that there is the separation of management from the board and, even though there may be an executive director, the non-executive directors in Australia by and large outnumber them on the board. There is also the requirement to act in the best interests of shareholders. I think also there is a closeness amongst the board. One of their key functions is to set remuneration, so they have to stay close to market rates, current practices and current trends in remuneration. They have a better feel for the executive's prior performance, not only in the financial sense but also in the other business skills as well. We are talking about taking away that responsibility from the board and putting it in the hands of shareholders who (a) might be quite removed from the company, (b) do not have that statutory requirement to act in the shareholders' best interests, and (c) perhaps may not even be particularly sophisticated. I think ASIC's recent report on individual financial education in Australia mentioned people's difficulty with working out percentages. Instead of asking these people to work out quite a complex structure of the many layers of an executive's remuneration package, have those appropriately balanced and then scale that against international counterparts, I think it would be much safer to have a non-binding vote on such a thing rather than a binding vote.

**Senator MURRAY**—But surely the most complex part of any director's package right now is already that which has the binding vote. There is nothing more complex than the various schemes that attach to share options or their realisation. The other point is that the greatest

concern is with excesses, not with what you could regard as reasonable remuneration. One of the possible concepts is for a binding vote to kick in above only a certain level of remuneration, such as 20 times male average earnings, $1 million or something of that sort. That would mean that for most executives, most directors, they are not in the mix, but those where there is the danger of excess would be caught up.

**Mr Wilson**—I think we would run the risk of having a clause in the contracts which anticipates the non-approval of the binding vote, which may actually exasperate the levels of largesse if it is voted down.

**Senator MURRAY**—I have many more questions but, due to the limited time available to us, this will be my last one. I am not sure yet of my own view, but I have wondered whether independence of non-executive directors would be better guaranteed if they had no right to own shares at all—in other words, if they were simply paid a fee for being a director and for their tenure they would know how much they would earn. It would distance them from the temptation which some directors have exhibited to participate in creative accounting to accelerate the value of their shares or to participate in company behaviour which might benefit short-term shareholders to the detriment of the long-term value of the company and so on. I am not casting aspersions on the general class of directors but, human nature being what it is, there have been people who have not behaved properly. Do you think it would be an overkill to prohibit the ownership of shares by non-executive directors?

**Mr Wilson**—It may well be. As Sandy Easterbrook said, quite a number of companies have instituted these director share plans where directors forgo, say, 20 per cent of their fee for shares which are usually bought on market. I hardly think that a director would consider playing around with accounting standards in order to increase that component of their remuneration. So I am not convinced that that would be the case. The other point that is often raised with us is that shareholders feel more comfortable when directors have some interest in the garden, even if it is a small amount of interest. When it gets large, that is when I think the independence question becomes more relevant.

**Senator MURRAY**—One reason I have toyed with this in my head—and I must stress that I have not come to a conclusion—is I read what was going on in America and saw the figures which claimed that by not expensing all the options that were out there profits had been overstated by 13 per cent, I think it was. I cannot vouch for whether or not that is accurate, but that was the view. Not expensing options has had huge effects on inflating profits in some companies. You would not have that temptation if you did not have any shares. Whether or not people were influenced, I do not know. There are no behavioural studies which show that. Essentially you are saying to us that your experience of interested shareholders in general is that they prefer those on their boards to have a stake in the future value of the company and not to just earn a fee? That is your evidence, isn't it?

**Mr Wilson**—That is the case. I think you mentioned before the word 'overkill'. My experience is as you said, but it also extends to the issue of non-executive directors owning options where there is a direct corollary between the expensing issue and the ownership of those options. So the current feeling from retail shareholders for a number of reasons is that non-executive directors should not participate in option schemes.

**Senator MURRAY**—And that they should be expensed?

**Mr Wilson**—And that they should be expensed, yes.

**Senator CONROY**—I want to touch on some of the issues you raised in your opening address. Your submission states:

> ... the ASA believes that to be absolutely certain that auditor independence is not compromised the auditor should be prohibited from providing ... all non-audit services to a company.

The ASA is proposing that, in addition to those services that are prohibited under Sarbanes-Oxley, all non-audit services should be prohibited. Could you advise the committee of your concerns with these non-audit services?

