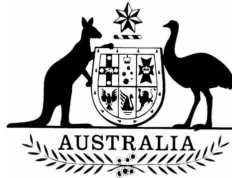

COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Shareholder engagement and participation

TUESDAY, 15 APRIL 2008

CANBERRA

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JOINT STATUTORYCOMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Tuesday, 15 April 2008

Members: Mr Ripoll *(Chair)*, Senator Chapman *(Deputy Chair)*, Senators Boyce, Kirk, Murray and Webber and Ms Grierson, Mr Keenan, Ms Owens and Mr Robert

Members in attendance: Senator Murray and Mr Keenan, Mr Ripoll and Mr Robert

Terms of reference for the inquiry:

To inquire into and report on:

Engagement and participation of shareholders in the corporate governance of the companies in which they are part-owners, with particular reference to:

1. barriers to the effective engagement of all shareholders in the governance of companies;
2. whether institutional shareholders are adequately engaged, or able to participate, in the relevant corporate affairs of the companies they invest in;
3. best practice in corporate governance mechanisms, including:
    a. preselection and nomination of director candidates;
    b. advertising of elections and providing information concerning director candidates, including direct interaction with institutional shareholders;
    c. presentation of ballot papers;
    d. voting arrangements (eg. direct, proxy); and
    e. conduct of Annual General Meetings.
4. the effectiveness of existing mechanisms for communicating and getting feedback from shareholders;
5. the particular needs of shareholders who may have limited knowledge of corporate and financial matters; and
6. the need for any legislative or regulatory change.

WITNESSES

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Committee met at 10.18 am

CHAIR (Mr Ripoll)—Welcome, everybody. I declare open this public hearing of the Joint Committee on Corporations and Financial Services. The committee is inquiring into shareholder engagement and participation. The committee has authorised the recording, broadcasting and rebroadcasting of these proceedings in accordance with the order of the Senate concerning broadcasting of committee proceedings. I inform the witnesses and committee members that there may be other recordings from outside sources other than Hansard. If anyone has any objection to this, please inform the committee. I remind everyone that committee witnesses are protected by parliamentary privilege with respect to their submissions and evidence. Any act which may disadvantage a witness on account of their evidence is a breach of privilege. The committee prefers to hear evidence in public, but we may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date. We would consult the witness concerned before doing this, of course.

[10.20 am]

CODINA, Mr Martin, Senior Policy Manager, Investment and Financial Services Association

O'SHAUGHNESSY, Mr John, Deputy Chief Executive Officer, Investment and Financial Services Association

SORBY, Mr Joseph, Senior Policy Manager, Investment and Financial Services Association

PAATSCH, Mr Dean Anthony, Director Asia-Pacific, RiskMetrics (Australia) Group Pty Ltd

CHAIR—Our first witnesses are from the Investment and Financial Services Association. Do you have anything to say about the capacity in which you appear?

Mr Paatsch—I am here in my capacity as a member of the IFSA voting round table.

CHAIR—I invite you to make a short opening statement if you wish, and then we will proceed to questions from the committee.

Mr O'Shaughnessy—Thank you for the opportunity to appear before the committee and to provide evidence. I am joined by my colleagues, and we are available to answer questions. We would like to start by making a brief opening statement. IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. We have over 140 members and more than $1 trillion invested on behalf of more than 10 million Australians. Member compliance with IFSA standards and guidance notes ensures the promotion of industry best practice. IFSA has been a strong supporter of and an active participant in the development of sound corporate governance practices and the encouragement of greater shareholder engagement. In fact, we see our role as that of a key stakeholder in the public policy setting process.

Australia is well regarded for the strengths of its regulatory regime and market integrity. Sound corporate governance practices increase shareholder confidence in the integrity and efficiency of the Australian capital markets and, in turn, enhance the competitiveness of Australia as a leading financial centre and support the Australian economy more generally. Industry and stakeholders will benefit from a market that is robust to shocks, provides liquidity and has an internationally competitive governance framework.

The IFSA submission to this inquiry addresses each of the terms of reference, specifically examining the role of industry in encouraging greater shareholder engagement and the adoption of best practice mechanisms in corporate governance. Our submission concentrates on proxy voting because voting is a key aspect of shareholder engagement. As noted earlier, we are active participants in the development of sound corporate governance practices, and this has included the establishment of IFSA standard No. 13 on proxy voting and corporate governance guidelines. Standard No. 13 is mandatory for IFSA members and requires members to vote on all resolutions

regardless of the materiality of a resolution or the size of a member's shareholdings. More specifically, standard No. 13 requires retail public offer schemes to publish at least annually an aggregated summary of their proxy voting record using the IFSA table prescribed in the standard. The standard also requires schemes to have formal proxy voting policies setting out the principles and guidelines under which proxies are voted. These policies must also be made available to scheme members, with many such policies publicly available on our member websites. Furthermore, our corporate governance guidelines encourage fund managers to establish direct contact with their companies, including constructive communication with both senior management and board members about performance, corporate governance and other matters affecting shareholders' interests.

We note that, in conjunction with the ASX's *Principles of Good Corporate Governance and Best Practice Recommendations*, the standards and guidelines have become widely acceptable to the investment and corporate community as providing best-practice guidelines for corporate governance—more specifically, about the proxy voting system. IFSA strongly believes that in order to maintain a sound system of corporate governance it is imperative that the processes that support proxy voting have a high degree of integrity. As a result, our submission focuses on the operation of the proxy voting system and recommends legislative and industry based reforms which we believe are necessary to improve the present system.

Our recommendations are the outcome of two, full proxy voting roundtables held in June 2006 and June 2007, bringing together a large number of stakeholders who all play a significant role in the proxy voting system. In addition to IFSA and our members, these roundtables have included the participation of all key stakeholders throughout the proxy voting chain, including the following bodies: the Association of Superannuation Funds of Australia, the Australian Council of Super Investors, the Australian Custodial Services Association, the Australian Institute of Company Directors, the Australasian Investor Relations Association and Chartered Secretaries Australia. Furthermore, representatives from other organisations participated, including from the ASX, CGI Glass Lewis, Computershare, Institutional Shareholder Services, Link Market Services, and Registries Ltd.

There was strong support at the roundtable to address the key risks of the present system, which we identified as being: concerns from institutional investors about the lack of an audit trail, including confirmation of the number of votes and the manner voted as between custodians and registrars; the time constraints and the potential loss of votes caused by the current cut-offs for the receipt of proxy instructions, and voting entitlements required to be held no more than 48 hours prior to the meeting date; issues around the tainting of votes relating to shareholders in omnibus accounts held by custodians, where some shareholders in the account may not have been entitled or permitted to vote; a high level of manual processing and an inconsistency of processes to determine the validity of proxy forms where those forms are unclear, incomplete or ineligible; and difficulties for share registry service providers in electronically processing split votes from registered shareholders, such as custodians, who typically hold shares for multiple clients.

The primary outcome of the roundtables was a collective recognition that the system can be improved, and there was considerable consensus amongst participants towards finding the best ways to address these concerns.

Senator MURRAY—Mr Chairman, what we are being given is a repeat of the submission already before us. I would rather not hear that because I have read it and it is on the record. I would rather get the opportunity to ask some questions.

Mr O'Shaughnessy—I have just got to go to our recommendations.

CHAIR—That is fine.

Senator MURRAY—They are in your submission? Your submission is on the record.

CHAIR—Maybe if you finish up with just the recommendation outlines and then we can move on to questions.

Mr O'Shaughnessy—The recommendations are as follows. Recommendation 1: that superannuation trustees and investment managers request issuers in which they hold shares to receive proxy instructions by electronic means. Recommendation 2: ASIC issue a policy statement clarifying that any issuer which accepts electronic proxies without a relevant constitutional change will not be taken to have breached the Corporations Act. Recommendation 3: an electronic proxy voting capability needs to be developed that will provide a meaningful audit trail from issuers to shareholders so that an appointed proxy is able to confidently declare how they voted in any instance. Recommendation 4: ASX, in consultation with industry, develop a template to facilitate standardised disclosure of proxy voting results, including the percentage of issued capital voted. Recommendation 5: amended Corporations Law to extend the record cut-off date to five business days before the meeting. Such a timetable will provide greater time to reconcile votes lodged against actual holdings. Thank you.

CHAIR—How much work was involved and how much complexity was involved in getting some agreement with your own membership to come up with those recommendations and that system and, in turn, how easily would you see that being implemented on a wider basis outside of your own membership?

Mr Codina—The process that John has gone through highlights to you the number of stakeholders who were around the table at these roundtable meetings. Our intention was to get every key body, which had some role to play or was able to influence in terms of delivering a solution, around the table. That is exactly what we had. There are a couple of elements, as you can see in the recommendations, where some of the fixes that we are looking for are aimed at the ASX perhaps taking a lead role, so that might be on the disclosure side of results.

