8 November 2007

Mr David Sullivan
Committee Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

Dear Mr Sullivan

Inquiry into shareholder engagement and participation

Please find attached the submission by the Australian Institute of Company Directors (AICD) to the inquiry into shareholder engagement and participation by the Parliamentary Joint Committee on Corporations and Financial Services.

AICD is the peak organisation representing the interests of company directors in Australia. Current membership consists of over 22,000 individuals drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors.

Thank you for providing an opportunity to contribute to this inquiry.

If you have any questions in connection with this submission please do not hesitate to contact me or Rob Elliott on (02) 8248 6600.

Yours sincerely

Ralph Evans
Chief Executive Officer

AICD SUBMISSION

Parliamentary Joint Committee - Corporations & Financial Services

Inquiry into shareholder engagement and participation

Table of Contents

INTRODUCTION 4

EXECUTIVE SUMMARY FOR PJC TERMS OF REFERENCE 7

Barriers to effective engagement of all shareholders in governance 7

Whether institutional shareholders are adequately engaged, able to participate 8

Pre-selection and nomination of director candidates (pp.33-38) 9

Advertising of elections and information about director candidates (pp 38-40) 11

Voting arrangements – direct and proxy (pp.40-44) 11

Conduct of annual general meetings (pp.44-48) 12

Effectiveness of existing communication/feedback mechanisms (pp.48-52) 13

The needs of shareholders with limited financial and corporate knowledge (pp.52-53) 14

GENERAL RECOMMENDATIONS 14

Legislative or regulatory change recommendations (pp.53-55) 18

CONCLUSION 19

FULL RESPONSE TO PJC TERMS OF REFERENCE 20

1 Barriers to effective engagement of all shareholders in the governance of companies 20

2 Whether institutional shareholders are adequately engaged, or able to participate, in the relevant corporate affairs of the companies they invest in 28

3 Best practice in corporate governance mechanisms 33
- a) Pre-selection and nomination of director candidates 33
- b) Advertising of elections and providing information concerning director candidates, including direct interaction with institutional shareholders 38
- c) Presentation of ballot papers 40
- d) Voting arrangements (eg direct, proxy) 40
- e) Conduct of annual general meetings 44

4 The effectiveness of existing mechanisms for communicating and getting feedback from shareholders 48

5 The particular needs of shareholders who may have limited knowledge of corporate and financial matters 52

6 The need for any legislative or regulatory change 53

CONCLUSION 56

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Introduction

> ‘Many forms of Government have been tried and will be tried in this world of sin and woe. No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government except all those other forms that have been tried from time to time.’
>
> Winston Churchill, Speech to the House of Commons, 1947

AICD supports the principles of transparency, accountability and engagement between boards and their shareholders and sees no imperative for changing the existing model of governance by directors. Australian companies vary in the degree to which these principles are employed in their interactions with shareholders. AICD’s submission highlights some well-regarded practices and further suggestions for public companies listed on the Australian Securities Exchange (ASX).

Australia has a world-class system of corporate governance, as indicated by recent international surveys of corporate boards. This, combined with political and economic stability, has been a considerable attraction for foreign investment, which currently comprises around 40 percent of the Australian financial market. For the past ten years Australian shareholders have enjoyed substantial increases in profits and dividends.

Boards have broad responsibilities to act in the best interests of the company. Shareholder engagement and participation are recognised principles in the Corporations Act. Shareholders have divergent private interests and transferring responsibility for decisions from directors to shareholders could have unintended outcomes that are not in the best interests of the company and shareholders as a whole.

Boards should be fully engaged and accountable to their shareholders but there are good reasons for leaving the control of a company’s business in the hands of the directors.

Many believe that boards should be closely involved in the detailed management of a company’s affairs to ensure that nothing can go wrong.

It leads to unrealistic expectations about what boards should be doing in areas that are the responsibility of management. It is the Chief Executive Officer and management team who run the company day-to-day.

The board's role is about stewardship, monitoring the performance of management and being involved in the broad, strategic direction of the company in the future. To explain this point in more detail, the major governance responsibilities of shareholders, the board and executive management are summarised in Exhibit 1 on page 6**.** Exhibit 1 illustrates that there are many opportunities in the current system for shareholders to engage and participate in the governance of companies.

The great majority of companies are successful and their shareholders are satisfied with their governance. It is only a very few cases where problems arise and these create pressures for changes in governance. When regulation is imposed in response to these few bad examples, it constrains innovation and development for all companies. The burden of regulation falls unequally and is detrimental to smaller companies in particular.

A quote from HIH Royal Commissioner, the Hon Justice Owen, is offered in closing.

> 'No system of corporate governance can prevent mistakes or shield companies and their stakeholders from the consequences of error. Corporate failures will occur. However, good governance principles help to focus those in charge of a company on the very purpose of their corporate activity and the direction of their business and enable them to identify emerging problems early.'[1]

[1] The Hon Justice Owen, *HIH Final Report*, Part Three, 6.1.2.

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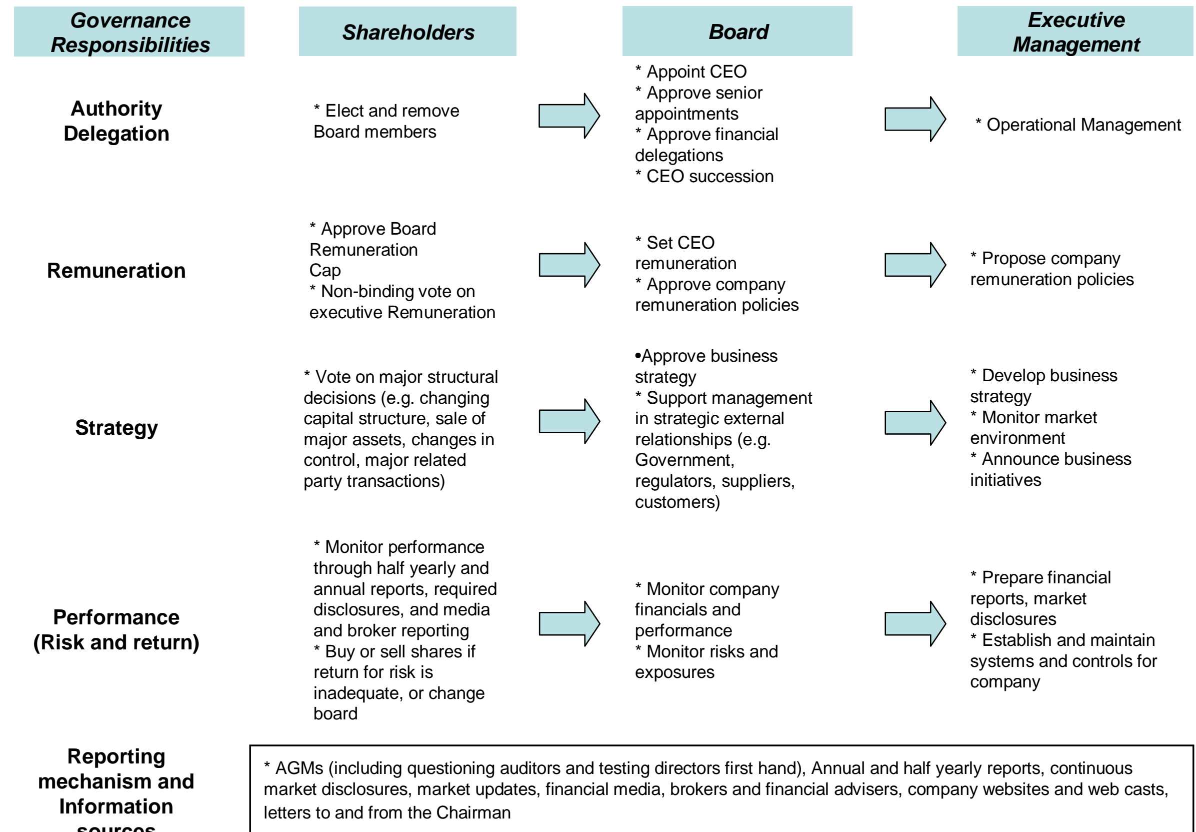
Exhibit 1

Corporate Governance: Roles of Shareholders, Board Members and Executives



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Executive Summary for PJC Terms of Reference

AICD's submission is written from the perspective of major publicly-listed companies. This approach is taken because the benchmarks for corporate governance tend to be set by the large companies, and offer leadership to the smaller companies. It is not intended to suggest that smaller companies are less important, nor that their issues are identical to the large companies.

Barriers to effective engagement of all shareholders in governance

Effective communication with shareholders and transparent board processes are essential (pp. 25-28).

- Shareholders are a diverse group with dynamic and global investment strategies. Shareholders have divergent private interests.
- There are more shareholders, new communication channels and increased globalisation compared with ten years ago.
- Today's shareholders may include a global hedge fund, a foreign investor and other investors with no interest in the company beyond a short-term trade.
- The traditional retail investor in Australian equities may represent a small proportion of the capital of a large ASX-listed company.
- Market composition is complex and more than 50 percent of the shares of many companies change hands annually.
- Directors face difficulties in identifying their major shareholders.
- Shareholder engagement and participation is well recognised as a principle in the Corporations Act.
- There is scope for extending the current range of communications with shareholders and reducing their complexity – improving the AGM, letters from chairmen to shareholders, expanding information on company websites – to allow investors to judge for themselves whether or not the company is aligned with their interests.
- Ultimately, each company and its shareholders need to agree the best approach to communication for their circumstances.

Boards are not democracies and they must balance competing interests (pp. 22-25).

- The owners of a company are its shareholders but control of a company is vested in its directors who delegate to executive managers.

- Boards have a broad responsibility to act in the best interests of the company for long term performance.
- Directors aim to achieve long term performance goals for companies, taking full account of the interests of employees, customers, suppliers and the community in the context of building long-term value for the company and for the shareholders.
- Directors are elected as representatives of the shareholders, not as delegates.
- Boards should be fully engaged and accountable to their shareholders but company decisions should be left to the directors.
- Shareholder participation in day-to-day affairs is impractical – information is commercially sensitive, business decisions require rapid resolution, accountability for decisions would be unclear and shareholders have no duty to act in the best interests of the company. They have only a duty to themselves.

Whether institutional shareholders are adequately engaged, able to participate

The interests of institutions should not be treated differently from the interests of other shareholders. ASX disclosure rules require that significant or price sensitive information must be reported immediately to all investors. Insider trading rules offer protection against privileged investment behaviour.