**Mr Wilson**—The issue of non-audit services, as I think I might have mentioned, is twofold. Firstly, in a financial sense, audit firms use the audit itself as bait for engaging in the non-audit services. A common argument that is thrown forward is that, because the auditor knows the business, they are better placed to provide the non-audit services and, 'Hey, we're giving you the audit for next to nothing, a few hundred thousand dollars,' and with that there is an expectation that they will be granted those more lucrative non-audit services. So, irrespective of what the audit service is, that financial incentive to get those non-audit services fundamentally compromises the independence of the audit.

**Senator CONROY**—The good news is that you have parliamentary privilege here; you can call it as you see it. Your submission says that, at a minimum, the services prohibited under Sarbanes-Oxley should be prohibited with the addition that there be strategic tax advice. Why do you think that strategic tax advice is a problem? Is it just that it is part of the overall quantum that could be greater than the fee for the audit, or is there something specific there?

**Mr Wilson**—No. I think the ones that are listed in Sarbanes-Oxley effectively relate to auditors marking their own work. One that has been left out in the US is strategic taxation advice. So where a company seeks advice on minimising its taxation and then having the auditor come back and say, 'That advice is correct and the amount of tax that you paid is correct,' we feel is one of those fundamental conflicts.

**Senator CONROY**—In light of the concerns you have raised today, is the current requirement under the CLERP 9 bill for disclosure of the non-audit services and a statement from the board that such services do not compromise audit independence sufficient?

**Mr Wilson**—No, it is not.

**Senator CONROY**—I want to talk about the cooling-off periods. The CLERP 9 bill requires a two-year cooling-off period before a member of an audit firm can join a former client. Does your organisation support a two-year cooling-off period, or do you support Justice Owen's recommendation in the HIH report that four years is an appropriate cooling-off period?

**Mr Wilson**—We supported the original HIH recommendations of four years. I guess we were quite concerned at some of the industry bodies' comments about the lack of career paths for their members.

**Senator CONROY**—Do you think they got it?

**Mr Wilson**—Yes.

**Senator CONROY**—It does not sound like it.

**Mr Wilson**—We were not swayed by that argument. We did not feel that a four-year gap would compromise the quality of the audit, so we could not see any reason for it to be reduced.

**Senator CONROY**—The CLERP 9 bill requires the CEO/CFO to sign off to the board on the financial accounts. However, the ASX corporate governance guidelines and the approach taken in the US go much further. Both require that the sign-off by the CEO/CFO should say that the statement is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board. In your view, should the CEO/CFO sign-off under CLERP 9 extend to a sign-off on the company's risk management procedures?

**Mr Wilson**—The ASX Corporate Governance Council have given risk management its own chapter. The Group of 100 were very supportive of it and provided a great deal of additional information for CFOs to ensure that their risk management processes were in place. We agree that the ASX approach is more favourable.

**Senator CONROY**—One of Justice Owen's recommendations relates to alternative accounting treatments. He states:

Where alternative accounting treatments are reasonably open from the reading of an accounting standard and the difference between those accounting treatments is material, the impact of the position taken by the reporting entity should be explained in the audit report.

Do you agree with that recommendation by Justice Owen?

**Mr Wilson**—That is a good question. I guess this is a question of how far we go. The auditor did put in the HIH accounts, I believe, an emphasis of matter in relation to some reinsurance contracts. I am not sure whether that is what Justice Owen was referring to. But I guess the question is: how far do we go? Do we put in the minutes of the audit committee report? Do we put in the minutes of the board considerations? I would be cautious of backing a line along those lines.

**Senator CONROY**—You heard CGI, the witness before you. CGI has suggested reintroducing the requirement for shareholders to approve the reappointment of the auditor at the AGM. What is the ASA's view on this proposal?

**Mr Wilson**—The first I have heard of that proposal is this afternoon. I understand that shareholders can move a motion to remove and replace an auditor at any time if they have the required number of votes.

**Senator CONROY**—They do this week. You never know: by next week it may be gone from most companies' constitutions.

**Mr Wilson**—Yes. So I am not sure. It certainly has been an issue that has been raised by our members—let's put it that way.