Other areas are where we are actually saying to companies, 'This is something your shareholders have represented in the roundtable,' which was basically all major institutional bodies that represent institutional shareholders. They are seeing these voting issues as critical to them being able to fulfil their own corporate governance obligations. So it was a clear message to them, saying, 'To the extent that you don't have a capability in terms of electronic proxy voting, then that is something your shareholders are telling you they value very strongly and something they want to see movement on fairly quickly.' We certainly are not pushing for a particular proprietary solution—is that what you are getting outside of our membership or only within our membership? Certainly IFSA's membership represents around 90 to 95 per cent of the funds that are under management, but we do need the buy-in from, in some cases, the underlying

superannuation funds and, I guess, more broadly from all investors, even if they are not necessarily IFSA members. So what we are promoting is a framework, and it is then up to companies to go to the market to look for providers that have a capability that meets that framework.

I think Dean is perhaps in a position to speak at a slightly higher level of detail around what the framework is and what the electronic capability is that we might be looking for. To be fair, it is not rocket science. It is really building on what is already there. A lot of companies do have some electronic interface but, unfortunately, there are still faxes sitting behind some of that. There might be an electronic interface between, let us say, the first two or three people in the proxy voting chain but then somewhere along the line that electronic processing breaks down and turns into a manual process. It may be between a custodian and a registry or it may be somewhere else in the chain. What we are trying to say is that the only way you will get real-time audit trails so that people can have confidence in the votes they have lodged and know that they were the votes that have been recorded at the other end—they have effectively voted in that way—is through some kind of real-time electronic system. That does not need to be proprietary but it needs to allow people, particularly those people who are lodging the votes, to get an indication back from the person who has received the vote that it has in fact been processed and has been cast in the way they have instructed.

CHAIR—In your submission you say that 82 per cent of your membership was using standard No. 13 that you have now implemented. Can you explain why that is not 100 per cent?

Mr O'Shaughnessy—The system is in its third year now; we implemented it in 2006. The compliance at the time, 30 September, was 82 per cent. Following that we have written letters to all those who were non-compliant—and a lot of them were for technical reasons, particularly around ease of disclosure—but all are compliant now. So we have had responses back from everyone who was not compliant as at 30 September and now all of our members are compliant. Every year we check all of our standards, not just this one, for compliance as at 30 September, and with those who are non-compliant we follow through the process.

CHAIR—What sort of feedback have you had from your membership on the compliance issue and the complication or ease of implementing the system, the use of electronic systems—how have they found that? What is the feedback you are getting?

Mr O'Shaughnessy—At the moment it is not an electronic system; some parts of it are electronic. The overwhelming sentiment of our members is that we move to an electronic system. The major reason for that is for the integrity of the process: they can see that their votes have been effective in that process. To date, there are concerns with the audit trail in that it is very hard to get that reconciliation process to a level of confidence that would satisfy our members.

Senator MURRAY—Mr O'Shaughnessy, I want to start by asking you about the issue of informed consent. I take the view that funds such as your members hold invest principally in the stock market on trust, either directly or indirectly, for those who invest with them. And in some situations your members are very good at asking for permission, for instance, for the investment strategy—you are given a series of investment strategies you can pick or if you choose not to there is a default strategy—but I do not see that in other areas. Perhaps it is just because of the

funds that I deal with. For instance, I do not see that there is informed consent with respect to voting, whereby investors are asked an opinion as to whether they want you to act on their behalf by default, in other words, or if there are particular strategies they want to follow. Do you think it is desirable for institutional investors to ascertain the voting preferences of those on whose behalf they invest?

Mr O'Shaughnessy—I suppose the principles of a collective investment vehicle, be it superannuation or otherwise, are such that you join like-minded people with regards to the type of investment portfolio that you go in. And then the principle is that either the trustee or the company director has an obligation under law to act in the best interests of either the member of a superannuation fund or the direct investor. Part of that is to clearly disclose the type of investment portfolio that one is going into. To take the informed consent back to the final investor would put complexity into the system which would take out a lot of the efficiencies of the collective investment.

Senator MURRAY—But let us go back on what you have just said. You are actually getting the consent of the investor already, which I think is desirable. You are saying, 'We will act on your behalf, but you choose the strategy you want us to follow.' That is informed consent. You can see anything up to five options, from memory, in those things and a default option of course. Why don't you carry through the same principle with respect to your voting requirements? You are asking, and I think very well, your members to abide by your proposition 13—

Mr O'Shaughnessy—The proxy voting standard.

Senator MURRAY—yes—and that is good. Why don't you say to your members, 'Do you want us to vote on your behalf or do you want to be advised when there is a vote'?

Mr Codina—Senator, I could answer that by thinking about it through a retail or a wholesale type paradigm. Where our members are managing a discrete mandate from a superannuation fund, quite often the way that mandate is set up is there is a discussion about how the voting is to be conducted: whether that is to be directed by the superannuation fund or the underlying shareholder in that context; whether the superannuation fund, having seen the principles that will guide the fund manager's voting discretion, is prepared to say to the investment manager or fund manager that they are comfortable with the investment manager exercising that discretion; and perhaps in some cases, subject to these areas, where these areas come up for a vote, that is an area where we want to retain the discretion ourselves and instruct you. That is the conversation that is very common.

Senator MURRAY—Let us test that proposition. In my view, the three most important areas where a fund should vote are issues of changes to the company constitution, the election of directors and the remuneration of directors. All of those issues affect the performance of the stock, and I would have thought that you go back to the original investor—either indirect, which is the principle, or direct, where you are doing to it directly—and say to them: 'We intend to at least exercise votes on that. Are you happy for us to do that on your behalf?' The principle of acting on behalf of somebody else is that you have their informed consent. Let me take you to where I am going with this. I understand there is a practice carried out by investment funds of lending their shares. That is giving away the right that somebody else holds for somebody else to exercise. That practice of lending shares is typically looked at from a profit perspective—in

other words, people are making a profit through the practice—but they are also being lent for voting purposes, which is what I want to talk to you about.

Mr Codina—We can talk to you about that.

Senator MURRAY—That is where people lend shares for voting purposes. I think it is immoral to do that unless you have informed consent.

Mr Codina—IFSA has actually put out a public statement in conjunction with ACCI saying that vote renting, which I guess is the term that exists to describe that, is something that we absolutely and unequivocally believe is wrong.

Senator MURRAY—Where I am really going to with all this is here: taking the perspective of those who invest, they need to know, I think, what you are going to be doing on their behalf. You very properly do that with the investment strategy.

Mr Codina—That is what the proxy voting standard is actually about. It is about making a policy public to the members of the scheme about how the manager—or fund manager or whatever you want to call that person—is going to exercise their voting rights on your behalf.

Senator MURRAY—I respond very favourably, I might say, to your submission on proxy voting—I think there are a lot of good aspects to it—but I am concerned you have not gone the extra step. I am concerned that what you are putting here is how you will deal with it administratively but you have not gone—and you have done this in respect of investment—to the informal consent issue: getting right at the outset the investor to say, 'I fully support your getting actively involved in voting on my behalf.'

Mr Codina—Dean is a bit closer to this.

Mr Paatsch—Senator Murray, our organisation not only provides proxy voting advice to a large number of Australian institutions but also delivers the votes. Globally, we act on behalf of 2,000 institutions who collectively would own something like a third of the world's tradeable equities. My view is that most of the major institutions in Australia actually do disclose in advance what their voting guidelines are. Obviously, there are some exceptions to that.

Senator MURRAY—That is not what I am asking. I am asking about informed consent.

Mr Paatsch—As for informed consent, if you sign up to Perpetual, for example, in a mutual fund, you know what Perpetual's corporate governance policies are and how they are likely to vote. You know those in advance.

Senator MURRAY—The investors do?

Mr Paatsch—Yes, they do.

Senator MURRAY—I would disagree with you. Take 100 investors out there and ask them the question: 'What is the corporate governance policy of Perpetual?' They will not be able to

tell you, because they have not seen, equivalent to the investor kind of strategy process, the corporate governance rules to which they are signing up.

Mr Paatsch—I think you would find that the funds could do a better job in terms of marketing exactly what they do. In the last five years we have seen the level of voting double. It used to be that roughly a quarter of Australian listed companies were voted routinely at annual general meetings. Now it is well over 50 per cent. They do disclose those. Most of them have policies that are variations on the IFSA blue book, which is the standard, if you like.

Senator MURRAY—You are still missing the point of my question, Mr Paatsch. I am happy with disclosure and I am happy with more marketing and information—that is very good. I think the advances made in the industry are terrific. I am talking about consent. The base investor, when putting their super money in, signs and agrees to a specific set of actions which will be undertaken on their behalf.

Mr Paatsch—In advance.