Many large companies offer investor relations services to support effective communication with institutional shareholders and their agents.

<u>Institutional shareholders employ agents and delegate engagement with companies</u> (pp 28-32).

- Intermediaries are used by institutional shareholders to engage and participate in company affairs. They include investment managers, governance advisors, proxy voting service providers and industry associations for the institutions and retail shareholders.

- Proxy and governance advisers tailor their advice to suit their investors and their niche in the competitive market of advisors. Their activities are not necessarily transparent to companies and this prevents companies from understanding their views and expectations.

- For companies, the complexity of the system of agents and intermediaries muffles the voice of the institutional shareholder.

They are also hampered in knowing the identity of their major shareholders, which could be alleviated by changes to the Corporations Act.

- The system of intermediaries fosters a short-term market perspective for investment, which in turn acts to restrict company growth and potential.

- Recent introduction of the non-binding vote on the remuneration report has increased the influence of advisors and intermediaries creating a further barrier to engagement between shareholder and company.

- These pressures push companies into compliance mode, to secure positive reports from advisors, which will encourage investors, particularly global investors.

- Some of these assessments are prepared for a global context and compare Australian company performance by international standards, despite the fact that some of these standards do not apply in Australia.

- The ASX Corporate Governance Council Principles have an ‘if not, why not’ option for companies that can demonstrate good cause for varying from the standard. This is regarded as one of the strengths of Australia’s corporate governance regime.

- A focus on compliance at the expense of alternatives that may better suit the needs of the business may not be in the best interests of the company long term.

Pre-selection and nomination of director candidates (pp.33-38)

- Recent findings from the world’s largest survey on corporate boards found that Australian businesses are the best in the world at selecting board members.[2]

- Board members have a shared and equal responsibility for a company. Independent views are usually encouraged however a board must act as a team to govern effectively. Boards usually make decisions by consensus and voting is rare in well-managed boards.

[2] Andrew Kakabadse, ‘Boards Walk the Talk’ *Business Review Weekly*, 20-26 September 2007

- Boards are not composed of shareholder representatives from different constituencies, who are chosen to advocate for external parties. Indeed, serious conflicts of interest have arisen in some cases where directors have been appointed to represent particular shareholders. Directors must act for all shareholders. They are required to exercise discretion and independent judgment in the best interests of the company.

- Boards look for new directors who will add to their collective skill set and who will work effectively with the team. Company needs are dynamic and board composition must reflect changing needs.

- Australia's leading companies value board candidates with a demonstrated track record of achievement at board and executive level due to global pressures and risk management obligations. Commercial savvy and financial literacy are important qualities for all ASX-listed boards and most boards of other entities.

- A board does not aim to be expert in the same way as management. The board's role is to monitor and challenge management but not to second-guess it.

- The major focus of the board will be to choose the best team of directors, yet shareholder interest in board appointments tends to focus on individual directors.

- Board nomination committees should follow a formal process for succession planning and renewal of board and management. They will often be guided by professional search firms and board performance reviews. Some boards tend to seek a new director on average every three years to re-balance the board's skill set.

- Listed company boards face competition from private equity boards in securing the best director candidates.

- Executives provide the most popular source of new board recruits. With changing workforce practices, younger executives are seeking board appointments earlier, as an alternative career in directorship, rather than remaining with a company until retirement as was once the case.

Advertising of elections and information about director candidates (pp 38-40)

- It is a challenge for boards to find suitable candidates where qualities of independence and experience are clearly displayed to the satisfaction of shareholders.
- Independent judgment is demonstrated by behaviour in the boardroom and is best assessed through rigorous board evaluation processes.
- It is reasonable to expect companies to provide detailed information on proposed candidates for election or re-election.
- Prior consultations by boards would familiarise institutional investors with the skills and experience that boards are seeking for new appointments. This would provide more support for the subsequent election process because shareholders would be more aware of the reasons for a board's choice of candidates for election and re-election.

Voting arrangements – direct and proxy (pp.40-44)

- Shareholders may vote at the annual general meeting in person or by appointing a proxy.
- At the meeting chairmen exercise discretion about how the voting will be taken but they have an obligation to ensure that the majority view of shareholders is reflected.
- Chairmen should be obliged to vote as directed by the proxy.
- Resolutions on non-controversial, procedural matters may be settled on a show of hands at the meeting.
- Resolutions on substantive or contentious matters may be determined as part of the meeting using proxies and direct votes with or without a show of hands, or by a poll conducted separately from the meeting.
- Some voting processes are more transparent than others but do not alter the outcome of the voting.
- Individual proxies are confidential to the company and are rarely disclosed. It is a matter for the voters to decide whether or not to

reveal their preferences. AICD supports the disclosure of aggregate information about proxy results.

- Suggestions for improving the voting process need to address both the mechanism for voting and the underlying incentives for shareholder participation. AICD suggests that the starting point is to improve the standard of engagement, both at the AGM and by other means. Companies are assisted with these objectives by advances in technology that support engagement and offer new voting options for shareholders who are unable to attend the AGM.

- Shareholders are entitled to have confidence in the processing of their proxy voting recommendations.

Conduct of annual general meetings (pp.44-48)

The AGM is a formal occasion, which is governed by procedures based in law. It remains a primary forum, particularly for retail shareholders, to engage with the board and senior executives.

The AGM keeps boards mindful of their accountability to shareholders and the need for transparency in the execution of their responsibilities.

The AGM gives shareholders an opportunity to assess the board first hand and to ask questions of the chairman on anything related to the company's business. Questions can also be asked of the auditor on matters relating to the audit.

Declining attendance suggests that the AGM is not as effective as it has been historically in supporting engagement and participation between the board and the shareholders. There may be another factor at work, in that investment returns have generally been very satisfactory in recent years.

Often institutional shareholders do not attend the AGM, as commonly a separate briefing cycle has been facilitated by the company to support their needs. Retail shareholders who are able to attend are the primary beneficiaries of the AGM today but they also express frustration at the length of meetings and the tendency for individuals and special interests to dominate.

Many companies are innovative in their engagement with shareholders, through the annual general meeting and in other ways.

Various improvements are underway.

- Taking questions on notice targets common shareholder priorities and uses time more efficiently at the meeting.
- Information booths in the foyer supplement the proceedings.
- Major shareholders might meet separately with the chairman, and this information could be shared with all shareholders using the company's website or other means.
- Shareholders are identified at the AGM to give them priority over non-shareholders.
- Letters to shareholders can address individual information needs.

AICD supports separating the information aspects of the AGM from the formal business and voting.

- Breaking the nexus between voting and the general meeting would be a better way of informing shareholders and fostering engagement.
- Interaction with company representatives in advance of voting would better prepare shareholders for reaching decisions on the resolutions proposed.
- Additional, periodic shareholder meetings could also provide current information on company performance and prospects.
- Briefings for institutional investors could be shared via webcasts to give all shareholders access to the same information. This would, incidentally, help protect against insider information.
- Electronic media offer a variety of other communication options.
- Company websites can be expanded and made interactive.

Effectiveness of existing communication/feedback mechanisms (pp.48-52)

AICD supports reducing the complexity in annual statutory reporting to shareholders.

This would be assisted by greater focus on performance matters and recognition of the benefits of voluntary reporting.

- Combined with continuous disclosure practices, the use of websites to disseminate information to shareholders provides opportunities for companies to offer concise, simplified reports, in addition to the mandatory reporting requirements.

- The current regime of mandatory statutory reports results in information overload.

- Financial statements based on IFRS are difficult to understand and are not a sound basis for assessing financial performance.

- Annual reports should be simplified and the new opt-in system is a step in the right direction.

In 2005 AICD released a 'Shareholder Friendly Report' with PricewaterhouseCoopers to give practical guidance on how companies might communicate more effectively with their shareholders.

In 2007 AICD developed ten principles of good communication with shareholders and highlighted some recent simplified reports (pp.39-40 refers).

The 'if not, why not' disclosure regime for the ASX Corporate Governance Council Principles is producing useful information on the governance activities of companies.

The needs of shareholders with limited financial and corporate knowledge (pp.52-53)

A 2006 study of share ownership found retail investors of today are more active and sophisticated than ever before.[3]

It is a matter for market participants to inform themselves. It is not a role for the companies in which they invest, particularly given the amount of information disclosed by companies and the extent of analysis available to Australian investors through stockbrokers and other agencies.

Companies can best meet the needs of such shareholders by ensuring the information they provide is clear, concise and written in good English with a minimum of jargon. Reducing the complexity of reporting would assist this group of shareholders.

General recommendations

Communication and participation

- There is scope for extending the current range of communications with shareholders and reducing their complexity.

- AICD sees need for continuous improvement in transparency, accountability and engagement between boards and their

[3] The 2006 Australian Share Ownership Study, available ASX website.

shareholders and sees no imperative for changing the existing model of governance by directors.

- AICD does not advocate the non-binding vote model for increasing shareholder participation. Boards should be fully engaged and accountable to their shareholders but company decisions should be left to the directors.

Institutional shareholders

- Improving transparency is an important objective for the activities and assessments of intermediaries because institutional shareholders will continue to use agents for their engagement with companies.

- Companies would like to be offered opportunities by intermediaries to discuss their conclusions before that advice is given to institutional investors. This would allow companies to correct misunderstandings about their activities and to change their practices, if they accept that a problem has been identified. Currently it is very difficult for a board to offer an informed response.

- Institutional shareholders need to question the uniform application of all prescriptions for good governance, whatever the source, but particularly when international standards are applied to Australian companies by the analytical tools used by intermediaries.

- Shareholders and their agents should retain the flexibility to vote on matters of priority. Mandatory voting obligations encourage tick-the-box compliance rather than genuine participation in company affairs. It fosters an industry of expert advisors, who filter the information between company and shareholder.

- While recognising the role of intermediaries, AICD fosters a direct dialogue between directors, superannuation funds and their industry associations to facilitate effective engagement with the beneficial owners of capital. Improved understanding of viewpoints will flow through to the practices of agents who act for the institutional shareholders.

- It is appropriate for voting rights to remain proportional to shareholdings as it serves the best interests of the company. Major shareholders have invested significant sums of money and are, therefore, entitled to more voting power in proportion with that investment.

- Institutional investors represent many small shareholders and in that capacity should have the same general interest in a company as retail shareholders.

- Retail and small shareholders are entitled to respect, courtesy and consideration of their needs in their engagement with companies. They are entitled to voting rights in proportion with the amount that they have invested.

