July 2003

Investment & Financial Services Association Ltd

SHAREHOLDER ACTIVISM AMONG FUND MANAGERS: POLICY AND PRACTICE

A report conducted by the Investment & Financial Services Association of Australia

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Executive summary

The survey was commissioned to investigate levels of voting amongst Investment and Financial Services Association Ltd (IFSA) members, as well as to examine the other means fund managers use to influence companies in their portfolio to promote high standards of board and management effectiveness. The study thus examines the activities of the investment management industry in influencing the standard of corporate governance in Australian companies.

Methodology

The research was conducted in survey style, with 33 respondents offering differing investment styles completing the questionnaire. The Managers' funds under management in Australian equities (AEFUM) ranged from $190M to $25,600M. The combined AEFUM of all institutions taking part in the survey was $157,400M, which represented over 98% of the total AEFUM held by IFSA members. (IFSA members represent over 95% of funds under management in Australia). IFSA members' total AEFUM accounted for approximately 25% of the market capitalisation of the Australian Stock Exchange (ASX). The research was conducted solely with IFSA member companies.

Findings

The principal findings were as follows

- The two main methods of institutional shareholder activism, were voting and routine analyst visits with company representatives. Participants reported that an average of 40% of all time spent on corporate governance related activity in an institution is accounted for by voting. This was noticeably up on the 29% of time spent on voting reported in the Eureka survey published in February 2001.

- 81% of respondents considered direct contact with management and routine analyst visits and enquiries, the most effective method of influencing governance and business directions of companies in their portfolios.

- The average fund manager in the survey lodged votes on 92**%** of all resolutions where they had the opportunity to vote. (This result is dramatically up on the result from the Eureka survey, where 67% of institutions lodged votes on all resolutions put forward.)

  However, this figure masks three fund manager types:

  - Routine voters, who vote on at least 90% of all resolutions put forward, accounted for 91% of institutions in the sample and 98% of AEFUM in the sample. This result was noticeably up from the Eureka survey (2001), which reported that 59% of institutions routinely voted and accounted for 69% of AEFUM.
  - Routine non-voters, who are small institutions accounted for 3% of institutions in the sample, and less than 0.1% of AEFUM. (Eureka survey results showed that 11% of institutions and 4% of AEFUM fitted into this grouping previously).
  - Other voters, (called Discretionary voters in the Eureka survey), vote only on selected resolutions. There were two small to medium size institutions in this group, which accounted for 6% of institutions in the sample, and 1.9% of AEFUM. Unlike 2001, the 2003 survey does not reveal a clear group of "Discretionary voters". In 2001 discretionary voters accounted 30% of institution and 27% of AEFUM in the sample.

  When comparing the results of the 2003 and 2001 surveys it can be concluded that institutions that were previously "Discretionary voters" have now become routine voters. This reveals that the level of corporate activism as demonstrated by voting has increased significantly between surveys.

- 45% of fund managers have occasionally discussed their views on corporate governance related matters with other institutions in regards to trying to improve standards of corporate governance. This compares with the Eureka survey (2001), which reported 39% of institutions previously discussed their views with other institutions.

Overall the survey shows that shareholder activism is high amongst fund managers. Regular voting and contact with management were shown to be key areas of fund managers' ever increasing activism to raise the bar on corporate governance. Of all shares held on behalf of investors, 98% are routinely voted on all company resolutions.

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Research context

Introduction

IFSA is pleased to release the report "Shareholder Activism Among Fund Managers: Policy and Practice" which has been prepared following a survey of IFSA members and independently verified by KPMG. The report contains a great deal of information on the nature and levels of shareholder activism by fund managers in relation to their shareholdings in Australian companies.

IFSA would like to thank all of its members who participated in the various aspects of the survey and verification process conducted on a confidential basis. IFSA appreciates the time and effort provided by members to help provide a more comprehensive understanding of the nature of the shareholder activities of IFSA members.

Investment & Financial Services Association

IFSA is the national peak body representing the wholesale and retail investment management, superannuation and life insurance industries. IFSA has over 100 members who invest approximately $630 billion dollars on behalf of over 9 million Australians.