Senator MURRAY—In advance, as they do for an investment strategy. For instance, they agree to their shares being lent or not for profit purposes. They agree to their shares being lent or not for voting purposes. They agree to their shares being voted or not for proxy purposes. I have never seen any situation where the base investor—not the principal, not the custodian, not the trustee and not the marketing company but the base investor—gives informed consent on that basis—which they properly do for investment strategies. That is my question.

Mr Paatsch—The shares are not held in their name, Senator Murray. They are basically buying units in a trust; they are not actually holding discrete shares in their own name.

Senator MURRAY—So why is the base investor picking an investment strategy if it is not being held in their name?

Mr Codina—Because the returns will correlate to the strategy.

Senator MURRAY—Exactly. If you are buying an investment strategy which says that this will be the portfolio mix with a certain return, this is more conservative and that is more risky, and you are able to make that judgement as a superannuation person, surely you are entitled to say that you give your consent to whatever shares are held in that mix being lent or voted?

Mr Codina—I think to a certain extent that what we have is a fiduciary based system. What flows from that is that you have basically given that right to the person who is acting as the fiduciary in that capacity to exercise and to make those day-to-day decisions on your behalf in your best interest.

Senator MURRAY—What is the essence of the democratic right of an individual? It is a vote, whether it is in a corporation or in a political democracy. My question to you is: can we extend that basis of permission, consent, further than it already applies? I would like you to go away and think about that because I do not think you have approached this question from that basis.

Mr O'Shaughnessy—Yes, we will go away and think about it but I want to restate a couple of things. Our proxy voting standard, No. 13, is not just about you having to vote on every resolution; it also says that you actually have to have a declared policy of how you will vote. You have to have a statement around the basis that you actually vote the proxies. That is over and above a declared mandate that is available. I would perhaps agree that, if you interviewed 100 original unit trust holders or investors, they probably would not be able to recall exactly what the principles were, but they are declared principles—they have to be made available, as does the nature of the investment scheme that that member is joining. We will go away and think about your point.

Senator MURRAY—Let me be precise as to my question on notice for you. What I want you to do is to ask your members whether they think it is proper to develop an original consent, which means that the basic unit holder or superannuation investor says that they want you to exercise their proxy vote on your behalf, even though they do not hold a specific share—they hold a portfolio—that they accept the principle that you will do that. I think they will give it, but that to me is a base question.

Mr Codina—My final point on democracy is that, in a sense, there is democracy in respect of the scheme. The scheme has a constitution; it is up to members to amend that constitution so that the scheme operates differently to how it was when they initially became members of that scheme. Members are free to join together to make the constitution deliver whatever it is that they want it to deliver. So there is democracy in respect of the scheme. That does not necessarily mean that it translates into democracy about every day-to-day aspect of either governance or the investment process for that matter or the underlying investments themselves.

Mr ROBERT—By way of background, what percentage of proxy votes are actually presented with respect to your members? For example, at an AGM a member company, let's call it XYZ, may have 100 million votes out there—what percentage of votes are actually presented on the floor in general? I am trying to get a view of the extent of proxy leakage.

Mr Paatsch—Are you asking about what is voted on the floor and what is voted by proxy? On average, much less than 20 per cent of total votes would be cast on the floor. The vast majority are cast by proxy.

Mr ROBERT—In terms of total votes presented would 80 per cent of the total voting rights be presented on the floor; would 70 per cent be? How many people would choose not to elect to actually put a proxy in and therefore not vote?

Mr Paatsch—It depends on the company, but on average across the ASX300 roughly 60 per cent of listed capital. So 60 per cent of shareholders by weight of money vote. The vast majority of those come from institutions.

Mr ROBERT—So you are saying that the vast majority of the 60 per cent are institutional votes.

Mr Paatsch—Correct.

Mr ROBERT—Your organisation says that 65 per cent of current stock—tradeable equities—is held by large institutions. That would indicate that there are also institutions not turning up.

Mr O'Shaughnessy—The 60 per cent is probably not accurate. The IFSA membership that we represent is probably closer to about 30 per cent of Australian holding. There are a number of foreign institutional holders as well, and there are also a number of holdings held outside of our membership. So we are probably closer to 30 per cent than 60 per cent.

Mr ROBERT—What is your view on proxy voting for all shareholders? I notice that your submission is heavily weighed towards institutional shareholders and superannuation funds. I am cognisant of your membership base, of course. What you are proposing with respect to electronic proxy voting is slated in a way towards institutional shareholders and superannuation funds. What is your view on providing an opportunity for all shareholders to electronically case a proxy vote, considering that currently only 60 per cent of eligible voters are currently bothering to vote?

Mr O'Shaughnessy—Our view would be that if we have an electronic proxy voting system then it will be much easier for all shareholders to vote. More importantly, it will also produce an audit trail that the shareholder can have confidence in. As far as getting those other shareholders engaged in voting, I would not be confident of how many would take up that opportunity.

Mr ROBERT—Would your organisation support an electronic internet based means—we are not talking about products—that would allow all shareholders, both individual and institutional, to exercise their right to vote?

Mr Paatsch—A number of the registrars have retail electronic systems at the moment. The level of take-up of that has been relatively low. I do not have the exact statistics, but I believe that something around 20 per cent of ASX300 issuers allow retail shareholders to vote. One of the points that we were making in the submission was that unfortunately that same system is not open to institutions, who own the vast majority of shares. So our base concern is to try and get that addressed, together with some sort of credible vote-counting system, which at the moment is so off the pace that it is embarrassing.

I will take a second of your time—and, Senator Murray, as a Western Australian you may be interested in this particularly—to raise the case of LinQ Resources, which is a listed investment company in Western Australia. Recently, a general meeting was concluded in which two hedge funds who had been agitating for the removal of the manager had their units selectively bought back at a very high premium on the current price. They were paid out respectively at $1.54 and $1.57. Today's unit price is roughly $1. More than $105 million was selectively paid out to those two offshore hedge funds. The vote difference was $200,000 worth of units. Here we have a paper based system in which $100 million of shareholders' funds has been paid out to two organisations and the vote result is determined with no comprehensive audit trail and with no ability for anyone to question that result on the public record. This is a matter of serious concern. Rebel Sport is another example where a scheme of arrangement was in place. The vote result was less than one per cent. Because shareholder votes can result in—

Mr Codina—They can affect transactions.

Mr Paatsch—changes of ownership, it is very important for market integrity purposes that there is a much better system in place so the interests of small shareholders and large shareholders are protected alike.

Mr ROBERT—What is your view on cost sharing for any electronic means for voting?

Mr Paatsch—Certainly the view of the voting roundtable was that, if there is a cost, the industry is prepared to pay. One of the main problems has been that the registrars are at the moment less than enthusiastic, let us say, about coming up with a cost proposal. At the moment, they say that it is not possible. But, if there were a market based electronic solution put in place, I am that sure the industry would pay.

Mr Codina—It is effectively a user-pays kind of system so, every time you vote, you can see a cost attaching to that for a certain period of time to justify the initial expense, the capital costs.

Mr ROBERT—With respect to large shareholdings with institutions, be they super, perpetual or mutual funds, you spoke before about how the policy sets out the governance of the fund and how, from that, you could legitimately derive how the institution might vote. What is your view on institutions actually publicly stating on a website, 'Here is how we intend to vote on these five points of order that the AGM has on the agenda'?

Mr O'Shaughnessy—Part of the standard that we have been talking about actually says that the fund manager must publicly declare how they have voted so there is transparency at that level.

Mr ROBERT—When your statement says 'publicly declare', do you mean, 'Here are the 10 points for the AGM; this is how we intend to vote'?

Mr O'Shaughnessy—That is right.

Mr ROBERT—Excellent. Thank you.

Mr KEENAN—I was really interested in the costs of the system, and Mr Robert has covered some of that. You said you are not really sure, but do you have some sort of ballpark figure for the compliance costs that might be associated with establishing a system like this? Ultimately, you say, the institutions will bear the costs, but surely that is going to flow on to consumers.

Mr Codina—There is the counterfactual aspect here as well—what happens if a change of controlled transaction is approved and then has to be unwound? That could be quite catastrophic. Going directly to your point about cost, we have not had any participant in the roundtable actually say to us, 'The cost of this is prohibitive.' I think what you are seeing is inertia rather than a case of somebody having actually looked into this thoroughly and worked out that this is a massive overhaul of perhaps what they have already got. To add to that, organisations such as SWIFT, which develop messaging standards—which I am certainly not an expert on, but nonetheless—have now come to the table and developed proxy-voting messaging protocols that are now going to be global, effectively, in their potential application. So a lot of the work is actually there. It is a question of somebody picking it up and building it into their existing systems to allow investors and shareholders to use that as the voting platform going forward.