Board composition and selection processes

- The present practice for shareholder voting on board composition works well to ensure that the board functions as a team with appropriate skills and experience.

- AICD recommends that nomination committees publish their methodologies for identifying and selecting directors for board appointments on company websites for the benefit of all shareholders.

- AICD also recommends using professional search firms to expand the pool of potential recruits. AICD maintains a Directors' Register, as do many State Governments. The AICD Register states the candidates' directorship qualifications.

- The confidence of shareholders in a board's composition is enhanced by disclosure of board evaluation processes.

Director candidates for election to boards

- Directors standing for election should provide details of their involvement with the company, their fields of activity and interest and what they bring to the board. The statement should include what they have done to develop their knowledge of directorship and details of their business experience. A full biography should be published with the notice of meeting that is sent to all shareholders.

- Directors are well advised to undertake some education, and continuing education, in directorship. AICD runs a program of internationally-recognised courses.

Voting arrangements

- It is important for companies to retain the flexibility to choose the voting process that meets their current needs and circumstances.

- AICD supports the use of polls to reflect the views of all shareholders intending to vote on substantive issues. A poll

includes the direct and proxy votes as well as the votes of shareholders (mainly retail) who are physically present at the annual general meeting. There is an obligation to vote all proxies as directed when a poll is called.

- It is reasonable for chairmen to exercise discretion about which voting method to employ, according to the circumstances. Routine and non-controversial matters will typically be settled by a show of hands at the annual general meeting, in the interests of efficiency.

- AICD supports proposals for electronic voting of proxies and the disclosure of aggregate voting information.

- It is reasonable for companies to state their policies for handling unclear proxy forms and cases where voting rights and intentions are not reconciled by the legal cut-off date before a general meeting.

Annual General Meetings

- Despite its limitations many still believe that the AGM provides a valuable opportunity for retail shareholders to raise issues, question the board and management and personally express their views on company resolutions. It is also important for shareholders' views to be heard by other shareholders at the meeting.

- More effective communication may be achieved by separating information and debate at the AGM from the voting.

- If separated, the meeting would become an opportunity for appraising board members and questioning the chairman and auditors.

- Any change must satisfy all shareholders that the alternative methods for communication are adequate and keep the board accountable.

Existing mechanisms for communicating and getting feedback

- In addition to mandatory statutory requirements, companies should provide voluntary disclosures where these are necessary to fully explain company performance.

- Examples include companies providing 'underlying profit figures' and publishing non-statutory annual reviews, shareholder newsletters and information on company websites. There needs to be consistency from year to year to avoid bad news being buried.

- These voluntary disclosures can be tailored to meet company circumstances and the characteristics of a company's shareholders, consistent with continuous disclosure obligations.

Shareholders with limited financial and corporate knowledge

- The best protection for investors with limited knowledge is education, not additional requirements on companies.

- If an inexperienced investor were to believe that they were protected from financial loss by regulation, they may be encouraged to take greater investment risks than if they understood the nature of their actual exposure.

Legislative or regulatory change recommendations (pp.53-55)

- More transparency is needed about the identity of major shareholders in listed companies to facilitate communication (section 672 of the Corporations Act 2001) (pp.25-26 refers).

- To encourage companies to provide more information to shareholders concerning forecasts, statutory protection should be provided in the form of an extended business judgment rule (section 180 of the Corporations Act 2001) where directors have acted in good faith and have taken reasonable steps in the derivation of forward-looking statements or financial forecasts (p.551-52 refers).

- Improved proxy voting processes are needed to give assurance to shareholders that their preferences are being counted and processed correctly.

- Chairmen should be required to vote as directed by the proxy, provided that they are aware of that appointment from the shareholder.

- The ASX Listing Rule definition of business days (rather than calendar days) should be adopted for the record cut-off date before an annual general meeting to assist with the processing of proxy votes (pp.40-44 refers).

- The 100 member rule should be changed to at least five percent of the total voting shares of a company to requisition a general meeting (section 249D of the Corporations Act 2001) (p.48 refers).

- Industry standards for financial planners should be reviewed to assist shareholders with limited knowledge of corporate and financial matters.

Conclusion

Company performance and economic activity determine the living standards of our nation. Australia has a very good record of strong performance by companies – boards, management and employees- that has delivered returns to shareholders while generating economic wealth for the nation.

Better communication between boards and their shareholders can help develop, maintain or restore trust and allow boards to focus on higher levels of performance, with appropriate corporate governance policies and practices.

Many companies are innovative in their engagement with shareholders. This is not something that suits regulation or mandatory reporting as each company must decide the form of engagement that best suits their circumstances and the nature of their shareholders.

November 2007

Full Response to PJC Terms of Reference

1 Barriers to effective engagement of all shareholders in the governance of companies

The Committee's first term of reference implies that effective engagement of all shareholders does not exist and that this is a consequence of barriers, which restrict shareholders from being engaged effectively. It leaves open the question of what constitutes 'effective engagement' but implies that companies would benefit.

Companies are not democracies but are governed by delegations of authority, with a board to monitor the progress and outcomes. As companies, shareholders and markets change, the basic rationale for having directors has proved remarkably constant for a very long period of time. The current system is working well for the shareholders and for the past ten years shareholders in Australia have enjoyed substantial increases in profits and dividends. AICD sees no imperative for changing the existing model of governance by directors.

Limited liability for shareholders and delegated authority to directors
Without the limited liability that the Corporations Act allows, everyone who invests in a business could be liable to the full extent of their wealth if the venture failed. The development of company law, with the concept of limited liability, allowed people to invest a defined capital amount, which was all they risked in the event of failure of the business. They invest their money, appoint the directors and leave the directors to oversee the company without interference (except in those matters that are reserved for shareholder decision).

Our corporate law is based on the dual premises that the owners of a company are its shareholders but that control of a company is vested in its directors who delegate to executive managers. With a small proprietary company, the same people are likely to be both the shareholders and the directors, and possibly also the managers. This suggests that their engagement in the business ought to be substantial. With a large company, there is a clear division between a small group of directors in control of the company's business and a large group of shareholders. AICD's submission will concentrate on the implications for public companies listed on the Australian Securities Exchange (ASX).

Shareholder engagement

Companies report to their shareholders through their annual and half-yearly reports. Large public companies provide investor briefings for their institutional shareholders. A listed company is also obliged to disclose immediately to the ASX any information that might have a material effect on the share price. The ASX makes the disclosure public and provides comment in the financial press.

Press commentary provides a significant means for shareholders, both retail and institutional, to be informed about companies. The commentary often includes the opinions of analysts and brokers.

The annual general meeting and information disclosure practices also give shareholders the opportunity to be informed about their company. This point is expanded in the section on annual meetings (pp.44-48 refer). In essence, directors are answerable to the shareholders at the annual general meeting, and it allows shareholders to both question the chairman and to participate in the election and removal of directors.

Shareholder participation

The law places control of the business of a company in the hands of the directors who delegate management to executives, both within the terms of the company's constitution and any regulation made by the company in general meeting.

A board appoints, removes and guides the CEO, determines the appropriate remuneration for that person and they are involved in the future strategic direction for the company. It is the CEO and management team who run the company day-to-day, not the directors.

The Corporations Act reserves for shareholders certain decisions that have a major impact on their investment, including changing the capital structure, sale of the major business of the company and transactions with related parties. It is only recently that there has been any pressure for further direct involvement by shareholders.

The most recent development in shareholder participation has been in the non-binding vote on the remuneration report, which is included with the Directors' Report at the annual general meeting. The views expressed through voting on resolutions at annual general meetings are not always indicative of the general attitude of shareholders. For example, negative votes on the remuneration report could reflect many different individual views which, when amalgamated, amount to a significant negative vote.

AICD's submission later addresses the activities of agents engaged by institutional shareholders to provide advice and voting services (pp.28-32). The non-binding vote on remuneration has increased the influence of proxy advisers who make recommendations to institutional shareholders on how their votes should be cast.

Different institutions use different proxy advisers and the advice is tailored to suit their customers and their niche in the competitive market of advisors. These activities are not necessarily transparent to companies and there are no guarantees that their advice is wholly based on informed, expert, impartial analysis. While the non-binding vote is intended to facilitate shareholder participation it also provides opportunities for proxy advisers to advance their interests without any obligation to act for the common shareholder good.

AICD does not support extending the non-binding voting model to other decisions that are made by directors on behalf of shareholders.

<u>Shareholder protections</u>

By law directors are required to exercise their powers in good faith and with due care in the best interests of the company. Shareholders who are dissatisfied with the company's management can sell their shares. If shareholders do not like the decisions made by directors, they have the option of voting them out when their term expires.

If enough shareholders are dissatisfied, they can remove the directors or sell their shares to a buyer who takes control. This power keeps boards and management mindful (through the share price and press commentary) of the possibility that they might be removed from their jobs by shareholder vote or by way of a takeover.

Shareholders may also put up their own candidates for election to a board and they can also influence boards as to whom they consider acceptable. This was demonstrated in 2006 when the ASX board decided to replace the ASX CEO with the CEO from the Sydney Futures Exchange when the two exchanges merged. This decision followed considerable agitation by institutional shareholders.

<u>Shareholders are a diverse group with dynamic, global investment strategies.</u>

There are good reasons for leaving the control of a company's business in the hands of the directors. Shareholders have invested capital in the company in the knowledge that they are entrusting its control to the board. It would not be practicable in the case of a listed company for the general body of shareholders to come to a coherent and agreed view on management matters.

Boards have a broad responsibility to act in the best interests of the company. Directors act as representatives of the shareholders generally, rather than as delegates of shareholders and they have flexibility to exercise judgment within the parameters of the company constitution. Shareholders have divergent private interests.

There are good reasons for shareholder engagement and participation in company affairs and this is a recognised principle in the Corporations Act. However, there are limits to how far that participation can be extended beyond the present broad oversight of the company's business and the general performance of directors. Transferring responsibility for decisions from directors to shareholders could have unintended outcomes that are not in the best interests of the company or shareholders as a whole. Consider the following:

- The classes of shareholders vary widely and might encompass retail shareholders, superannuation funds, hedge funds and asset managers, and also short and long-term holders within each of these classes. The shareholding base is constantly changing.

- More than 50% of the shares of many companies change hands annually. Shares held by some types of hedge funds may be traded very frequently, for example 'quant funds' that trade on the basis of mathematical algorithms.

- Giving shareholders more statutory opportunities for participation could lead to more powerful shareholders seeking to influence decisions for their own benefit.