IFSA's mission is to play a significant role in the development of the social, economic and regulatory framework in which our members operate, thereby assisting members to serve their customers better.

IFSA works to achieve its mission by encouraging ethical and equitable behaviour by its members through the development of industry standards; contributing to the development of simple and efficient regulatory regimes; creating competitive markets; and contributing to a strong national economy by encouraging savings.

Background to Shareholder Activism Research

For a number of years there has been debate about the level of fund manager participation in corporate governance, in particular in relation to the voting of proxies.

In 2001, IFSA commissioned research by Eureka Strategic Research to survey its members on their nature and level of shareholder activism.

The objectives of the project were to:

- provide a comprehensive picture of members' corporate governance activities;
- assist IFSA to develop policies to promote good governance;
- identify obstacles to member participation in corporate governance with a view to developing strategies to overcome any impediments.

The 2001 Eureka report found a high level of voting and direct contact with companies among IFSA members. IFSA decided to refresh the survey figures in order to provide updated information regarding the level of activism by fund managers.

Share ownership in Australia

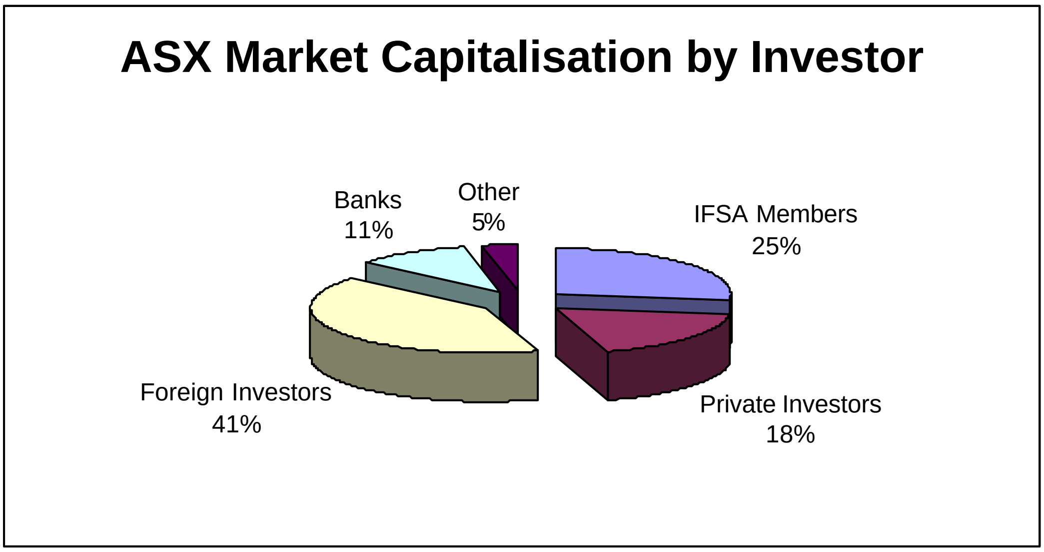
The following ABS data provides a breakdown of share ownership by type of shareholder from December 2000 to December 2002:

	Dec. 00	Dec. 01	Dec. 02
Private Investors	23.10%	21.77%	18.40%
Foreign Investors	34.84%	37.07%	40.57%
Banks and financial intermediaries n.e.c	9.35%	10.21%	10.64%
Super funds	16.18%	15.57%	16.06%
Life and other insurance corp.	9.31%	9.08%	8.61%
National, State and local general govt	5.86%	4.57%	4.15%
Private non-financial corp.	1.36%	1.79%	1.62%
Total	100.00%	100.00%	100.00%

Assets invested by IFSA members in the Australian equities market would include the following categories, Banks and Financial Intermediaries, Superannuation funds and Life & Other

Insurance Corporations. (However IFSA members do not account for the total amount in these categories).

As at March 2003, Australian fund managers invested approximately $160 billion in Australian domestic equities (source: ASSIRT). The market capitalisation of the ASX at March 2003 was $646 billion (source: ASX data). Therefore, Australian fund managers hold approximately 25% of the market capitalisation of the ASX. The remaining assets are invested in cash, property, bonds, venture capital, private equity, international equities and fixed income. IFSA member's percentage of the market capitalisation of the ASX has been increasing over the past three years, largely due to retail investors moving out of the market.