Mr Paatsch—There is no compulsion at the moment. That is where the stand-off is. The industry is very clearly saying to both the issuers and the registrars who accept votes on their behalf, 'We want an electronic system,' yet there has been nothing to break that deadlock. We deliver votes on behalf of most of the institutions in the Australian market. I have a line item sitting in my budget for 'Development interface to any electronic system', and it has been sitting there for two years. I would be happy to spend it if somebody told me exactly what shape they wanted the data in.

Just on Martin's point, this is a well-beaten path: there has been a SWIFT messaging development for proxy voting for the last two years, and that will provide an audit trail from go to whoa. We just do not want to send an electronic message in and have it lost. We want a bankable receipt that comes back. Then, in the event of an aberrant result, or if something looks a bit fishy, you can slice open the electronic system and a third-party auditor can come in and have confidence that everything that hit that message centre was bankable. At the moment we do not know. So, if I send in a paper proxy form with a wet signature for 100 million shares and the registrar's fax machine has run out of paper or the form is not processed, I do not know—and that is a disgrace.

Mr KEENAN—When you talk about platforms, I assume it is just some sort of internet based thing where you can verify your identity or something like that and then cast your ballot. Is it as simple as that?

Mr Paatsch—It can be. It depends on how you do it. I actually quite like the Hong Kong system, whereby there is an entitlement for individual shareholders to come and do that but there is also the opportunity for a platform provider to drop in a master file on behalf of several issuers; it is like a gateway. That is quite neat as well. I do not like the idea of developing an Australia-only system, because you have to interface with global custodial banks. I do like the idea of using SWIFT as the major messaging interface. Who knows where that development will go, but it is not expensive, it has been tested and it is already happening in interbank messaging offshore. So I like that idea.

CHAIR—Just following on from what Mr Keenan has been raising: is there enough momentum out in the marketplace for a better system? This appears to me as though it would be an advantage, an add-on service or some sort of a better mechanism within large companies, organisations, trusts and so forth to actually go down this path. Surely you would think that there would be that sort of momentum now or some inertia, as was said before, to have more people want to comply for their own purposes. Or is that not the case? Does this then need some mechanism for compulsion to get the sort of compliance you need?

Mr O'Shaughnessy—The mere fact that we have been able to get all interested parties around a table twice and come up with a series of five recommendations I think is evidence that there is a will and, in your words, momentum to move forward. It requires some regulatory change, some industry practice change and, ideally, some legislative change with regard to timing. We would like to bring all of those recommendations together at the one time.

Senator MURRAY—Could I ask that we add a question on notice, because the questions that have just come through have been very much to the point. You have told the committee what you think should happen—which, as I said to you earlier, I react very favourably to—but you have

not told the committee how it should happen. I wonder if you could go back and give some thought to that. I will give you an example. The corporate governance principles were developed on a terrifically cooperative, sensible and practical basis. ASX, ASIC and key institutions sat down and worked out the corporate governance principles. I wonder if you could tell the committee for our report how you think this could best be done—what process.

Mr O'Shaughnessy—We will take that on notice and resubmit.

CHAIR—What has been ASIC's response to your request for clarifications on companies that are accepting electronic proxy vote lodgements but without the specific constitutional mechanisms?

Mr Codina—From memory—I do not want to be unfair to ASIC—ASIC is in a 'watch this space' mood in relation to this issue.

CHAIR—Have they given you a specific response? You have requested from them some clarification.

Mr Codina—We have not had a response. I think you can safely assume that one of the reasons why our submission is so focused on this issue and that we saw this inquiry as so timely for us was that it provided—in a sense going to Senator Murray's question about process—a wonderful avenue for us to air this as publicly as possible and hopefully to put the spotlight back on those people who are, I guess, the subjects of some of these recommendations, to sort of re-engage with these issues. From our perspective they are not going away.

CHAIR—Is it the case that, where a constitution is silent on this matter, the interpretation is that then you can go ahead and lodge electronic proxies?

Mr Paatsch—There are a variety of interpretations are out there. Some registrars and issuers are relying on a very, very conservative legal interpretation—'No, we could never accept electronic instruction without a constitutional change, and that is three years away.' A no-action letter takes care of that in one fell swoop. We are in the 21st century and, provided that—

CHAIR—It might be a definitional problem as to what a proxy vote is and how it is then received.

Mr Codina—The legislation itself certainly allows explicitly for this to happen. It is just a question of a disconnect, potentially, between some earlier constitutions and those amendments in the Corporations Act.

CHAIR—Thank you very much for the evidence you have provided today.

Proceedings suspended from 11.04 am to 11.17 am

GAIR, Mr Bill, Managing Director, Boardroomradio.com Pty Ltd

MURRAY, Mr John, Chairman, Boardroomradio.com Pty Ltd

CHAIR—Welcome. Would you like to make an opening statement?

Mr Gair—Thank you for the opportunity to present today. Boardroomradio is an online broadcasting business founded in 2005. We began the business seeing that there was a genuine business opportunity to endeavour to bring the communications coming out of the executive suites a bit closer to, particularly, the retail shareholders. It was a real opportunity to increase both the flow and the immediacy of that information. Our interest today in presenting is to highlight that there are large numbers of investors at this stage who do not get access to the immediacy of information that is coming through and that there is an opportunity there to improve that. Our company currently has in excess of an average 300,000 listeners per month.

Senator MURRAY—Goodness me!

Mr Gair—Our business model is one where listed companies subscribe to our services and we have close to 300 companies—close to 10 per cent of the market—who subscribe to Boardroomradio. We have an archive of close to 5,000 broadcasts in place now, which is a great advantage to investors; not only do they get to listen to what might be happening today but they can also go back to previous years and find out what companies might have said they were going to do. We distribute our information through 50 partner websites—most of the significant financial websites in Australia—to get access to the market. John Murray will give you a quick overview of why we think it is relevant to present here today.

Mr Murray—When we looked at the terms of reference, we looked at shareholder engagement. One of the key issues that we have is that shareholders need to feel that they are part of the business—that they own part of the business—that they are not just at a casino betting on chips and hoping that they go up and down. One of the things that we have seen recently is a huge divergence in the information available to professional investors in comparison to what is available to the individual investors. That has come about because of a change in technology. Let me explain that. In times gone by a great idea would be to take the chief executive up to the boardroom of AMP and he would then explain to the investors at AMP what his plans were and give them what is called a briefing and he would then perhaps have lunch at Deutsche Bank or somewhere like that and the analysts and other investors would come along and listen to what he had to say.

Currently, that chief executive is required to lodge the PowerPoint presentation with the ASX—and that is it. So, if you are a private investor, you never get to hear all the commentary that pertains to those slides and makes them meaningful—and we think that is wrong. Technology has come along to such a stage where everybody can get that information. The best example you can see of that is right here in this room. Ten years ago you would not have had cameras. People would not have been able to watch this when they wanted. Obviously the parliament has decided that it is a good idea to make this available to everybody. For those people who want to log onto the website and watch this broadcast, they can, or they can listen to

it when they go home, because it is a great idea to make it available to as many people as possible. Our company is about exactly the same thing.

I will give you one quick example of why we think it is important that something changes. I have here with me a chart of a company called MFS. The particular day is 18 January. As you can see on the graph, the share price opened at $2.20 and started to increase. The company scheduled a conference call—a selective, invitation-only briefing to selected analysts and investors. That is not available to you and I. The conference call starts—and, as you can see, the information provided is not going very well. Those people who are lucky enough to be on that conference call get an opportunity to sell their stock. You and I, however, do not hear anything about that until it is too late. That was not 10 years ago or five years ago; that was just a couple of months ago.

We have a couple of other examples which are not quite so biting with regard to, say, Centro and ANZ. The Centro Retail Trust had a briefing which had a massive impact on the price of Centro, if you were lucky enough to be on that briefing. With ANZ and their first conference call, you can see from the graph the wild swings and volumes during the call. Interestingly enough, after their latest call in April, they did provide a web address where the public could go and listen to that conference call. That is what we are all about. We are saying that everybody should be given access to this information at the same time. The technology has now come so far that you do not need to have selective briefings. You can, economically, make those briefings available to everybody for free.

CHAIR—I have a question regarding the issue of shareholder apathy in terms of access to information, proxy voting and a range of other issues. How do you see that from your perspective at Boardroomradio? Is it due to apathy that shareholders do not participate as much or is it more about smaller shareholders making a decision not to participate—whether it be proxy voting or anything else?

Mr Murray—In our submission there is some quite good commentary from David Gonski. I think he talks very well about the disconnect between a shareholder and the company. Shareholders can see the board at the AGM, but the number of people who go to the AGM is tragically low. The AGM could be at 10 o'clock on a Wednesday—and most people have jobs. So they never see the management. They never interact with them or get to ask them any questions. Part of the solution is to humanise the management of those companies—to bring out the 'humanness' of the directors and the chairmen. That is a very poor description, but I do not know how else to say it. David Gonski expresses it much better. Bill, what do you think?