As a rule, directors are required to act for the benefit of the company and, effectively, for the benefit of all shareholders who hold their shares in perpetuity. They aim to achieve long-term performance goals for companies. This allows full account to be taken of the interests of employees, customers, suppliers and the community in the context of the long-term value to the shareholders. This gives effect to the duty of directors in the Corporations Act to 'act in the best interests of the company.'

An in-depth survey of directors, published in 2007 by the University of Melbourne[4] showed that a majority of Australian directors believe that acting in the best interests of the company means that they are required to

[4] Professor Ian Ramsay, Centre for Corporate Law and Securities and Shelley Marshall, Centre for Employment and Labour Relations Law, University of Melbourne, September 2007, Research study into stakeholder ranking by directors.

balance the competing and sometimes conflicting interests of all stakeholders, such as shareholders, employees and creditors. Australian directors were more likely to make this judgment than their US counterparts.

Over 38 percent of respondents to this survey believed that acting in the best interests of the company meant that they were required to act in the interests of all stakeholders to ensure the long term interests of shareholders. Very few directors (0.3 percent) equate the best interests of the company with the short-term interests of shareholders.

Companies exist in a competitive environment

- In the context of large, listed companies directors exist for practical reasons. It would not be feasible to bring all shareholders together regularly to engage in the day-to-day affairs of running a company.

- Business decisions frequently require rapid resolution. Obtaining a decision from shareholders takes a minimum of four weeks, but more likely over six weeks.

- Preparing for shareholder meetings is an expensive exercise for a company and this cost will be met from shareholder funds.

- Involving shareholders in company decisions would require giving them access to commercially-sensitive information and, in effect, making such information publicly available. Companies exist in a competitive environment and there is competition from other listed companies, foreign companies, private equity and customers. These would be the beneficiaries and the shareholders would lose.

Would Qantas want to disclose its plans for warding off the threats posed by Virgin or Emirates, for example? Shareholders are assisted by having a governing board with confidential access to information that would be damaging to the company's competitive position if not kept confidential. Too much transparency would expose listed companies to aggressive tactics by competitors.

- Few matters coming before boards require a straightforward yes or no. The response time needed to ensure that shareholders were fully informed would be unwieldy. It would make negotiations, including mergers and acquisition activities, impossible.

- Directors must consider all relevant facts before reaching a decision and they are legally liable for the consequences of their decisions. If shareholders were involved directors might take conservative

decisions rather than risk uncertainty if the facts turn out differently from the projections and forecasts.

Excessively risk-averse behaviour by directors is not in the interests of innovation and improving company performance.

Legal liability for decisions affecting the company

- It could become more difficult for shareholders to hold directors accountable for the outcomes if shareholders participated in decisions currently reserved for the board.

- For example if shareholders were to reject the share allocations offered to executive directors, the executive might resign or a premium cash payment might be required to retain their services. The accountability of non-executive directors for remuneration costs and the quality of the management team would be diminished by the fact that shareholders contributed to the outcome.

- Extending shareholder engagement to capital allocation decisions would make it difficult to hold directors liable if the company were later to run out of funds.

If shareholders were to become more widely engaged in decisions, it is a small step to seeing them as shadow directors and hence liable for insolvent trading or other laws and regulations affecting director responsibilities that carry criminal and civil sanctions.

Communication and transparent board processes are essential
Shareholder engagement is not new but there are now more shareholders, new communication channels and increased globalisation.

Broadly speaking the shareholder base comprises institutional investors and private investors but the market composition is complex. There is a wide range of financial products and professionally managed funds (quant funds, index funds, derivatives) that are available for superannuation funds and other forms of wealth management.

Today's shareholders may include a global hedge fund or a foreign (or domestic) investor with no interest in the company beyond a short-term trade. The traditional investor in Australian equities may represent a small proportion of the capital of a large ASX-listed company on any given day.

- One difficulty for directors seeking to communicate directly with their shareholders is identifying who their major shareholders might be. Changes to section 672 of the *Corporations Act 2001* are required to provide more transparency about share ownership in listed

companies in order to facilitate shareholder engagement.[5]

- The practice by companies of outsourcing their share registries has introduced another intermediary between shareholder and company. Large companies have responded by establishing investor relations services to support a direct point of contact for shareholders. While mainly focused on institutional investors, the service could be extended to retail shareholders.

- Competition for capital has, and will continue, to drive innovation in shareholder engagement and how companies communicate.

- There is scope for extending the range of communications with shareholders.

- Chairmen could consider making more use of letters to shareholders to update them on current priorities and future directions.

- Companies should give priority to communicating their broad strategy (within the limits of commercial confidentiality) so that investors can judge whether or not it aligns with their interests.

- The corporate governance sections of company websites could include a broader range of information about the approach adopted by the board in relation to evaluation of the board and the directors.

International comparisons

Australia is highly regarded for its well-regulated market and national system of corporate governance. There is a well-instituted regime of continuous disclosure and election of individual directors at annual general meetings.

A recent survey of seventeen countries between 2004 and 2007 concluded that the top 10 percent of Australian boards are among the most outstanding in the world.[6]

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[5] The Australian Investor Relations Association (AIRA) maintains that the increased use of derivative instruments is ‘clouding’ the true beneficial ownership of a company. This lack of transparency makes it difficult for companies to identify their largest shareholders in order to facilitate engagement with them. It increases the cost of researching and maintaining shareholder registers and for shareholder communications. The situation also causes difficulties in maintaining the link between economic ownership and voting rights. See AIRA’s submission to this inquiry for more explanation.

[6] Andrew Kakabadse, Professor of International Management Development, Cranfield University, UK. as reported in ‘Boards Walk the Talk’, *Business Review Weekly*, article by David James, September 20-26 2007,

By comparison, the United States has a state-based system, quarterly financial reporting requirements (not continuous disclosure), poison pills to make takeovers difficult, and usually directors who are voted on a group ticket making it difficult for shareholders to remove non-performing individuals. The combined role of board chairman and CEO is common in the USA but unusual in Australia.

Corporate governance experts in the USA cite Australia as a leading light in governance regulation. Our world-class system of corporate governance, combined with political and economic stability, has been a considerable attraction for foreign investment, which currently comprises around 40 percent of the Australian financial market.

These are important considerations if any changes to the Australian regulatory model were being contemplated.

Competing shareholder interests
Both offshore and domestic ‘activist hedge funds’ are emerging in the Australian market amid an increasing trend for shareholder activism. The hedge funds are very demanding shareholders but their demands may not be aligned with the best interests of the company and the long-term shareholders.

Many retail investors see institutional investors as holding power over them. The term ‘shareholder democracy’ has tended to be equated with the interests of retail investors and their relative under-representation in voting on company affairs, relative to institutional investors. The term is sometimes equated the concept of one person, one vote regardless of their shareholdings, as a means of redressing the imbalance. Such a policy would give a person with 100 shares the same number of votes as an institution with a holding of 100,000 shares.

This would distort the legitimate rights of the major shareholders and is not in the best interests of the company or shareholders as a whole. The institutional shareholders are generally representing the collective shareholdings of many small, retail shareholders. In this sense the interests of institutions are no different from the interests of the retail shareholder who invests on his or her own behalf.

AICD is strongly of the view that voting rights should continue to be proportional to shareholdings. A change to one vote per shareholder would be likely to lead to a drying up of the Australian market in initial public offerings of companies and the shifting of many companies to offshore listing and domicile.

It is recognised that many retail investors dislike volatility in capital markets. They may want to retain a stable portfolio of blue-chip stocks. While private equity buy-outs may offer them a good share price, they may come at the expense of capital gains tax and the need to find alternative equities that provide good, reliable and fully-franked dividends. These are legitimate concerns but the scale of shareholdings by institutions generally results in the institutional view prevailing over the small shareholder in voting on resolutions.

To conclude, the engagement between boards and shareholders in the governance of companies is a matter for continuous improvement. There are, however, sound reasons for decision-making being delegated to directors to act in the best interests of the company as a whole.

2 Whether institutional shareholders are adequately engaged, or able to participate, in the relevant corporate affairs of the companies they invest in

Institutional shareholders do not have a discrete or different standing compared with other shareholders and they should not be entitled to it. This is reflected in the law through the principle of continuous disclosure and the law regarding insider trading. Care is needed not to give privileged information to one group of investors without making it available to the whole market.

Institutional shareholders represent the savings of countless small investors and there is no general reason for seeing the interests of an institution as differing from those of shareholders generally.

Many companies provide special briefings for institutional investors and AICD recommends that this information be provided on company websites to assist all shareholders. These briefings give institutional investors opportunities to question the board and management on more detailed matters, often financial, than might be raised at annual general meetings. Such briefings are not a means for giving some shareholders inside information and anything significant should be reported immediately to all investors. The company may not divulge any exclusive information or anything that is price sensitive.

<u>Companies engage with agents more than with institutional shareholders</u>
When the voting model was first established, shareholders would exercise their votes directly, based on a thoughtful engagement with the companies in which they invested.

For the large, institutional shareholders there are now intermediaries engaged to vote on their behalf and to give advice about what their voting

preferences should be. The business interests of these intermediaries are not the same as the institutional shareholders.

The term institutional investor is loosely applied to the institutional shareholder and the investment or fund managers but a distinction is needed between the beneficial owners of capital and the agents who act on their behalf.

The large institutional shareholders in Australia are typically superannuation funds, most of the larger ones being industry funds and funds representing the public sector and tertiary education. The large superannuation funds delegate shareholder engagement with companies to agents and intermediaries.

There are two sets of agents:

- Governance and proxy advisers who influence the decisions of institutional shareholders and the regulation of companies. These advisers operate on a commercial business model; and

- Investment or fund managers who have different business interests that are based around managing assets on behalf of the institutional shareholders.

The superannuation funds can, and do, influence the approach adopted with companies by these agents and intermediaries, but to some extent they also operate independently and are motivated by commercial considerations of their own.

Investment managers

Investment managers are given mandates by superannuation funds when they are engaged to manage their money. These mandates frequently contain instructions on the voting of shares that are owned by the superannuation fund.

An investment manager's personal remuneration and business model depends on outperforming other investment managers at specified risk levels. So the investment manager will be interested primarily in those stocks that are highly weighted in their portfolio and where they have concerns about governance issues being detrimental to a company's performance.

Unless there are concerns about governance issues, investment managers do not have a strong stake in voting on resolutions for corporate governance. In the absence of specific governance concerns, such voting decisions rarely affect the share price performance directly. Voting may not be discretionary but it may be perceived as work that does not add value

for the client. This is a disincentive for investment managers to exercise the voting rights that they control.