**Senator CONROY**—As you are aware, ASX listing rule 12.7 requires companies within the ASX All Ordinaries Index to have an audit committee. In your view, should CLERP 9 mandate the audit committee requirements that have been set out in the ASX corporate governance guidelines? Those requirements include that the audit committee have, for example, only non-executive directors, a majority of independent directors, an independent chairperson who is not the chairperson of the board, at least three members and a formal charter.

**Mr Wilson**—If you are referring to every company or even every listed company, I think it is a tough question to answer. I would imagine that shareholders in companies outside of the top 200 would be concerned at the additional layer there, assuming of course that the board as a whole would take responsibility for the audit committee function in those instances. But I guess as an ideal principle, yes, we support the implementation of those properly structured audit committees.

**Senator CONROY**—Should the CLERP 9 bill also require companies within the ASX All Ordinaries Index to have appropriately composed remuneration and nomination committees as well, or are the ASX corporate governance guidelines sufficient in this regard?

**Mr Wilson**—I think that remuneration and nomination committees have a very good function. However, I think that having the board outside of any particular candidate collectively deliberating on those sorts of decisions would be sufficient for most shareholders.

**Senator CONROY**—You had a discussion with Senator Murray about the non-binding vote—and obviously you support it, as opposed to Senator Murray's proposition. The non-binding vote has been criticised by the Business Council of Australia on the following basis:

> It would be reasonable to expect that expanding the current disclosure system—while appearing to empower shareholders—would contribute to an increase, not decrease, in overall pay levels.

Is the BCA correct?

**Mr Wilson**—The BCA is wrong. In the submission I think I used as an example the investment banking industry, where you have only one listed entity in Australia, Macquarie Bank, that discloses remuneration. We have no idea what all the others are paying their people. But, taking Macquarie Bank's figures, you would say that the non-disclosure of the industry generally has not in any way reduced the level of remuneration. Out there there are networks, there are remuneration consultants, there are remuneration experts. This information may not be as public in the investment banking industry as it could be. But the people who need to know what those figures are do, and they use that information to their best advantage. I think that reducing disclosure would have no impact.

**Senator CONROY**—On the BCA's logic, reducing disclosure would lead to a fall in salaries, for God's sake. Let's just end all disclosure; that would solve it. We would have salaries plummeting. Senator Murray, will you be in that?

**Senator MURRAY**—Absolutely. That is very good logic.

**Senator CONROY**—That is about as good as the logic in the other direction. Your submission states that the ASA believes that all equity based remuneration schemes should be approved by shareholders prior to implementation. You would have heard us have a bit of discussion with Mr Easterbrook about that. Could you advise us why you believe shareholders should approve these equity based schemes? I know you did mention a little earlier the rort where I think you mentioned at least five companies slipped a package to their incoming CEO—what I often call a 'golden hello'. Why do you believe shareholders should be given a vote in this issue?

**Mr Wilson**—I guess this is one of those fundamental rights. Wherever there is a potential increase in the amount of equity and therefore the potential dilution of shareholders' funds, there should be some sort of shareholder approval to have that enacted. It is a fundamental right for shareholders, and to get around that by devious means is plainly just not right.

**Senator CONROY**—Should approval of equity based remuneration schemes be binding as opposed to non-binding?

**Mr Wilson**—Equity based, yes; absolutely.

**Senator CONROY**—The previous parliamentary secretary to the Treasurer, Mr Ian Campbell, said that the government would require upfront and real time—he has quoted that to me at least 50 times in parliamentary debate—disclosure of executive contracts. The CLERP 9 bill fails to implement this requirement. However, the ASX listing rules were changed in May last year to require disclosure of material parts of a CEO's contract. In your view, should the requirement to disclose executive contracts in real time and upfront be extended beyond the CEO to other directors and senior managers?

**Mr Wilson**—That is a good question. Should it be extended? I guess there may be some rare circumstances where it could be—where the CEO is not the key person in the company. I think Microsoft might have that situation at the moment. So I can see limited scope for that, yes.

**Senator CONROY**—You might have heard my discussion with Mr Easterbrook about the formula that exists currently within the Corporations Law in its section 200G. It states that shareholder approval for retirement benefits is required only where the payout exceeds the amount prescribed by the formula. For example, an executive director or director can obtain a retirement package without shareholder approval of—I listed before the criteria. In your view, should these types of payments be approved by shareholders?