Mr Gair—Apathy also has come through fairly buoyant times in the market. This technology that we are using is readily available. Webcasting is not new. I suspect that there will be less apathy going forward, particularly from small shareholders, as to what is happening in the businesses that they are involved in. Then it becomes even more appropriate that they get to hear what the executives have to say. As John pointed out, when we have surveyed our listener base one of the key things that has come through is that the shareholder is getting direct access to the CEO. We thought initially that it might be seen as just advertorial—'It is just the CEO selling their story'—but there is real value attached, particularly for small shareholders, to that level of contact that they can have with the executives. And I think we are part of a change that is taking

place, making the communication more relevant than it has been. The paper trail that has been in place has created, I think to a large extent, the apathy that we refer to.

Mr ROBERT—In your submission, the majority of which I do not disagree with, you have not actually listed any recommendations. What would you recommend?

Mr Murray—The key recommendation that we have is that the selective briefings be made available to all investors. In other words, whether it is through our company or through someone else, those conference calls and the dialogue that goes around those selective briefings should be made available to all investors.

Mr ROBERT—Could that be as simple as the conference call as a streamed audio from its website?

Mr Murray—Yes. For at least half of the 300 companies that we have as clients, we dial into their conference call and just stream it. It is quite a good idea, because it saves the company money, but it does make it available to anybody who wants to listen to it, and there is an archived record of it.

Mr ROBERT—I do not believe the current Corporations Act deals with this at all. It simply makes the point that an AGM could be in multiple venues, which keeps the door open to allow an AGM, but I do not believe—and I could be wrong, having not read the Corporations Act for a little while—that it actually makes provision for this with respect to selective briefings. Senator Murray, you might be able to help.

Senator MURRAY—It does not prohibit it; it is silent on it.

Mr Gair—Obviously we are looking for some definition there. I think the other issue is the inclusion of newswire services such as ours in the process of disclosure. Currently it is a requirement of companies to first release to the ASX in a written format. In other marketplaces it is appropriate for them to release in a written format but also to release at the same time in an audio format.

Mr ROBERT—Mr Murray, I will ask you about MFS, since I am the federal member for Fadden on the northern Gold Coast and MFS is a Gold Coast based company, but put aside the company; it is largely irrelevant. Using your graph, which I am well aware of, was it only the main institutional investors that were part of the actual conference call in question, or was that conference call available to all institutional investors? How does that generally operate?

Mr Murray—It is on an invited basis. It works quite simply: the company either has an internal investor relations person or employs an external investor relations consultant. It is the responsibility of that investor relations individual to send out the invitations. I do not know if you have ever seen one, but you get a phone number and an ID number that you punch in and then you are welcome to the conference call.

Mr ROBERT—Therefore, a company could release information that is certainly going to impact the share price—and you gave a number of examples—and release that information only to a select number of individuals. Is that your contention?

Mr Murray—That is what happens now. If a company had no information to be released and it was not of significance, why have the conference call or the briefing?

Mr ROBERT—In your submission you quote ASX's statement that 'timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and the ASX have a legitimate interest'. That statement inclusively speaks of investors—which is all investors, retail and institution. Considering what you have just said, do you believe that companies are currently operating in the spirit of that statement, that they are providing timely disclosure to all investors on information which may affect values?

Mr Murray—No, not to all investors. The examples of that are constant. There would be 20 presentations going on today to which not all investors are invited. Ten years ago, or six years ago, the technology was not available to remedy that situation. I guess the point that we are making is that we do not want to stop the chief executive sitting down with some institutional investors and giving them a better understanding of the company that he or she runs; what we are suggesting is that that information should be shared widely.

Mr ROBERT—Considering that your contention is that companies are not operating in the faith of the ASX statement on providing timely disclosure to all investors, have you spoken to the ASX, provided any written comment to them or sought advice or guidance from them?

Mr Murray—We have been in constant contact with the ASX about ways that we might work together—and, indeed, we are doing that with the New Zealand stock exchange because the New Zealand stock exchange can see a need for that—but, because it is a relatively new concept, I guess you have to wend your way through the bureaucracy.

Mr ROBERT—If there were a requirement for companies to provide access to that conference call, or any other medium whereby they discharge any information that may have a material impact on security values, how would you see that being enacted? Is that a legislative decision? Is it an ASX or ASIC issue?

Mr Murray—The whole regulation of the release of company information is—or should be—going through quite a serious review, given the testing times that we have seen. So I am not too sure who is going to end up with the regulatory responsibility. But what I do know is that over the last six months we have certainly seen different groups of shareholders and investors getting different information at different times. Whoever is going to end up being in charge of regulating that, they are going to have to address this issue.

Mr Gair—I would suggest that the first thing we would like to see would be an option for companies to jointly release through the ASX in a written format—perhaps a copy of the PowerPoint presentation that is being made—as well as an audio format through news wires similar to us.

Senator MURRAY—I find this very interesting. What you are proposing, basically, is real-time disclosure to the mass market. It extends the modern concept that markets are instant, universal, 24 hour, international et cetera. The difficulty will always be those who are hooked in or who have access. It seems to me that you would look to segment your market as to who

should be reached. The people I want to ask you questions about are self-managed super funds. I forget the exact figures, but I think there are over 300,000 of them, they are about a quarter of all invested funds et cetera. Do self-managed super funds use your service to any extent?

Mr Murray—I think the best way to answer that is to say that we give all our broadcasts away free. There is no password or logon. We think that this month 500,000 broadcasts will be listened to; we are halfway through the month, so we are not too sure what the final figure will be. When I say that we give it away free, I mean that we take our broadcasts and give it to people like CommSec, E*Trade, the ASX, news.com.au, Bloomberg and IRIS for nothing, and then they distribute it. If someone who runs a self-managed superannuation fund has somehow missed our broadcast I would not say that it would be a miracle, but it would be very hard not to see that broadcast across one of those services.

Senator MURRAY—Do you know what your market is and who is listening to your material?

Mr Gair—As John pointed out, we allow people to go straight to a broadcast from the front page. There is no registration, so we are not getting down to the detail of each individual who is actually listening. But in general terms we see the market, probably, divided into three. We can measure where people are coming to our site from. There is the community that is actually trading at desks and is looking at the market minute by minute; they represent about a third of our business. There is another third, the self-managed super fund group, and then there is a third consisting of the retail investors, who tend to look at things the next day or at the weekend and not with the same degree of urgency that the first two groups seem to. But we do not have precise numbers on each of those.

Senator MURRAY—Do you find that participation in this form of communication and disclosure depends on the company and the chief executive—in other words, somebody who is—

Mr Murray—A bit more lively?

Senator MURRAY—lively, up-to-date, modern, if you want to call it that?

Mr Murray—We see trends when sectors are fashionable—for example, a year ago, I think it was uranium. We had very big listener numbers to all the uranium companies as they explained their story. It did not much matter whether they were the more talented, interesting and engaging presenter or the more pedestrian presenter—they all attracted similar interest. It was more the market's interest in that sector that drove the listener numbers.

Senator MURRAY—I thought the question of one of my colleagues earlier was very pertinent. What committees like this try and do is distil the wisdom that is given to us and come up with proposals as to how to advance good causes. If yours is a good cause, you need to give us more guidance as to what the committee could do to advance greater disclosure on this basis. Could I ask you on notice to go away and think about that and to propose a process to us, whether it is legislative change, regulatory initiatives, interactions between ASIC and ASX or whatever may encourage you? What I see here is a commercial approach which has real benefit

in terms of market information and which is right on the button, but I do not really understand what we can do to assist.

Mr Murray—Okay.

Mr KEENAN—In many ways this follows on from what Senator Murray was just talking about. I am not really sure whether you are proposing that we legislate for some sort of real-time disclosure. I understand with your model that the companies pay for your service as opposed to the consumers of the information. I assume these companies would have an interest in running things properly, which would be most companies operating in the marketplace in Australia. But there is really no incentive for companies that might have an interest in not sharing information to use the service. I am not sure whether you are saying to us that we should be looking at a model where we legislate for 100 per cent of companies to use the service to disclose this information.

Mr Murray—No. We are a two-year-old company and have not presented at a forum like this before. What we are saying—and it is a clear message—

Mr KEENAN—I am sure it would be good commercially for you if we were to do that!

Mr Murray—Yes. If you could write that, that would be great. What we are really trying to say is that there are two information disclosure regimes. We want the disclosure regime to be uniform and fair—and that is all we want. When a company goes to a boardroom to do a presentation, it is very simple for us to capture the audio and to stream it live so that people who were not invited can participate in the information that is imparted at that presentation. Following on from Senator Murray's question, we will distil that into half a paragraph. It is pretty simple from where we sit. Perhaps we have not answered the question very well.