Increasingly superannuation funds are seeing voting as an important opportunity to participate in the governance of companies. The policy of active share ownership requires that investment managers exercise all voting rights and this policy is advocated by the IFSA.[7]

AICD would prefer that this obligation not be mandated and that investment managers retain the flexibility to vote on matters of priority. There is a danger that a tick-the-box approach will be implemented to satisfy any mandatory obligation. There is also a risk that fund managers could abdicate their role in favour of the 'experts' so as to manage mandate risk, having taken expert advice.

Governance and Proxy Advisers

Not all superannuation funds have the resources to independently review the voting recommendations from intermediaries. Time constraints and the volume of companies and resolutions make such consultation difficult and tilt the balance in favour of the outsourced recommendation.

This system makes intermediaries a very influential group.[8] There is potential for conflicts of interest in this industry of intermediaries. The investment manager who also supplies proxy advisory services is exposed to potential conflicts. So too the governance adviser who rates a company's governance standards but also sells services to improve their governance performance.

Industry associations

Many institutional shareholders, such as superannuation funds, rely on various not-for-profit industry associations to provide alternative sources of advice on proxy voting. There is also growing interest in corporate governance and corporate social responsibility from these industry associations.[9]

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[7] The Investment and Financial Services Association (IFSA) represents the funds management industry.

[8] The major players are Risk Metrics Group (previously Institutional Shareholder Services/Proxy Australia) and CGI Glass Lewis (incorporating Corporate Governance International), both of which are global companies with local affiliates. Regnan (previously BT Governance Advisory Services) is an Australian company with global shareholders.

[9] The Australian Council of Superannuation Investors (ACSI) takes a prominent public position on matters that concern this Inquiry. The Association of Superannuation Funds of Australia (ASFA) promotes a policy of active share ownership with its members. Together with the Australian Institute of Superannuation Trustees (AIST) they are all members of the ASX Corporate Governance Council. Retail investors are assisted by the Australian Shareholders Association (ASA).

Forms of engagement with the agents of institutional shareholders
It is an increasingly common practice for company chairmen to engage in regular briefing with investment managers, in a manner that is consistent with continuous disclosure obligations. It is also common for investment managers to discuss proposed resolutions with chairmen in advance of annual general meetings. This may cover issues raised by the remuneration report, election of directors, or other matters coming before the annual general meeting that require a vote.

Many large listed companies offer investor relations services to support effective communication between the company and investment managers. This engagement aims to facilitate voting at annual general meetings. These services also inform financial markets about the company in recognition of the fact that companies operate in a competitive market for capital.

The complexity of the system of agents and intermediaries muffles the voice of the institutional shareholder in dealings with companies and their directors. Companies may also have difficulty knowing the identity of their major shareholders.

Companies may be frustrated that their activities are reported second hand to the beneficial owner of the capital, sometimes without any opportunity for the company to correct inaccuracies and misinterpretations. In some cases, companies are unaware of any problems until the voting occurs for resolutions at annual general meetings.

There is a lack of transparency around the activities of some firms in the proxy advising and governance advising industries. These advisers rate the governance credentials of companies and make voting recommendations to institutional shareholders.

The Corporate Governance Principles and Responsibilities produced by the ASX Corporate Governance Council allow for variations provided that explanation is given about how the company's practices accord with the 'spirit' of a Principle, demonstrating that the company understands the relevant issues and has considered the impact of its alternative approach.

The ASX views this disclosure as the means by which boards are held accountable to shareholders. Their performance with disclosure is judged by the financial markets and is reflected in their market valuation. Disclosure allows the financial markets to reach an informed decision about whether the governance standards are acceptable, irrespective of whether they have been met 'in spirit' or 'in fact'. There is no such leeway in governance ratings when a 'tick the box' approach prevails and it is

difficult when international standards are applied, including elements that do not apply in Australia.

Corporate Governance Ratings of Companies
Most governance ratings by intermediaries are managed using automated checking systems to facilitate comparisons between companies. While adjustments for the governance system in Australia might be needed, it is simply not practical, nor cost effective, to attempt this on a broad scale.

So companies are faced with the pressure to conform to various governance standards[10], of which the ASX is the most widely respected in Australia, or face negative ratings of their governance, which in turn deters investment in their companies. This undermines the intended flexibility of the ASX governance principles that are designed to support alternative practices to reflect the needs of individual companies and circumstances. This is a source of great frustration to company directors.

For this reason AICD welcomes efforts from the superannuation industry to seek accountability from agents and intermediaries for their funds. The policy for active share ownership by the funds is a significant development for corporate governance.

While recognising that the institutional shareholders will continue to use intermediaries, AICD fosters a direct dialogue with the superannuation funds and their industry associations. We believe that direct dialogue will facilitate effective engagement and participation with the beneficial owners of the capital that is invested in their companies. Improved understanding of viewpoints on both sides will flow through to sound and transparent practices by the agents and intermediaries they engage to act on their behalf.

Agents and the media drive short-termism in financial markets
The delegation of responsibilities to agents is well established in the superannuation industry and it supports a chain of intermediaries, each with their own performance incentives and reward structures. At one end is the superannuation fund and at the other lies the company. Both share an interest in supporting long term, stable growth but the performance of intermediaries is assessed in the short term and this fosters market volatility.

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[10] Business Council of Australia, 2004, *Seeing Between the Lines, Looking Beyond the Horizon, Short Termism in Australia: a call to think into the future* provides a comprehensive analysis of the market structure and incentives see pp 42-44.
[11] Institutional investors follow various codes of corporate governance in addition to the ASX Principles. ACSI offers another standard, as does IFSA's Blue Book.

Many commentators agree that the short-term market perspective is dominating the current business environment[11]. This is due at least in part, to the close scrutiny of investment managers, who compete fiercely to invest the assets of large superannuation funds, on the basis of their short-term performance. A related factor is that investment managers are, in many cases, rewarded very highly on the same short term measures of investment performance.

3 Best practice in corporate governance mechanisms

What constitutes 'best practice' will vary according to the circumstances of a company, which may take many forms. The term was removed from the latest edition of the ASX Corporate Governance Principles to lessen the impression of prescription and to encourage companies to focus on the quality of their disclosure[12].

AICD has addressed its submission to ASX-listed public companies, which may be large, medium or small and which, in some cases, may have dual listings in international markets. The practices of the larger companies tend to guide smaller companies. It is not always possible for smaller listed companies to match fully the example set by larger companies. It may be impractical for the scale or location of their operations and they face more competition for high calibre directors than larger companies.

The ASX Corporate Governance Council Principles accommodate such differences through the 'if not, why not' disclosure regime that allows all companies to explain their special circumstances to the investment market.

a) Pre-selection and nomination of director candidates

Recent findings from the world's largest survey on corporate boards and their performance found that Australian businesses are the best in the world at selecting board members[13].

The survey found that the best boards in Australia are very effective at business leadership and are particularly good at professional selection, creating a robust CEO/Chairman relationship. This survey examined 17

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[12] ASX Corporate Governance Council *Response to Submissions of Review of Corporate Governance Principles and Recommendations,* August 2007, p. 9.
[13] Andrew Kakabadse, Professor of International Management Development, Cranfield University, UK. as reported in 'Boards Walk the Talk', *Business Review Weekly*, article by David James, September 20-26 2007.

countries between 2004 and 2007, including Australia, China, United Kingdom, USA, Ireland and Russia.

Directors are required by law to act in the best interests of the company as a whole. Directors have a shared and equal responsibility for a company. While independent views are encouraged, a board must act as a team to govern effectively.

An effective board has a well-balanced combination of capable board members who are well suited to the circumstances and needs of the company. This is the rationale for boards proposing new directors for election by shareholders. Boards look for people who will add to their collective skills set and will be able to contribute in the board environment.

New directors are usually nominated by the board after a careful selection process and are elected formally by shareholders at the next annual general meeting. Their independence is safeguarded by the fact that they cannot be removed except by the shareholders at another general meeting.

It is the usual practice for new board members to be appointed to casual vacancies by the board during the year with the formal election being confirmed by shareholders. The board may not endorse a director for re-election if there are concerns about performance or suitability. Generally a director will not seek re-election without the support of the board and may choose to resign sooner if the support of board colleagues is lost.

A common misunderstanding perceives the board as needing to be expert in the field in the same way as management. The board aims to challenge management in its decision making but not to second-guess it. To be effective it must work as a team, both within the boardroom and in combination with management. The best decisions are made where there is total candour and trust in the boardroom.

Boards are not parliamentary in style where partisan views are advocated and decisions made by a majority. Boards make decisions by consensus, a point seemingly not always appreciated by observers. Voting is rare in well-managed boards.

The evolution of nomination committees in Australia has been an important development in establishing a formal process for succession planning and renewal of the board and management. The nominations committee can recommend adjustments to board membership to achieve an appropriate mix of skills and a balance between members

who are independent and those with experience. The advice of executive search firms is often used to assist the nomination committee's work.

Compatibility is an important consideration for the harmony of the team. Commercial savvy and financial literacy are essential qualities for all directors of listed companies. Company needs are dynamic and board composition must reflect changing needs. The board's task is broader than in the past. The pressures on companies are more complex due to globalisation.

Well-managed boards are mindful of the need for refreshment and renewal of board skill sets, whilst at the same time balancing the need to retain adequate knowledge of their company. People with executive and director experience are well regarded by boards faced with increasing obligations for risk management. It is essential to have directors with knowledge of the industry in which the company operates. Strategic skills are also important in driving the business direction and adding to shareholder wealth.

Boards seek specialist skills, such as legal and accounting skills, in response to regulation and technology. They are also looking for younger members, with appropriate experience, who may have more affinity with the younger demographic in their market. Experience in human resources is a valued skill on today's board, reflecting the complexity of a multi-generational workforce and the recognition that human capital is a critical asset.

Listed company boards face competition from private equity boards in seeking new directors, particularly among retiring chief executives. The attractions of private equity are apparent also to experienced directors who can see the appeal of focusing more attention on the performance and medium-term value of the business concerned and less on compliance with market rules. There is also the possibility of large financial rewards upon successful exit from the investment.

Increasingly, today's boards are accepting of an apprenticeship role for skilled executives who are new to directorship and have not followed the traditional management path.