According to ABS data at December 2002, other significant investors in the Australian market include private investors (approximately 18%), foreign investors (approximately 41%) and other institutions.

Setting Best Practice through IFSA Guidelines

IFSA's long-standing policy on a number of relevant issues is contained in *Corporate Governance: A Guide for Investment Managers and Corporations*, which was issued in 1995 and rewritten and published as the 4th edition in December 2002. The publication is commonly referred to as the "IFSA Blue Book." The recommendations include that IFSA members should:

- encourage direct contact with companies, including communication with senior management and board members about performance, corporate governance and other matters affecting shareholders' interests;
- vote on all material issues at all Australian company meetings where they have the voting authority and responsibility to do so;
- have a written policy on the exercising of proxy votes; and
- report on voting activities to clients who have delegated the responsibility for exercising proxy votes to the fund manager.

IFSA's recently released an updated Standard Investment Management Agreement reinforces this policy by including several clauses which aim to clarify the rights of the investment manager to exercise the votes attached to shares being held on behalf of a client.

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Research methodology

The population base for the questionnaire was IFSA members (excluding those who were not fund managers, adopted a “manager of managers” style, or did not hold Australian equity portfolios). There were 33 respondents offering differing investment styles who completed the questionnaire.

There were four responses from multi-managers that were excluded from the sample to ensure there was no “double counting” of AEFUM. Although IFSA is aware that the majority of AEFUM held by these members was not accounted for by other members, it was considered necessary to exclude responses from these managers to ensure the integrity of the research.

The Manager’s funds under management in Australian equities (AEFUM) ranged from $190M to $25,600M. The combined AEFUM of all institutions taking part in the survey was $157,400M, which represented over 98% of the total AEFUM held by IFSA members. (IFSA members represent over 95% of funds under management in Australia). IFSA members total AEFUM accounts for approximately 25% of the market capitalisation of the Australian Stock Exchange (ASX). The research was conducted solely with IFSA member companies.

Following IFSA’s survey of its members, we commissioned KPMG to test a sample of survey respondents to provide verification of the aggregate levels of proxy voting by IFSA members, as stated in responses to the initial survey. The verification process and results are summarised in KPMG’s report to IFSA. The report states that the KPMG findings support the accuracy of the voting level results in the IFSA survey.

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Research outcomes

4.1 Methods used to influence corporate governance

The two main methods of promoting high standards of corporate governance identified in this research were voting and routine analyst visits and enquiries with relevant people in the company in question.

Although there are differences among fund managers in terms of the amount of corporate governance-related activity dedicated to voting versus routine analyst visits companies, almost all institutions engage in a combination of the two approaches.

Close to a half of participants (45%) reported that they occasionally make contact with other fund managers in assessing an issue that has arisen in a company in which the two (or group of-) institutions have invested. The Eureka (2001) survey found that 39% of managers made contact with other fund managers on corporate governance related issues.

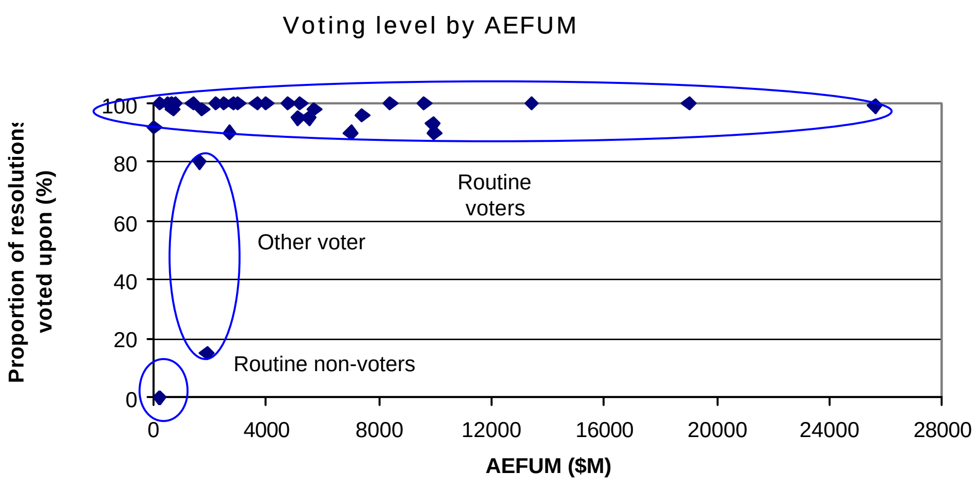
Of the participants who did not discuss views with other institutions on corporate governance related issues, 59% of these organisations stated that they did not due to concerns over the potential legal implications of forming collaborative networks.