Mr Gair—It is the inclusion of the audio presentation or a format similar to ours—both the audio and the PowerPoint are included on our audio file—as being a legitimate way for companies to release information to the market under the terms of continuous disclosure, as well as the existing PDF files that must be sent to the ASX. We are not looking for exclusivity. We are just saying that, in other marketplaces, it is appropriate for news wire services to be part of the process of releasing information. In this market that is currently not the case. It is post the event. It is not as a mechanism for releasing to the market the initial announcement.

Mr KEENAN—This is more by way of a comment, I suppose, than a question. On the conference call example—which, by the way, was an excellent example about the effect that selective information disclosure can have—I suppose we could say, as legislators, that when you are holding a conference call with investors you need to broadcast that real time. The company that might be interested in hiding information might then change the terminology of what they were doing, but there is nothing to stop them from going out and selectively briefing investors unless we make some sort of blanket rule that when you are disclosing any information to any investor at any time that needs to be made 100 per cent public—which would of course be an extraordinarily cumbersome thing for any legislative authority to enforce. As I said, that is more of a comment than a question, but if you want to consider that in your response to Senator Murray's question on notice that might be useful.

Mr Murray—Yes. It is quite a random, ad hoc process. Obviously, companies do it to varying degrees; some companies are presenting all the time, some companies present rarely—to answer your question about some companies not wanting to disclose information. We will make sure that we include that in the response to Senator Murray's question on notice.

Senator MURRAY—If I can give you a thought which might help, I think you should speak to ASIC. My understanding of the law at present is that it would be open to ASIC to require that any selected disclosure be available on a broad basis, and they could put out a practice note to that effect. The question is whether they have thought about that or whether they would not want to do it. I would suggest that before you respond to us you have a chat with them about that, because that is the way in which it would be made obligatory. Obviously it would not just be to you; it would be to anybody. They would need to think it through.

Mr Murray—They did write a note—

Senator MURRAY—You have been talking to the ASX. In your response I think you should convey to us the ASX view, as you understand it, and ASIC's view, so that we can then examine that.

Mr Murray—Yes. ASIC did write some papers in 2001 about this subject, then it seemed to have cooled down a bit. So we will go back and speak to ASIC and include their view in the answer.

Senator MURRAY—Thank you.

CHAIR—I have a few questions slightly off that topic. What is your opinion of the 100-member rule?

Mr Murray—For a meeting?

CHAIR—Yes, for calling for meetings.

Mr Murray—I think if we can move to an area where you can do it electronically and host a virtual AGM then you will never have any trouble in meeting that rule. I think it is a good rule. The example that the previous speakers gave about those two hedge funds that extracted a pretty awesome price and a toll on the unit holders in that fund is, I think, a great example. If you make it any easier to call a meeting I think that would be to the detriment of shareholders, funnily enough.

CHAIR—Okay; it was just a broad question. We have heard a fair bit this morning about proxy voting arrangements and so forth. What is your understanding of that and how do you see the current system or improvements to the system?

Mr Gair—In a business sense, we can see ourselves working in synergy with companies that provide secure ways for shareholders to vote, and it would work perfectly well with our live broadcast of an AGM. Obviously we would look forward to or encourage that opportunity happening in Australia.

Mr Murray—The gentlemen who were here before referred to and made representations about the ASX 300, which is their area of expertise, but there are 2,700 or 2,800 listed companies so it is just a tad over 10 per cent. Generally, the problems occur with the bottom 90 per cent—they are the slow adapters; they do not have the budgets to bring all this on—and that is where the shareholders are really disaffected because those companies are very slow to change. You can go to those AGMs and there will be two people there, which is never going to happen at Westpac or the Commonwealth Bank. So they are the companies that really would benefit from these sorts of changes, and an example could be a little mining company in Perth. I think half our customers are in Perth and a third of all listed companies are based in Western Australia, yet the shareholding base is not based in Western Australia, it is based here.

Let me give you an example. If a company has something bad that they want to get through at the AGM, they will just host it in Kalgoorlie or Fremantle or somewhere like that, knowing it is very hard for people to go over there and turn up at the meeting. No institutions will be on the register because it is outside the ASX 300. It does not make them any less responsible a custodian of public funds; it just makes it easier for them to do things away from scrutiny. That problem to a certain extent would be resolved with electronic voting and virtual AGMs because you would not have to go to Perth to do your voting or send in your proxy.

CHAIR—It is interesting that you raise that because it opens up a whole other area to look at—particularly with what you do and some of your recommendations, which I think are quite good. Given that there are so many options out there in terms of how you would disclose or disseminate information, from a simple email, to a media release, to a webcast—and there are probably 20 or 30 other ways you could do it today—where would you draw the line? What would be a base line, an entry-level line, which we as a committee could look at as a minimum standard apart from what is there now—some extra disclosure in electronic form, be it email alerts or some other mechanism or even just web content?

Mr Murray—I think the basis has to be that it is available free to the public. Even if you release that information through one of the news wire services, if you have to subscribe and pay to get that it does limit the number of investors who are going to get that information. That is the ASX model; you are obliged to send them the information and then they charge the news services for access to it. It is a great business model. So the base level would be access that is free to the public. The company's website is a great start, although it is not often that well visited. But that would be the basis.

CHAIR—I am particularly referring to the other 90 per cent that you referred to. For the top 10 per cent—Westpac and the majors—it is certainly not going to be a problem either. They have the resources, the capacity and the ability to make these things happen in any form. I am referring to the other 90 per cent—the lower end.

Mr Murray—I do not know how you write this into the legislation, but that is why I have gone to places like CommSec. People who use the internet to invest money go to CommSec, E*Trade, Bell Direct, Fat Prophets and the ASX website, which take our content. We have tried to go to all the places where we think we can capture and give information for free to the people who are electronically engaging in the stock market or have some understanding of how to log onto a website.

Mr Gair—It is difficult to be overly precise with that because the landscape is changing. But the raw simplicity is an email to begin with—be it an alert or the full information—and we would see ourselves as being an adjunct to that. It should not be restricted to audio; it should obviously include video as well. But this is the next step. Of course, there is a generation coming through now who know almost no other way of communicating with each other, and also, for receiving information, that is what they go to first. So that linkage between email and broadcasting online is the sort of connection we would like to see.

CHAIR—Do you see a distinction between providing that information on a website and emailing that information directly to investors who have provided an email address? The limitation would be that, as a starting point, it can only be those who provide an email address.

Mr Murray—You would go back to an almost selective disclosure because if you do not give them your email address you are excluded from that information. I think Bill and I would say that a combination must be available on a website somewhere for free. That would be the first point. That does not exclude anyone.

CHAIR—Literally. Let us say 'nearly everybody', depending on a range of factors and other issues.

Mr Murray—But those people who do not use a computer are not going to be helped by these changes anyway. There is nothing much that technology can do to help those people if they do not want to use the internet to get the information at the same time.

Mr Gair—Our business model was predicated—it is obvious I guess—on the basis that we would ultimately be in a position to provide that information for free and broadly to investors and the profits for our business would come out of a subscription model to the companies themselves. The way we have set this up is to be able to fulfil that objective so that there is no hurdle for investors to get access to that information.

CHAIR—Mr Murray and Mr Gair, as there are no further questions, thank you very much for appearing before the committee today.

Mr Murray—Should we email the committee secretariat with our response to Senator Murray's question?

CHAIR—Yes. Thank you.

[11.53 am]

CLARE, Mr Ross William, Director of Research, Association of Superannuation Funds of Australia Ltd

CHAIR—Welcome. Would you like to make a short opening statement?

Mr Clare—Thank you for the invitation to attend today to speak on the submission that we made. ASFA is a broad representative association for superannuation funds in Australia and collectively those superannuation funds represent about 80 per cent of superannuation savings, about $1.2 trillion in total. In terms of the invested funds in Australia, our members are responsible for a considerable proportion of them.

Within our membership we have quite a diversity of members across various superannuation funds and there is a range of diversity between their circumstances. We represent retail superannuation funds, industry funds, corporate funds and public sector funds and also have a representative role with self-managed superannuation funds, mainly through their advisers and service providers. We also have service provider members, including investment managers. So it is quite a broad constituency, ranging from funds with between $20 billion and $30 billion in assets to funds with around $50 million in assets.

Just about all of those superannuation funds would have some exposure to Australian equities—holding shares in Australian companies—with an overall average holding of around the 25 per cent mark, normally as part of a diversified portfolio. But, again, there are variations between funds. In terms of the self-managed fund sector, their holdings of Australian equities are fairly like the holdings of mum and dad investors, because that is often what they are. They have limited holdings of the blue-chip stocks. For the larger funds, often there will be a holding of shares which is quite similar to, or drawn from, the top ASX 50 or top ASX 300 and sometimes further. So there are a variety of circumstances within our membership and a variety of needs in terms of their involvement and engagement with corporations that are operating in Australia.