A recent source of new recruits to boardrooms has come from younger executives who depart corporate life in search of alternative and more flexible careers in directorship. This trend includes executives who retire early from highly paid careers, and others whose careers have been disrupted by takeovers and corporate change. Women, in particular, may seek board appointments at a younger age as they

seek more flexible career paths. New board recruits must demonstrate good business judgment if they are to be recruited.

Board composition and selection processes are evolving in response to global markets and increased competition. This evolution will continue as the needs of companies change. These selection processes are a planned and considered approach to identifying the skills and qualities needed for effective board leadership. Companies vary in the sophistication of their approach to board selection. Some of the larger Australian companies provide good examples to assist companies whose practices are less developed.

An Australian study, released in September 2007,[14] identified board evaluation as a significant positive trend in corporate governance, noting that the outcomes were applied to succession planning and identifying the skills needed on a board.

There is growing interest among shareholder groups in the composition and selection of board members. Some shareholders are expressing interest in appointing directors who will be sympathetic to their views. Most often the debate is focused on the appointment of individual directors when the major task before the board is in choosing the best team.

AICD would have strong objections to shareholder appointments that are made with the intention of representing sectional interests.

Boards are not composed of shareholder representatives from different constituencies. Directors may not represent special interests or advocate the preferences of external parties if they are to carry out their fiduciary responsibilities as a director. Directors who are appointed with the support of a major shareholder must ‘leave their interests at the door’ or risk serious conflicts of interest.

Directors are required to act on behalf of all shareholders and exercise discretion and independent judgment in the best interests of the company.

There are some boards that are representative in nature and they often experience more disharmonies with company governance. The former NRMA is a good example of a board that was politicised by the high degree of shareholder representation. HCF is a more recent example where the election of directors became a popularity contest, with

[14] UTS Centre for Corporate Governance, September 2007*, The Changing Roles and Responsibilities of Company Boards and Directors*, Final Report.

directors self-funding their campaigns. These experiences highlight the need for board members to be educated about their duties as directors.

Some public sector boards have been perceived as less effective than their private counterparts due to compulsory external appointments. These appointments may create disharmony through representing special interests rather than the interests of the organisation as a whole.

The size of the board is another consideration. Large boards can be unworkable, with too many directors wanting to speak and influence the outcomes. Different companies have different needs but a maximum of around 10-12 board members is a popular convention. The BHP/Billiton board has ten members for example. This is contrasted, for instance, with the much larger governing boards for some academic institutions, which experience well-publicised disharmony and factional activity from time to time.

- AICD respects the rights of shareholders to nominate, elect and remove directors and does not seek to diminish those rights in any respect.

- The present practice whereby shareholders vote on the board composition works well to ensure that the board functions as a team with appropriate skills and experience.

- It would be a good practice for nomination committees to publish their methodologies for selecting and appointing directors on company websites for the benefit of shareholders.

- AICD recommends the use of executive search firms to ensure the selection process is professional and to expand the pool of potential recruits to Australian boardrooms. AICD also maintains a Directors' Register.

- Shareholders, including institutional investors, should be able to make suggestions about the skills and experience that they see as being needed for appointments to specified boards, and for boards in general.

- Board evaluation is an important element of communicating with shareholders about board performance, including considerations of tenure, board composition, workload and whether individuals are able to commit the time required.

- The confidence of shareholders in a board's composition is enhanced by disclosure of the process for evaluating the performance of the board and individual directors.

b) Advertising of elections and providing information concerning director candidates, including direct interaction with institutional shareholders

It is a challenge for boards to find suitable candidates where qualities of independence and experience are clearly displayed to the satisfaction of shareholders.

Many shareholders have called from the floor of annual general meetings for a director to speak in support of his or her election or re-election. Such speeches inevitably take on a political quality and not all shareholders are represented at the meeting, with the majority of votes having been cast by proxy in advance.

Attempts to define independence have been controversial. If taken to extreme the 'independence from association' approach, which is used in the ASX Corporate Governance Council Principles, could result in the board being made up of people with no experience with the industry in which the company operates.

The capacity for independent thinking is highly valued by institutional investors and the ASX Council Principles accept this as a matter for judgment by boards. A director's independence reflects personal qualities such as integrity that cannot be prescribed. The demonstration of independence is indicated by a director's behaviour and performance in the boardroom, and this is only able to be observed by other board members.

Independence is not the only desirable quality in the boardroom and institutional investors recognise the value of industry experience and a good track record of performance.

The main considerations for board composition cover membership renewal, directors who are open to fresh ideas, independent thinking, all of which need to be balanced with relevant experience. The market for directors of large listed companies is competitive and favours proven performers with a sound track record in directorship. This reflects increasing risk and regulatory exposure for company directors.

It is reasonable to expect companies to provide detailed information on proposed candidates for election. This information could demonstrate

both the candidate's experience and background, and how their involvement will complement the skills of existing directors.

A statement in the annual report covering what the directors have done to develop their knowledge of directorship and their business experience would also assist shareholders in understanding the skills of board members.

Prior consultations between nomination committee chairmen and institutional investors and shareholder associations could identify where more information is required to support the election process for directors. Although there are practical advantages in gauging the views of major shareholders, boards must nevertheless act in the interests of all shareholders, both large and small.

- Boards should aim to provide all shareholders with adequate information on which to make an informed vote at the annual meeting, including a statement of a director's involvement with the company, their particular fields of activity and interest and what they bring to the board.

- It should be standard practice for a full biography of a proposed director to be published in the notice of meeting that is distributed to all shareholders.

- The notice of meeting distributed in 2006 by BHP Billiton is one approach to candidate profiles that is well regarded by shareholder associations.

- The chairmen of nomination committees may find it useful to consult with institutional investors about the skills and experience seen to be desirable for appointment to their board. They would not be seeking nominations for election. The aim would be to inform the board about the attitudes of institutional investors.

- Directors are well advised to undertake some education (and continuing education) in directorship to give assurance to shareholders that they have the requisite skills and knowledge. AICD runs an extensive program of internationally recognised courses for the aspiring and novice director through to advanced study for mastering the boardroom. It is reasonable for shareholders to seek up-to-date information from boards about their professional training in directorship.

c) Presentation of ballot papers

The election of governments and company directors are distinctly different. The terms ballot papers and pre-selections that are used in the terms of reference for the PJC Inquiry are more relevant in the political arena than for the successful operation of companies. AICD's comments on nomination and selection processes and board composition are covered above under 3 a) and 3 b).

d) Voting arrangements (eg direct, proxy)

Just as politicians do not poll their electorate before every vote in the Parliament, directors do not poll the shareholders on matters in the boardroom. Again like politicians, directors are judged on their record of performance when they stand for re-election.

Shareholders may vote at the annual general meeting in person or by appointing a proxy and the voting process may be conducted in a variety of ways.

- Resolutions on non-controversial, procedural matters may be settled on a show of hands at the meeting, provided that the outcome is supported by the majority of proxy and direct votes where this applies.

- Resolutions on substantive or contentious matters may be determined in a number of ways:

  - A combination of proxies and direct votes lodged before the meeting, plus a show of hands at the meeting;

  - Determination by proxies and direct votes alone, if the mood of the meeting departs from the majority view.[15]

  - A poll conducted separately from the meeting, inviting shareholders to indicate their preferences, either by proxy or direct vote, or by placing a vote in the ballot box located at the meeting.[16]

[15] Where a chairman realises that the majority view of the proxies is different to the majority view at the meeting, it is advisable to call a poll to provide more transparency about voting intentions. This preference may also be expressed at the meeting by shareholders who are frustrated when their views are not adopted.

[16] Calling a poll is time consuming and delays notification of voting results until after the meeting. For this reason, chairmen may rely on a show of hands at the meeting, with the knowledge that the result reflects the majority view of votes lodged by proxy.

There are relative advantages and disadvantages associated with each of these voting processes and board chairmen exercise discretion about which method is employed, according to the circumstances.

Some companies use polls for all but the procedural voting so as to include both proxy votes and the votes from the meeting. Meetings that rely on a show of hands are more susceptible to special interest groups that dominate proceedings without the support of a majority of shareholders.

The principle remains, however, that chairmen have an obligation to ensure that the wishes of the majority of shareholders are reflected in any vote.

The difficulty for shareholders is that some of the processes are more transparent than others and chairmen need to be mindful of these perceptions when choosing a voting process and making the reasons for that choice known to the shareholders attending the meeting. For example, the failure to call a poll can be perceived by some shareholders as a lack of transparency in the voting process but it does not alter the outcome of the voting.

Various suggestions have been made for improving the voting process, particularly for proxy voting and the processing of proxy votes. Tightening the voting process will better reflect shareholder intentions.

Whatever voting method is chosen it is self-evident that it will only engage those shareholders who intend to vote. For this reason any suggestions for improving the voting process will not necessarily address the underlying incentives for shareholder participation.

AICD suggests that the starting point is to improve the standard of engagement between company and shareholder, both at the annual general meeting and by other means. Better engagement and information will flow-on to increasing the incentives for participation through voting.

Companies and shareholders are assisted in this objective by advances in technology that support more frequent, timely and current information being made available to shareholders. Technology also provides more voting options for shareholders who do not attend annual general meetings. Such options could replace proxy voting or

be used in parallel. The direct voting proposal from Chartered Secretaries Australia[17] is one example, which AICD supports.

There needs to be a mechanism to reflect the views of all shareholders, not just the few who vote.

- AICD supports the use of polls and direct voting, and it may also be appropriate for chairmen to rely on a show of hands where the outcome reflects the majority view of shareholders who have voted, including proxies.
- Chairmen should be required to vote in accordance with the wishes of the shareholder who gives them a proxy, provided that they are aware of their appointment. This would reduce opportunities for 'cherry picking' votes[18]. A minor amendment to the Corporations Act would be required.
- Shareholders are entitled to have confidence in the processing of their proxy voting recommendations and options for improvement, such as electronic notification of proxies, warrant closer examination.[19]
- AICD supports the use of technology-enabled processes to widen the participation of shareholders in voting on company affairs.

Proxy Voting Process[20]

Proxy voting permits shareholders who do not attend an annual general meeting to participate in the corporate governance of the company. It is currently the preferred method of voting for institutional shareholders and their agents. A proxy in favour of the chairman is the equivalent of a direct vote (see footnote below for explanation).

[17] The submission to the PJC Inquiry from Chartered Secretaries Australia advocates the case for direct voting which gives shareholders not attending an annual general meeting the option of completing a voting form that can be lodged by post, fax or electronically without the need to appoint a proxy.