**Mr Wilson**—In relation to executive remuneration, any non-equity based remuneration can be paid to the executive—and you can call it what you like, whether it be a performance bonus of $15 million or otherwise. Any of those payments being included in a non-binding vote would be sufficient for us. On saying that, though, we are currently pursuing a director who is looking to

be re-elected this year and it seems his sole reason for doing so is to click over the time until he will be entitled to his retirement benefit. We are appalled by this sort of thing.

**Senator CONROY**—Name names, Mr Wilson.

**Mr Wilson**—This is the former chairman of Aristocrat Leisure, John Ducker. At last year's annual general meeting he said that he would be retiring as chairman and retiring as a director in the near future. Because Aristocrat is a gaming company it needs all sorts of licences and approvals, so he could not have done it on the spot. All of the people who are required are now there but he has still not resigned, and he is entitled to his retirement benefit in a few months time. An annual general meeting is coming up in the meantime where he is standing for re-election. We are urging all of the shareholders to vote against his re-election. But it would be much simpler to get this particular aspect of the law out of the way. Like I said, all of the industry groups that matter seem to think it is a bad idea. So it really is quite redundant at the moment.

**Senator CONROY**—This formula is little known, I would probably say mainly because at the moment companies have just managed to find so many holes in the prescription that no-one takes it seriously anyway. But it is relevant now because of this new CLERP 9 draft, and that is why I have raised it. Because it is something that is relatively obscure, most people do not even realise that it is there.

Look at the sorts of figures that, under this bill we are talking about today, you are able to avoid putting under the scrutiny of shareholders. Under the formula—and I call this my 'greed graph'—if you have worked at a company for three years and you had a $5 million salary, which we talked about before, it is $17.5 million that does not require shareholder approval. The maths is simple: if you have worked at a company for five years and your salary was $4 million, it is $20 million; if you have worked at a company for seven years and you earn $4 million, it is $28 million.

My concern is, notwithstanding that we are hopefully going to get this non-binding vote and that will give shareholders a lot more power than they have currently got to take up these matters, you actually could find that they are making payments without shareholder approval, quoting this section of the Corporations Law back to you. Just for those relatively short periods they are able to come up with some truly extraordinary payout figures. You might think they could not possibly do that, but look at the sorts of examples we have talked about where five companies have slipped 'golden hellos' in and you have one director who is running just for his retirement benefit. If people have a loophole in the Corporations Law that they can exploit and it is worth $28 million to them, I have to tell you that I would expect them to exploit the loophole. You have a lot more experience of dealing with the loophole exploiters than me.

**Mr Wilson**—They have not. I guess it is theoretical, because they have not. I think directors do have a responsibility to act in the best interests of the shareholders, so we have not seen that enacted. I am not quite sure why it is in the law, but it seems to be—

**Senator CONROY**—But it is given new power because of this reference in the CLERP 9 bill; that is what concerns me. That is what has made me look this up and go, 'You can't be serious.' I have gone through it and done a few simple calculations, and it is just staggering the sort of

money that could be slipped past you and they can just go, 'Well, we didn't have to get your approval for it.' Maybe you want to look at that and think about it. It is obscure; most people do not know it is there.

**Senator MURRAY**—I was thinking of my econometrics and exponential growth.

**Senator CONROY**—It gets better. It is quite a doozey there, Senator Murray. I know that you would never be in it, but I tell you what! I want to briefly talk about the remuneration report. The regulations stating what will be included in the remuneration report have not been released, so it is difficult to say what shareholders will be voting on. In your view, should the directors' report require disclosure of the following in addition to disclosure of the executive's remuneration: the 'golden hellos' we have already talked about; equity value protection schemes—the things that we have seen in the newspapers a little bit; and the duration of their contract?

**Mr Wilson**—Yes to both of those.

**Senator CONROY**—Could you advise the committee of what the ASA's position is on non-recourse loans?

**Mr Wilson**—This is something that we have had quite a look at recently because we have seen an increased incidence of non-recourse loans to senior executives as a component of their share plan. We are not quite sure why this has been the case. But, if you take an executive option and you value it according to Black-Scholes, and then you take an executive share incentive scheme or performance share scheme that involves the purchase of a share using a non-recourse interest-free loan that is given to the executive by the company, the valuation is exactly the same. So we at the ASA have a dilemma where we say that we can approve option plans if they have relevant performance hurdles, but many of our members do not like the idea of an interest-free non-recourse loan to executives.