4.2 Voting Patterns

On average institutions lodge votes on approximately 92% of all resolutions put forward by the companies in their portfolios. However, the data reveals two distinct segments of voters and a segment, which has become largely obsolete since the last proxy voting survey was undertaken by Eureka in February 2001.

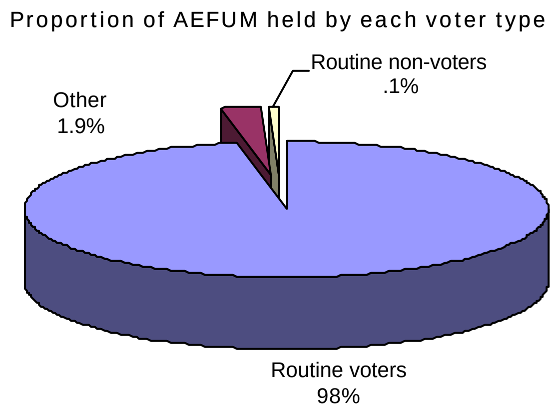
One of the distinct segments represents fund managers that vote on "almost all occasions" (Routine voters). The other distinct segment represents managers who "never vote" (Non voters). In the Eureka survey there was a third segment, which represented fund managers who voted on a few select resolutions (Discretionary Voters). However this segment appears to have become obsolete, as there were only two managers who fitted into this category. The other previous respondents in this segment have become routine voters, as the sample of routine voters has increased in this survey.

It is interesting to note that there is only one manager who is not currently voting their proxies. While this manager was small manager by FUM, it should be noted that many small managers are routine voter.



Among managers of all sizes, routine non-voters are a minority. Considering those managers holding in excess of $2,000M in AEFUM, all are routine voters. This pattern of results means that 98% of the investment in Australian equities is voted.

The pie chart below shows the proportion of AEFUM held by each voter type.



Looking at each segment separately, Routine voters vote on an average of 98% of all resolutions. It should be noted that this figure has been bolstered by the advent of the three largest index managers voting on between 90% and 100% of resolutions.

The following table summaries the characteristics of Routine voters and Routine non-voters:

Routine voters	▪ Vote on all issues ▪ May be small or large fund managers, but more often larger ▪ Represent 91% of respondents ▪ Account for 98% of AEFUM
Routine non-voters	▪ Never vote ▪ A Small fund manager ▪ Represent 3% of respondents (1 institutions) ▪ Account for 0.1% of AEFUM

4.3 Voting Policies

In the survey questionnaire, we asked respondents to indicate whether they had a formal voting policy, and if so to provide information regarding the policy. The results were as follows:

% of sample	Responses
94	Of respondents had a formal voting policy
	Of those managers that did have a formal voting policy
72	Were required to vote on all resolutions
16	Were required to vote on all material issues
12	Were required to vote at their discretion

Voting policies: Material and discretionary

Material and discretionary respondents were asked to provide details on the types of corporate issues in which their institution is likely to become involved. Specifically, there were two questions that addressed this:

- What types of corporate issues are considered "material" within your institution?
- What types of issues do you usually vote on?

Some of these issues are listed below:

- Issues that managers felt could materially impact on a company's operations and share price
- Management/Board remuneration – eg lack of, or inappropriate performance hurdles.
- Lack of sufficient independent directors on the Board.
- Approval of major asset sales or purchases
- Mergers or schemes of acquisition

4.4 Voting Results and Guidance

Voting decisions. 83% of all proxies, voted in favour of the company's resolutions. 12% were against the resolutions and in 5% of cases managers abstained from voting.