[18] 'Cherry picking' refers to the practice of voting some but not all the shares covered by the proxy. It is regarded as a good practice for chairmen to exercise their proxies as instructed. If a chairman did not exercise proxies, and that non exercise was not bona fide, so as to improperly influence the outcome of a vote, then the chairman could be considered to be in breach of duty and the resolution passed or not passed may be open to challenge in the courts. An example of such court action occurred with the NRMA when Mr Nick Whitlam was chairman.

[19] IFSA's submission to this PJC Inquiry contains a proposal for electronic notification of proxies that is supported by AICD.

[20] Andrew Lumsden, 1998, *Managing Proxies and the Role of the Chairman*, AICD Publications

Individual proxies are confidential to the company and, with a few exceptions, are not disclosed. AICD believes that shareholders who give a proxy should retain the right for details of this to remain private. It is a matter for the voters to decide whether or not to reveal their voting preferences.

AICD supports the suggestion from IFSA for disclosure of aggregated voting information, such as the number of votes lodged for/against/abstain for each resolution at general meetings, including the votes as a proportion of issued capital.

Many shareholders believe that they are casting their vote via the proxy. In fact they are temporarily transferring their voting rights to another party. The proxy holder has the same rights as a shareholder to vote or not vote, having regard to any shareholder direction.

Shareholders do have a right to oblige their proxy to vote (in accordance with agency law) and it is not necessary to impose a legal obligation on all proxy holders (other than the chairman) to vote. If a poll is conducted there is an obligation to vote, as directed, all the proxies.

The use of proxies raises issues of how undirected proxies should be voted and when the result of proxy voting should be made known at the annual general meeting. Under current legislation the chairman retains a discretion as to whether, and how, to vote for open-ended proxies that do not give instructions. These must be exercised in the best interests of the company.

Early disclosure of proxies can assist proceedings at general meetings by preventing unnecessary discussion or disruption that the chairman can cut short by referring to the weight of general shareholder support. One practice is to display the proxy vote tallies on a board at the front of the room in full view of the participants.

The disadvantage of this approach is that it may prevent directors from hearing shareholder views by stifling debate and it may influence the shareholder vote. Shareholders attending the meeting may be antagonised that their preferences are not considered if the proxies favour a different outcome. Some chairmen resolve this dilemma by allowing time for discussion before the proxies are revealed and then proceeding to a vote.

- AICD supports the practice of companies stating their policy for handling unclear proxy forms and cases where voting rights and

intentions are not reconciled by the legal cut-off date for proxies before a general meeting.

e) Conduct of annual general meetings

The annual general meeting is a formal occasion and is governed by meeting procedures based in law.

A listed company 'engages' with shareholders at the annual general meeting. It gives shareholders the right to receive annual and semi-annual reports, to participate in the election of directors and to appoint or remove directors. Shareholders are given opportunities to ask questions on anything relating to the company's business and to ask questions of the auditors in regard to the audit.

The tone of general meetings is important as it is a forum for shareholders to assess the board first hand. The chairman normally chairs the meeting and should provide sufficient opportunities for shareholders to express their views. Questions may be taken before or during the meeting.

Chairmen need to provide an opportunity for all shareholders who want to express an opinion to do so, without allowing special interest groups to dominate.

Historically the annual general meeting has been the centrepiece for communications between companies and their shareholders but technological innovation offers many other opportunities to communicate effectively.

There is evidence that the value derived from the traditional general meeting is diminishing and shareholder attendance is falling. This suggests the need to improve the way in which the annual general meeting is conducted so that it better suits the needs of shareholders.

- While remaining an important forum for retail shareholders, they may rely more on the financial media for information and to monitor company performance.

- The investment world is fast moving and the company's results are released well in advance of the meeting.

- It may be more helpful to customise information to better reflect the interests of retail shareholders and institutional shareholders,

while ensuring that both groups have access to the same sources of information.

- Few institutional investors attend the meeting, relying instead on proxy voting and special briefings to interact with the company and board. This information should be accessible to all shareholders.

- The rise of shareholder activism is diverting attention away from the traditional agenda of the annual meeting. There is an increasing trend for general meetings to be used as a platform for special interest groups.

AICD collaborated with the Business Council of Australia and other industry associations in 2004 to produce a discussion paper[21] about a range of new approaches to the annual meeting and options to improve communication with shareholders.

Options for restructuring the annual general meeting

- Shareholders could be invited to identify the issues they would like to discuss when they receive their notice of meeting and annual report.

- Taking questions on notice can make more efficient use of time at the meeting. An increasing number of companies are already doing this.

- The chairman may respond to commonly raised issues at the meeting or a shareholder may be sent a response directly from the company to address individual concerns. Responses to questions could be posted on the company's websites, either as transcripts or as recorded image and voice, for the benefit of shareholders who are unable to attend the meeting.

- Information booths staffed by company representatives can offer advice and information in the meeting foyer.

- Governance issues raised by large shareholders may be addressed by a separate meeting with the chairman, with any significant information being made available on the company website for all shareholders.

[21] *Company+Shareholder Dialogue: Fresh Approaches to Communication between Companies and their Shareholders,* 2004, Business Council of Australia publication.

- A system to identify shareholders at the meeting would better manage the length of time taken and avoids questions from the floor when the inquirer is not a shareholder.

These options would not necessarily replace discussion at the general meeting because other shareholders may have a common interest in the information. It should, however, assist with the flow and duration of the meeting to make the best use of the time available for those in attendance.

Options for supplementing the annual general meeting

- Additional shareholder information meetings could be scheduled on a regular basis. This could provide shareholders with more up-to-date information on company performance and prospects.

- Each company would need to evaluate the benefits of increased regular engagement with shareholders against the significant additional costs of that activity. It may not be a viable option for smaller companies.

- Another suggestion is to expand the audience for special briefings provided to investment analysts. The information could be shared via webcasts, without inviting wider comment, so as not to dilute the benefit to the institutions.

- Another option is to hold a series of concurrent meetings around Australia, some of which target the analysts and institutional investors, with separate briefings for retail and other shareholders.

- Electronic media offer new methods such as online discussion boards for communicating with shareholders.

- Websites for large companies are likely to have a section on corporate governance offering a range of information resources for shareholders.

- Video links, webcasts and podcasts for information briefings offer all the opportunity for engagement regardless of location and at a time that suits the shareholder.

Supplementary meetings allow for more informal communication than the annual general meeting and more flexibility to address any issues raised by shareholders. The frequency and location could be adjusted to suit the shareholder base and their information needs.

Additional communication and meetings do, however, come at a cost. They require time from management for preparation and this comes at the shareholders' expense. It also reduces the time available for lifting the performance of a company, and can potentially reduce the investment returns for shareholders.

Each company will need to find the balance that suits their needs and the needs of their shareholders. Mandating obligations for additional communication and reporting will impede companies in finding the balance that is consistent with strong performance.

Options for reforming the annual general meeting

- The formal requirements of the annual general meeting for voting and election of directors could be separated from the reporting aspects of the meeting, allowing more time for shareholders to raise concerns with company management and directors.

- Other options for improving the voting process at annual general meetings were outlined in the previous section (pp.40-44 refer). In particular, tightening the proxy voting process will give greater assurance to shareholders.

Despite its limitations many still believe that the annual general meeting provides an invaluable opportunity for shareholders – particularly retail shareholders – to raise issues, question the board and management and personally express their views on company performance.

The meeting provides a forum for personal appraisal of new candidates for election to the board and the way in which the meeting is conducted conveys to shareholders something of the culture of the board and the chairman's character.

Shareholder engagement at annual general meetings is expected to continue and AICD does not recommend that it be replaced.

Ultimately each company and its shareholders need to agree the best approach to communication for their circumstances. Companies with many retail shareholders will want a different approach to communication than those concerned primarily with institutional and foreign investors.

100-member rule

In 2005 AICD joined Australia's peak business and shareholder groups to repeal the rule in section 249D of the Corporations Act 2001 allowing

100 members to requisition general meetings of companies. The business coalition supported the proposal that five percent of total voting shares of a company be used as the relevant threshold to requisition a general meeting.

AICD continues to support this amendment due to concerns that a range of minor, special interest issues could interfere with the proceedings of annual general meetings. This would make them larger and longer, to the detriment and cost of other shareholders and the company. A general meeting is a very costly exercise for a company and a strong case from a substantial proportion of shareholders should be required to requisition an extraordinary meeting.

AICD supports retention of sub-section 249N (1)(b) and 249 (2)(b) that preserves the rights of members to put a resolution on the agenda of an annual general meeting and request the company to distribute a statement to all its members. These provisions are adequate in protecting the rights of small groups of members to have their concerns addressed on the agenda.

4 The effectiveness of existing mechanisms for communicating and getting feedback from shareholders

AICD considers that communication with shareholders can be made more effective by having –

- greater focus on ‘performance’ rather than ‘conformance’ matters in statutory annual reporting requirements;
- greater recognition of the merits of voluntary reporting as an important means of better communication with shareholders; and
- an extended statutory business judgment rule that applies to forward looking information.

Statutory annual reports are not meeting the needs of shareholders

AICD has previously expressed concerns about the conformance-driven nature of statutory annual reporting. The current reporting regime results in information overload for shareholders, and form over substance in the preparation of statutory reports. This conformance mentality is evidenced by the development of ‘concise’ annual reporting requirements - which started in concept as a simplified alternative to a full annual report but ended up with a multitude of compliance requirements that need to be met.

AICD's concerns in this area have grown with the adoption in Australia of International Financial Reporting Standards (IFRS). While there are flow-on benefits to both listed companies and investors of a universal set of accounting standards, there is widespread recognition that financial statements based on current IFRS are often difficult to understand, and do not generally provide a sound basis for assessing the financial performance or financial position of a company.

There needs to be greater focus on performance rather than conformance matters in statutory reporting requirements, so as to provide more meaningful information to shareholders and others. As part of this process, the level of complexity in annual reporting should be reduced where possible.[22]

The growth in voluntary disclosures around annual reports should be encouraged

AICD believes one answer to current communication problems associated with statutory annual reports, lies with companies providing additional voluntary disclosures that are appropriate for their circumstances.

We are starting to see a marked growth in such voluntary disclosures, manifested in the provision of ‘underlying profit’ figures by companies, and in the publication of more understandable and meaningful reports for shareholders (eg non-statutory annual reviews and shareholder newsletters). Companies are able to tailor such reports to appropriately represent their individual circumstances, having regard to their various shareholder bases. This activity should, within appropriate limits[23], be encouraged.