As to the ASFA policy positions, we certainly recognise that the voting rights and the involvement of shareholders in the governance of corporations are an important part of the ownership of shares. So it is appropriate for those voting rights to be exercised and engagement to occur with companies in appropriate circumstances. But what those appropriate circumstances will be will vary from fund to fund and also from company to company. Also, over time, on some issues funds may seek to engage whereas at other times their involvement may not be as active. Given that superannuation funds in total have engagement with just about every company listed in Australia, it is difficult for individual trustee boards to engage on every issue with every fund. The trustees of each fund have responsibilities with regard to a number of matters, and just one part of it is the engagement with companies and participation in the voting processes.

The best practice principles that we have put forward to our members in our best practice paper—a copy of which I can make available to you, if you would like to see it—are broad principles. We have also as an association engaged with a number of other organisations in a range of processes, including the ASIC corporate governance roundtable. We have also been

involved in the development of the IFSA ‘blue book’ standards—and I understand that Richard Gilbert and colleagues appeared before the committee this morning. ASFA has also been an active member of the ASX Corporate Governance Council and has participated in the IFSA proxy voting roundtable. I have already mentioned that we have issued best practice guidance—which is, I think it is fair to say, fairly similar to the IFSA guidelines.

In terms of a number of the issues that have been raised in submissions to the committee, we would agree that making some of the mechanisms for shareholder engagement work better would be desirable. One of the priorities for the association going forward is to have better use of electronic commerce processes. I note that a number of submissions and proposals have been put forward for making proxy voting work better, moving away from what has in the past been all too often a paper trail with at times the bits of paper not getting to where they should in the time frames allowed. Communication issues are very much in the mind of the association. Our member funds have challenges in communicating with members of funds. Equally, corporations have challenges in communicating with shareholders in both a timely and a meaningful way. They are my broad opening comments. We have provided a written submission. I would be pleased to answer any questions that you might have.

CHAIR—Thank you for the opening statement as well as your submission. By what principle means do superannuation fund trustees engage with company boards? What role do they take with AGMs? Do they take an active role? How do they participate? Are boards generally accessible to trustees at other times? What sorts of levels of involvement do they have?

Mr Clare—There is a great diversity in the ways of engaging and in the different levels of engagement. Given the diversity of superannuation funds, it is easier for some funds to engage at the direct level if a fund has a major shareholding. Doors are more open and there is a greater incentive for the fund to engage with the company concerned. The way that funds hold their shareholdings can influence the manner of engagement. Some funds make use of pooled superannuation trusts. With others, the services investment managers may hold the legal title and may have the voting rights. There are different ways of engaging. In some circumstances, it will be through contributing to a joint approach. A number of the submissions that you have received are from organisations that are involved in those sorts of processes. The Australian Council of Super Investors, who will be appearing this afternoon, assists a number of superannuation funds in engaging with companies.

For other superannuation funds, their engagement may be direct. In other cases, it may be through the influence of the voting behaviour and other activities of investment managers. In some cases, it might be fair to say that trustees have made a decision that in most circumstances their level of engagement with boards and the voting process may be minimal unless there is a specific reason to become involved. For some funds, the objective is to have an investment portfolio that is similar to or a proxy for an index fund in terms of reflecting the broad range of access to shares. The incentive there is more to reflect those weightings rather than necessarily be an active shareholder. For others, as I said, the rights apart from the dividends that ownership of shares brings are very important property rights. That is a bit of a convoluted answer but, given the diversity of circumstances of superannuation fund investors, that is unavoidable. It depends on the size of the fund, the scale of a shareholding within an individual company and also the individual resources.

For the smaller superannuation funds, very often, just about all of the services are contracted out—they are purchased. That may include investment management. For other funds, increasingly the office of the trustee is becoming larger; there will be a chief investment officer, and/or others within the employment of the trustee, who will take an interest in the governance matters within Australian companies. So it does depend on the capability of the fund to engage with a company. And there is no uniform pattern across our membership or across the sector.

CHAIR—Does your association keep data and statistics on voting patterns or specific policies with the different super funds in terms of how they use their voting powers?

Mr Clare—It is not something that we have collected. Surveying superannuation funds is not an easy task; I know that from my own experiences where I have done it on various issues in the past. Getting reporting on that is quite difficult. I do note from some of the submissions that you have received, including AMP Capital—I think that was one of the ones I saw—that there have been some surveys of involvement. Also, IFSA has reported to you in terms of adherence with their standards. But it does come down to what the nature of the exercise of the vote is. Is the default position going with the voting for the recommendation of the directors unless there is a reason not to? Very often that may be the case in terms of the behaviours. And it is one of the dangers. If there were a mandated requirement to vote, it may result in default voting rules being put together which may not be helpful. At the moment voting is voluntary; funds decide when to vote and in which direction, and when they do so it is an engaged process.

CHAIR—Do you have any data or empirical evidence of the impact of those sorts of decisions—as to whether they do or do not vote or how they vote?

Mr Clare—No data, just anecdotal information—and from secondary sources. The custodians have some impression of what happens with the shares that they have in their custody, because they are often the funnel for the proxy voting process. So, that may be a productive area to survey or to seek the views in terms of what happens within those organisations. But it is a growing trend. The anecdotal and the partial evidence would tend to indicate that there is growing engagement and more active involvement of superannuation funds in voting. The extent of it in numerical terms is far harder to determine and it also comes down to whether a vote, as a matter of rule, is tied up—which responds to directors' recommendations. What significance is to be read into that? Certainly there is evidence of greater involvement, both at the individual fund level and through the collective representation processes, because meaningful voting is actually quite resource intensive for funds. So it comes down to how best to do it, and collective arrangements can support that.

For the largest funds it may be possible to have informed opinions developed within the fund itself, through the advice of staff at the fund, feeding into the trustee board of directors, and then leading to a vote being exercised. But the mechanics of doing it sometimes make it difficult to achieve within the time frame—working from the time that information is received and that the resolutions that are being put forward are received by the superannuation fund. Then the evaluation needs to be made, and then the mechanical process of the vote being exercised can make it a challenging process. But when the incentive is to do it, and on the big enough issues, it happens; it also happens when there are efficient processes put in place, including those collective arrangements that evidence has been given to the committee about.

Mr KEENAN—It is interesting you would say that—that it is hard for the larger superannuation funds to make informed decisions about some of these issues. It means of course that it would be very difficult for individual investors. But let us just say you are a big fund and the AGM for a company in which you own a reasonably sized stake is coming up, and executive remuneration is up for discussion at that AGM. What sorts of processes would some of these larger funds go through to make a sensible decision about whether the remuneration package for the executives of the company is appropriate?

Mr Clare—It is like any institutional or other investor making an assessment. There are various guidelines that have been developed about executive remuneration and there are also different organisations which specialise in providing advice on voting issues. Certainly, executive remuneration has been one of those issues that have been given increasing attention, and I think there is increasing exposition of what are appropriate principles for the provision of executive remuneration packages—what makes sense in terms of reward for certain behaviours or what thresholds have to be met before bonuses or discretionary or additional payments are made. The media itself plays a role, through its highlighting of contentious issues. If we could get to a situation where directors' proposals with regard to executive remuneration were entirely sensible and fitted the principles that seem to be developing in terms of appropriate reward for a good or outstanding performance, then there will be less of a need for shareholders, including superannuation funds, to intervene.

Mr KEENAN—Are there examples of your member funds intervening to make changes to remuneration packages for the executives?

Mr Clare—Again, we have not done any hard surveys of this, so it is just anecdotal.

Mr KEENAN—Even if it is anecdotal, is it a regular occurrence?

Mr Clare—I am not sure I would go so far as to say it is regular. I think ACSI, who you are seeing this afternoon, would be better placed to respond to that, given that they are involved in that on a day-to-day basis.

Mr KEENAN—So you do not give any guidance to your member funds, for instance, about what they might do in these circumstances?

Mr Clare—Our guidance is that they should consider carefully what is being put forward and exercise a vote if appropriate.

Mr KEENAN—I meant for specific AGMs. Let us just say there is an AGM coming up for a big company; you do not issue any guidance about how you think it might be appropriate for your member funds to vote?

Mr Clare—It has not been a role for our association. Our principles and our policies have been more about the general framework, what funds should consider and what processes they might contemplate undertaking. It is not a function of our association to make evaluations of individual cases and bring forward recommendations. In terms of the way we operate and the way our policies are set, it is unlikely we would be able to do it in a timely way and, to be frank, I think it is outside our remit in terms of our representation of super funds. There are certainly

organisations available which market their services to superannuation funds, amongst others, who do make recommendations in these matters.

Mr KEENAN—I understand some of the other groups that represent superannuation funds do make recommendations in the lead-up to AGMs about how they think their members should vote.