Client instructions. Approximately 0.5% (averaged over the sample) of all resolutions put forward are not voted due to the instructions of a client. This figure varies considerably between institutions, being as high as 7% for some fund managers.

4.5 Voting Disclosure

Disclosure of voting. The overwhelming majority of fund managers were against the notion of publicly disclosing the way in which they voted on a specific resolution, including institutions with a policy to vote on all resolutions. It appears that, regardless of whether a fund manager votes on all resolutions or not, the freedom to choose whether to vote is nonetheless important. Disclosing how they voted or requiring mandatory voting reduces this freedom and limits the options available for a fund manager to influence company's decisions.

Some of the reasons why fund managers stated they did not wish to disclose the way in which they voted were:

- That this information is commercially sensitive and disclosing this information may impact on the share price via negative publicity from the media, which may create greater volatility in the market in general.

- It may open fund managers up to pressure from lobby groups, which could interfere with their fiduciary duty to make decisions solely for the benefit of investors. This could lead to investment managers' time being taken up in explaining voting outcomes, potentially impacting investment performance, and service to clients.

- Public disclosure of how fund managers voted may give a misguided perception. Fund managers may have already brokered a better outcome than was initially proposed and thus they might vote on a resolution that may still be contentious to retail investors.

- Fund Managers' already report on how they vote to superannuation trustees, whereas there are very few requests from retail clients as to how fund managers vote.

- Public disclosure would result in information overload for investors, which would be meaningless to investors. One member reported that they voted on 1700 resolutions in the last financial year.

Institutional Investors. Fund managers generally report on how they voted to their institutional clients (such as Superannuation Trustees).

The table below outlines the frequency of reporting to institutional clients in regards to how fund managers vote proxies:

%	Frequency of reporting to Institutional clients:
32%	By quarterly report
14%	By annual report
14%	Not at all
50%	Other

Wholesale investors. Respondents where asked in the survey to what degree, "Have wholesale clients increased their interest in shareholder activities". The overwhelming response was that wholesale clients showed only a small increase in the level of interest in fund managers' shareholder activities.

Retail investors. 61% of respondents stated they have never been contacted by retail clients requesting information on the way in which they voted company resolutions.

Of those that had been contacted by retail clients the average number of requests in the last 12 months was less then 4 retail client queries per fund manager.

4.6 Effective influence: voting or routine analyst visits

An important question to ask is: what is the relative effectiveness of voting and routine analyst visits and enquires in terms of influencing the standards of corporate governance within a company in which an institution has invested?

Respondents were asked in the survey questionnaire to estimate the percentage of all the time spent influencing corporate governance (including administration), accounted for by:

1. Routine analyst visits
2. Direct contact in response to an issue that has arisen
3. Voting

Respondents were also asked to rank these three methods of influencing company decision making in terms of their effectiveness in achieving the fund manager's desired outcomes for the company. The table below shows the results of these two questions, averaged across the sample for both the Eureka survey and the IFSA survey.

	Mean of all corporate governance time spent on ...	Eureka (2001) survey result	Rated effectiveness out of 3	Eureka (2001) survey result
Direct contact in response to an issue	22%	21%	1.35	1.48
Routine analyst visits	38%	50%	2.38	1.77
Voting	40%	29%	2.27	2.71

The lower the score, the higher the method of shareholder activism was ranked on average (where 1 is the highest score).

It is interesting to note that the percentage of time spent on voting has noticeably increased from 29% of time in the Eureka (2001) survey to 40% of the time in this survey. This was followed closely by routine analyst visits (38%) and lastly direct contact (22%). Furthermore, it is clear from the rank-score means that direct contact is considered by far the most effective method of influencing board and management decision making. Yet direct contact accounted for the least amount of time spent on corporate governance issues. In fact, voting was considered only slightly more effective than routine analyst visits. However, presumably the fact that an institution has the ability and willingness to vote lends force to the comments of visiting analysts and direct contact on specific issues.

In determining levels of shareholder activism within the sample, it is inappropriate to consider only voting levels (or, for that matter, only levels of direct contact). Rather, the data collected in this study on the effectiveness, and frequency of use of the various methods of shareholder activism demonstrates that both voting and direct contact must be taken into account.