With this in mind, AICD applauds the recent changes to the Corporations Act that introduced an ‘opt in’ system for hard copies of annual reports, where an electronic copy is made available on the relevant company's website. This will result in material cost savings for companies.

We consider many companies will now choose to publish a shortened, more meaningful form of annual review, possibly for dispatch with an AGM notice or a dividend statement, and refer readers for further information to the full statutory report on their website.

[22] To take one example, AICD believes the requirement for parent company financial statements to be prepared and published should be removed where consolidated reports are available.
[23] For example, ‘underlying profit’ should be reconciled back to statutory profit.

AICD has developed some practical guidance on how companies might communicate more effectively with their shareholders

In 2005, in conjunction with PricewaterhouseCoopers, AICD released a 'Shareholder Friendly Report' (SFR).

Written from a non-technical perspective, the SFR provides an example of a comprehensive scorecard on the company's overall performance. It reports not only the historic results and trends against key financial and non-financial strategies, but also the company's outlook for the future. Summarised financial information, with limited explanatory notes, is confirmed by both the directors and the auditors as being consistent with the full annual statutory financial report of the company.

In 2007, following on from the SFR, AICD developed ten principles of good communication with shareholders and highlighted some recent simplified reports.[24] These principles are intended to provide practical guidance to company directors and others regarding the preparation of simplified reports in a wide variety of companies, where the intended audience is mainly retail shareholders. Adherence to the principles is regarded as good practice when producing simplified reports. The principles in summary form are -

- Principle 1 - A Simplified Report should present a balanced view
- Principle 2 - A Simplified Report should be in plain English
- Principle 3 - A Simplified Report should be written specifically to inform shareholders about company performance
- Principle 4 - A Simplified Report should be designed to provide a clear understanding of the components of the financial results of the business, rather than just statements which comply with regulatory requirements
- Principle 5 - A Simplified Report should set out key highlights
- Principle 6 - Company performance should be described against stated corporate strategies, although companies should assess what level of strategic disclosure is appropriate in their circumstances

[24] Refer to http://www.companydirectors.com.au/Policy/Policies+And+Papers/2007/Good+Communication+With+Shareholders.htm

- Principle 7 - Companies should consider their own circumstances when deciding whether to include financial forecasts or projections

- Principle 8 - A Simplified Report should include summarised divisional reports

- Principle 9 - A Simplified Report should include Reviews by the Chairman and the CEO

- Principle 10 - Consideration should be given to the appropriateness of a directors' declaration and/or an auditor's report.

A statutory business judgment rule should exist for forward looking statements made by directors

One area of disclosure where the prevailing laws are not conducive to optimum shareholder communication is forward looking information.

Inherent in the laws governing financial reporting, is a bias against the provision of forward looking information or forecasts. This is because the usual providers of such information, directors, are given insufficient statutory protection should the information in question prove to be incorrect. The main risk of concern here in the provision of such information is that directors will be judged with '20/20' hindsight.

AICD continues to maintain directors should be afforded statutory protection, in the form of a general defence for offences under the Corporations Act.[25] In March 2007 the Federal Treasurer announced a review to establish the extent to which sanctions under corporate law may be influencing business decisions. In response, AICD has proposed a general defence for directors (modelled on the business judgement rule in section 180(2) of the Corporations Act).

The defence would extend to other sections of the Corporations Act, unlike the business judgment rule that only applies as a defence to section 180(1) for breaches of care and diligence by a director. The AICD's general defence has a high threshold and would only be available if directors acted in good faith, informed themselves about the subject matter to the extent that they reasonably believe is appropriate and the decision is in the best interests of the corporation.

25 Refer to the Corporations Act, section 180.

AICD's submission is available at:

http://www.companydirectors.com.au/Policy/Submissions/2007/Review+of+Sanctions+in+Corporate+Law.htm

The 'if not, why not' disclosure regime in Australia is producing useful information on the governance activities of companies

In relation to disclosure of corporate governance practices by listed companies, AICD notes there is already a good deal of information available to shareholders in the context of the Principles and Recommendations of the ASX Corporate Governance Council.

In June 2007 the ASX Council confirmed that reporting against the Principles and Recommendations has continued to improve. The study showed that the overall reporting level for listed companies – the aggregate of adoption of recommended practices and of 'if not, why not' reporting – was higher in 2006 (90 percent) than in either of the two previous years ASX has conducted the review (2005 – 88 percent and 2004 – 84 percent).[26]

The ASX Council has recently gone through an extensive consultation process and in August 2007 issued revised Principles, Recommendations and Guidance[27]. There was continued widespread support for the 'if not, why not' approach to reporting of corporate governance practices.

5 The particular needs of shareholders who may have limited knowledge of corporate and financial matters

The best protection for those investors with a limited knowledge of corporate and financial affairs is education, not additional requirements on companies

Shareholders with limited knowledge of corporate and financial affairs are afforded protection at a number of levels.

- These investors are often 'price protected' when trading on secondary markets in liquid stocks.[28]

- There is protection through obligations on financial advisors such as the 'know your client rule'[29]. These protections are over and above periodic and continuous reporting requirements, and laws relating to false and misleading statements.

[26] For further detail refer to http://www.asx.com.au/about/pdf/mr20070613_corporate_governance_disclosure_analysis.pdf
[27] Refer to http://www.asx.com.au/about/pdf/mr20070802_revised_corporate_governance_principles.pdf
[28] There is considerable academic support for semi-strong efficiency in market prices. That is, at a market level, all publicly available information is accounted for in a company's share price.
[29] Refer to the Corporations Act, section 945A.

The answer to limited knowledge of some shareholders is not additional mandatory reporting requirements. Rather, it is general education of such investors by government and/or market providers regarding the nature of investing and the associated risks, and the benefits of a balanced portfolio of investments.

Any appearance that they are protected against loss may lead to 'moral hazard' and greater risk taking by inexperienced investors, who may consider that government, companies and advisers should be held responsible if they lose their money.

It is worth noting a 2006 Australian Share Ownership Study recently published by ASX suggesting that retail share investors of today are more active and sophisticated than ever before.[30]

It is a matter for participants in a market to inform themselves. It is not a role for the companies in which they invest, nor is it appropriate due to conflicts of interest.

Companies can best meet the needs of such shareholders by ensuring the information they provide is clear, concise and written in good English with a minimum of jargon.

6 The need for any legislative or regulatory change

AICD does not see legislative or regulatory change as the main avenue for supporting shareholder engagement and participation. Our priority is to sponsor opportunities for direct engagement between directors and shareholders.

AICD supports greater transparency on the part of boards regarding a nomination committee's approach to board selection and composition. AICD also emphasises the need for regular, robust board evaluation processes to give assurance to shareholders that the matters raised in this inquiry are being managed professionally and to a high standard.

Within this context we draw attention to a number of specific changes that are identified in this submission to improve shareholder engagement that would require legislative or regulatory change:

[30] The 2006 Australian Share Ownership Study is available at http://www.asx.com.au/about/pdf/shareownership_study_2006.pdf

- Changes to section 672 of the *Corporations Act 2001* are required to provide more transparency about the identity of major shareholders in listed companies in order to facilitate direct communication (pp.25-26).

- Improved proxy voting processes are needed to give assurance to shareholders that their preferences are being counted (pp.40-44 refer).

- Chairmen should be required to vote in accordance with the wishes of the shareholder. This would reduce opportunities for 'cherry picking' votes. A minor amendment to the Corporations Act would be required.

- Shareholders are entitled to have confidence in the processing of their proxy voting recommendations and options for improvement, such as electronic notification of proxies, warrant closer examination. AICD supports adopting the ASX Listing Rule definition of business days.[31]The present 48 hour cut-off date can be arbitrary and inconvenient, particularly over weekends and public holidays.

- Section 249D of the *Corporations Act 2001*, prescribes the number of members needed to requisition general meetings of companies. Currently known as the 100 member rule, AICD recommends changing the rule to at least five percent of the total voting shares of a company in order to requisition a general meeting (pp. 47-48 refer).

- Company directors should be afforded statutory protection, in the form of an extended business judgment rule (Section 180 of the *Corporations Act 2001*)' where they have acted in good faith and have taken reasonable steps in the derivation of forward-looking or financial forecasts (pp. 51-52 refer).

- Industry standards for financial planners should be reviewed to assist shareholders with limited knowledge of corporate and financial matters.

Public education
Currently there is an expectation gap in the community in that many believe that boards should be closely involved in the company to ensure that nothing can go wrong.

It finds expression as a loss of confidence in corporate leadership and unrealistic expectations about what boards should be doing in areas that are the responsibility of management.

[31] IFSA Industry Roundtable proposal for electronic processing of proxy votes

Secondly, the expectation gap is increasing the regulatory burden on boards, resulting in more and more time being spent on compliance and less time on strategy and direction setting to lift company performance.

The Federal Treasurer's February 2007 Statement of Expectations for the Australian Prudential Regulation Authority confirmed that regulation cannot and should not seek a zero failure rate of institutions or provide absolute protection for market participants (including consumers).

AICD endorses the Treasurer's comments that 'a regulatory framework of this intensity would remove the natural spectrum of risk that is fundamental to well-functioning markets, and ultimately reduces the efficiency and growth of the Australian economy'.

Conclusion

A balance is needed between performance and compliance.
Effective communication between boards and their shareholders can help develop, maintain and restore trust allowing boards to focus on higher levels of performance, rather than have higher levels of compliance bureaucracy imposed on them.

Engagement with shareholders is not something that suits regulation or mandatory reporting as each company must decide the form of engagement that best suits their circumstances and the nature of their shareholders.

Higher levels of performance, achieved with appropriate corporate governance policies and practices, are important for directors and shareholders.

The whole community has a stake in how well our companies perform because the level of economic activity determines the living standards of the nation.

To conclude with the words of the Hon Justice Owen in his final HIH Report:

> 'I think that any attempt to impose governance systems or structures that are overly prescriptive or specific is fraught with danger. By its very nature corporate governance is not something where "one size fits all". Even with companies within a class, such as publicly listed companies, their capital base, risk profile, corporate history, business activity and management and personnel arrangements will be varied. It would be impractical and undesirable to attempt to place them all in a single straightjacket of structures and processes. A degree of flexibility and an acceptance that systems can and should be modified to suit the particular attributes and needs of each company is necessary if the objectives of improved governance are to be achieved.'[32]

November 2007

[32] The Hon Justice Owen., *HIH Final Report* ,6.1.2 and 6.1.3, Part Three, Directions for the Future