**Senator CONROY**—The idea, though, is to say what we want is to align interests. But, if it is not their money that is being put up, has the alignment really taken place? If they borrowed it off the company, is the alignment really there?

**Mr Wilson**—The alignment argument is not really used for the option schemes anymore because it clearly aligns executives' interests with option holders rather than shareholders. The same can be said because these schemes are really just synthetic options. But at this moment we have stopped short of saying that all non-recourse loans are bad because we can see the similarity between the two schemes.

**Senator CONROY**—I turn to ASIC's infringement power. Your submission states that you support the proposal to give ASIC the power to issue infringement notices in relation to breaches of the continuous disclosure regime. However, you suggest that ASIC maintains a record of infringement notices similar to the ASX announcements. Could you advise the committee of the purpose of such a register? Is this a shame file?

**Mr Wilson**—I think it is, yes. The amount of the fine will not impact the company, and therefore the shareholders, so we have no problem with that. Really, the big thing is the shame file. We would expect everyone to understand that the payment of a fine may not necessarily

mean that the company is guilty; it may mean just that the company feels it is the most efficient way to deal with the issue. But at the same time I think shareholders should be entitled to go to a register to see the repeat offenders' names when they are making an investment decision.

**Senator CONROY**—Presumably you believe the register should be public?

**Mr Wilson**—Yes.

**Senator CONROY**—Do you think ASIC should be able to publish the notice of infringement? You may be aware, if you have looked at it—this is a discussion I had recently with ASIC—that ASIC are not allowed to publish or publicise an infringement notice. It has to be after the final point, whether it is the settlement, the court case or whatever. That could be some time afterwards. So should infringement notices be published?

**Mr Wilson**—Yes.

**Senator CONROY**—I know this is an old chestnut for the ASA, but your submission notes:

> It is unclear what is required by a corporate proxy representative in order to nominate a representative to vote proxies given to the body corporate.

I know that has caused you a lot of concern in the past and a lot of smart lawyers can give you a bit of grief at times. What is the simple way to fix this?

**Mr Wilson**—Really, we just need some guidelines. We have had some very good relationships with the registers that we usually deal with with regard to this. So we just need to come to some sort of agreement whereby if someone appoints, for instance, ASA, or the shareholders association, that can be identified.

**Senator CONROY**—It could be Stuart Wilson or it could be any officer or agent of?

**Mr Wilson**—Yes, so long as there is a letter from the ASA saying, 'This person is the representative at this meeting.'

**Senator CONROY**—That is not contained in the bill?

**Mr Wilson**—I do not believe so, no.

**Senator CONROY**—I know that is something that you have campaigned on for many years. It is a relatively simple thing, you would have thought, to—

**Mr Wilson**—The general concept is contained in the bill, but we were querying just the mechanics of it.

**Senator CONROY**—I want to move on to Boral. Your submission says that, in light of the resolution passed by Boral in October 2003 which 'nullifies' the 100 shareholder test in relation to the proposal of certain types of resolutions for debate, an amendment should be made to

ensure that the Corporations Act takes precedence over provisions in a company's constitution. Are you concerned that other companies will try to follow Boral's lead?

**Mr Wilson**—We are concerned. I am sure that it is not intended towards the ASA that that particular Boral amendment was put through. I think it was also very concerning that the institutions waved it through as well. But we are concerned. We are considering testing that at Boral's next annual general meeting by putting forward a resolution perhaps to reduce the non-executive directors' fees, with the signatures of 100 shareholders attached. Yes, we are concerned. We think that it could very well be extended to other areas.

**Senator CONROY**—I am not sure whether you have had a chance to see all the Senate *Hansard* on it. We have had a lengthy discussion with ASIC about it, and it does seem that their interpretation of the law has the potential to be very broad ranging. I think it is very important to try to get it addressed. In your view, are Boral's actions consistent with chapter 8 of the CLERP 9, which relates to shareholder participation?

**Mr Wilson**—It is not consistent at all. You have a situation where a company is attempting to curb shareholders' rights.

**Senator CONROY**—You did mention this earlier in your opening statement, but your submission states that there is a separate set of rules for listed trusts. For example, listed trusts are not required to hold annual meetings for their unit holders. Could you just expand on your concerns in that area?

**Mr Wilson**—You have a situation where there are a large number of very widely held unit trusts. They have yield currently of between eight and 10 per cent, so they are very attractive to the individual who is retired and self-funded. At the same time you have a situation where at no time is there a meeting called where the people who run the trust have to stand up and report to the owners of the trust. At no time is a public forum held where someone can stand up, ask questions and criticise the trust—apart from the circumstance where a trust wants to get more money so it has to call a meeting to raise it. It is a deficiency that is really quite confusing to us because the structure is not that different; it is an investment that people make.

**Senator CONROY**—Would this be all or just ones that are widely held? I am just trying to get a sense of—

**Mr Wilson**—We suggested listed investment trusts, so those listed on the ASX. We have stopped short of calling for unlisted ones, but they could be even more widely held—the more popular trusts: the BTs, the Colonial First States. But we have stopped short of that at this stage. We just think that, whilst you have a regime for listed companies, it could be easily extended to listed trusts.

**Senator CONROY**—Your submission states that a five per cent threshold for calling a company meeting is too high. You suggest that the 100 member rule should be retained for companies listed on the ASX and that each member must hold a marketable parcel of shares with a minimum value of $500. As you know, we have debated the five per cent rule before. But what are the ASA's concerns around five per cent?

**Mr Wilson**—The ASA's concern is that that five per cent effectively locks out retail shareholders. We have from time to time attempted campaigns for a number of things and can get 100 shareholders' signatures, sometimes with some difficulty, but five per cent means that we are reliant on a large investor. Most of the time large investors have identical agendas to us, benefiting the end shareholder, but quite often they are reluctant to put pen to paper on calling a meeting. There has been only one time that the ASA have ever attempted to call a meeting to remove a director—a couple of years ago—and at that time we were able to get the requisite five per cent. But we have an internal view that, unless you are going to win the resolution, you should not call the meeting, but at the same time we do not want to see the shareholders' rights curtailed because it, quite frankly, could be the case where all the institutional shareholders agree with us and will vote with us but will not call the meeting because they do not want the media publicity, they do not want the bad blood with the directors' clubs or for whatever reason.

**Senator MURRAY**—Did I hear you say 100 shareholders with a marketable parcel of shares which should be of the value of at least $500?

**Mr Wilson**—That is a suggestion of ours. I guess we are concerned with the likes of NRMA, where you do not have a marketable parcel but are just a member. We are not drafters of legislation, but we can see the unintended consequence that that might lock out NRMA from that sort of thing.

**Senator MURRAY**—My point is simply that $500 can be very easily reached with some shares, and I wondered why you have not gone to a definition of what a marketable parcel would be—for instance, 100 shares.

**Mr Wilson**—I think that the $500 might well be achieved. But someone may have a $2,000 investment that tanks and loses 75 per cent of its value so is currently worth $500, and they are upset about it.

**Senator MURRAY**—I understand that. I just wondered, though, whether you need a marketable parcel to be defined as, for instance, 100 shares or some round figure so that it is very easily assessed.

**Mr Wilson**—I think there is some sort of a definition that it is $500.

**Senator MURRAY**—Not in the Corporations Law, as I recall.

**Mr Wilson**—I am not quite sure where, but there is something whereby companies can buy back unmarketable parcels or parcels of shares under $500 in order to clean up their register so that they do not to have send out annual reports, notices of meetings and that sort of thing. Shareholders have the right to write back to the company and say, 'No, don't.' But, if they do not, the shares are sold and the funds are returned to the—

**Senator MURRAY**—But, for certainty in this area, would you have any objection to a legislative proposal which determined for these purposes a marketable parcel as being, for instance, 100 shares?

**Mr Wilson**—No, I do not have a problem. I would prefer a dollar value.

**Senator MURRAY**—You can have both, you see.

**Mr Wilson**—Yes. No, I do not have a problem with that at all.

**CHAIRMAN**—There being no further questions, I thank you for your appearance before the committee.

**Committee adjourned at 7.01 p.m.**