Mr Clare—Are they representative of superannuation funds or service providers?

Mr KEENAN—Some of the representative bodies, I suppose—the big representative bodies. I do not want to go into it. That is my understanding of what they do.

Mr Clare—I am aware that IFSA has its blue book, but I have not seen any guidance from them on specific issues. It is not something I am personally aware of.

Mr KEENAN—So ASFA does not. IFSA and ACCI have a view on stock lending and they have put that view out via a joint statement. Does ASFA have a view?

Mr Clare—We are currently developing our policy statement, our policy position, with regard to stock lending. We have a meeting of our board of directors on Friday this week. One of the items on the agenda for our policy committee is the issue of stock lending and related matters that have been in the media recently. We have certainly read and taken on board what materials have already been put out there. I would anticipate that after the meeting on Friday our association would be better placed to have a firm position on it. But at the moment there is not a position, as far as I am aware.

Some superannuation funds lend stock; others do not. Some have ceased lending stock, I understand from media reports. I think that the whole issue is one whereby superannuation funds, in terms of their individual situations, have been reviewing what they have been doing and what the risk-return structure is for them in how they do it. Generally, superannuation funds do not have direct dealings with the ultimate borrowers of the stocks. Often the arrangements are through their custodians, so their counterparty risk is with the custodians. It has been an activity with very minimal risk for the superannuation funds. Whether individual funds undertake such activity has been a matter for individual funds. In terms of our association, it is an issue, as I have said, that we have under active consideration. But I think that generally greater disclosure seems to be something that all parties appear to support in terms of what is happening. I think that is likely to be recognised, but it is not for me to anticipate what the association will decide is its policy on this matter.

Mr ROBERT—Is ASFA a member of IFSA?

Mr Clare—No, we are not a member of IFSA. Most members of IFSA, however, are members of ASFA. They have both a narrow and a broad constituency. They are focused on retail superannuation funds, insurance companies, investment managers and some service providers. As I indicated in my opening remarks, we have the complete range of superannuation funds within our membership. We have a cordial and quite close relationship with IFSA, particularly on matters that arise. We work together. We often have commonality of views on some matters. Our association would leave it to IFSA to have the primary running on some. We

do joint work. On other issues we may have separate but quite similar approaches. On very few issues we may have different approaches.

Mr ROBERT—What is your view on IFSA standard No. 13, which, if you are not across it, is to deal with proxy voting and how their members are to exercise that right?

Mr Clare—In terms of my association's view, we certainly recognise that IFSA has that standard. But, in terms of what we say, our policy is that it is best practice for fund trustees to be active share owners, which we define as including not only proxy voting but engagement with companies. So that is the general position of the association. It is one whereby we encourage the member funds, the trustees, to be active share owners.

Mr ROBERT—Have you released any public statements with respect to IFSA standard No. 13, as to whether your association actively supports it?

Mr Clare—Not that I am aware of. We have our own policy principles which we publish. We have our own best practice paper. The approach of ASFA has been more to encourage best practice amongst our members. We do not have any specific means for developing or enforcing standards within our members, but we encourage them to use best practice.

Mr ROBERT—What would be your view if the International Organisation for Standardisation or Standards Australia sought to produce a best practice standard on proxy voting in a similar vein to how they have produced one for corporate governance?

Mr Clare—I am sure our association would wish to be an active participant in the development of any such work, but it basically would be a matter that our association would need to consider. It is not something that we have a specific position on.

Mr ROBERT—Your policy on active share ownership was included as part of your submission. Are all your members signatories to that? Is it only a best practice standard?

Mr Clare—Basically it is a best practice standard. Given the diversity of circumstances of our member funds, how they approach these issues will vary. In terms of the IFSA membership, they tend to be very large investment managers, where it will generally be appropriate and necessary for them to engage in the way that is put forward in the standard. That is a matter for IFSA and its members. In terms of our membership, given the diversity of it, including some quite small ones where most of their functions are carried out for them by third parties, it would not be realistic or appropriate for them to have behaviours that might be reasonable for others of our members. So what we try to do is encourage best practice amongst our members, with that best practice varying depending on the circumstances of the member. We do have a very diverse range.

Mr ROBERT—So is it fair to assume that your members will pick and choose parts of the policy as fits their size and market position?

Mr Clare—I am not sure I would put it as 'pick and choose'. They certainly will make informed decisions based on a variety of materials, including our best practice guidelines. The regulator, APRA, is also quite mindful of the need to both encourage and enforce consideration

by trustees of all relevant matters. In the superannuation sector it is more about the process and about superannuation trustees considering all relevant matters rather than about prescribing how they should act within individual circumstances or even a bit more broadly in terms of voting on all matters. It is something that they should consider. What their response is may differ from fund to fund.

Mr ROBERT—With respect to proxy voting, have any of your members expressed any problems they have had in lodging and exercising their proxy vote at an AGM?

Mr Clare—At industry forums there has been discussion at times about the mechanics of it being challenging. I have already mentioned that part of it is the time frame in which information goes out, where there are a number of days between the information, such as proposed resolutions, being made available to shareholders and the time of voting. That can be a challenging time frame for an institutional voter, including a superannuation fund.

A number of submissions the committee has received have also pointed to the challenges of the proxy trail, particularly when there are investment managers or custodians involved. For example, the fund needs to receive notice of the motion; it often will require advice as to what an appropriate response is; the board of directors will need to determine how to vote.

Mr ROBERT—Just to go back: you said there are challenging time frames. Are you saying that some corporations are not giving enough time for information to get out to institutions like super funds to make an informed decision?

Mr Clare—I am not saying that. It is always a balance between the need for business to be done and what a reasonable time frame is. I think suggestions have been made that if the process of communication—that is, communication as received by funds and also in terms of the instruction process—could be made more efficient then that would be helpful.

Mr ROBERT—How would you recommend that could be made more efficient?

Mr Clare—There have been a number of suggestions about electronic means rather than paper based ones. Paper and signatures and physical transmission do seem to slow things down, or potentially might, and a number of solutions are about making things happen within the time frames available. Our association has not suggested in any submission a change to those time frames; I am not aware of any suggestion it has made in that regard. But in terms of being supportive of more efficient processes and greater use of electronic means, our association is certainly keen for processes to be developed, if that will assist.

Mr ROBERT—In your submission you list relevant share ownership policy principles, and the principle at 24.25 is:

> Where the trustee invests in a pooled arrangement the trustee should develop a written policy which sets out how the trustee evaluates pooled fund managers' voting policies in the selection process and how it monitors any selected manager's activity against the manager's policy.

In such pooled arrangements where a fund may have a range of proxy votes and may have many hundreds, if not more, pooled arrangements whereby they have to vote on behalf of those

different entities, have there been any challenges from your funds with respect to making that happen and exercising the proxy on behalf of those perhaps hundreds of pooled entities?

Mr Clare—Again, I am not aware of any evidence of particular difficulties. The only anecdotal evidence I have heard has been more that the mechanics of arrangements are sometimes difficult and that, if you go back and have a look at the trail to see whether what was requested or directed has actually occurred, there have been some instances where things have not happened when they should have. They appear to be relatively minor in the scale of things and are put down more to the mechanics being difficult rather than any systematic pattern of things not working. The impression from the various papers, submissions and discussions that I have come across is more that, when the spirit is willing on the part of all the parties involved, sometimes the processes can make it difficult to happen, at least in a minority of cases.

In terms of the sector, superannuation funds are developing processes, including greater audit, to see and ensure that their instructions are being carried out. It is a developing field. Ten years ago I think there was far less emphasis on it. In the current climate it is an area where there is increasing attention by superannuation funds and by organisations who are aiming to assist superannuation funds exercise that part of their ownership right.

Mr ROBERT—Thank you.

Senator MURRAY—Mr Clare, I want to focus on voting, which is an essential exercise of the right of a shareholder owner. I hold the view that regardless of the diversity of your members they hold shares directly or indirectly in trust for their base investors, superannuation contributors and so on. If that is so, then the way in which a fund decides to exercise the power to vote is a matter of real concern. My first question is this: does ASFA believe that lending shares for voting purposes should be promoted?

Mr Clare—As I indicated earlier, the whole issue of share lending is something that is being considered by the ASFA board this week. It is not an issue that is covered in any principle or policy statement that has been made to date. It is an issue under active consideration.

Senator MURRAY—I heard that answer, Mr Clare, and I got the impression that the answer was really focused on lending shares for market purposes, for profit-making purposes. There are two forms of share lending that go on at variance within those forms. One is for profit taking or profit making in the current environment—

Mr Clare—Or attempting it anyway.

Senator MURRAY—In the current market loss making—and I disagree with your view it has been a low risk to superannuation funds—I think the result of share lending has caused a massive loss in value for superannuation funds, but we will leave that for the moment. So one is that side, which is what the media have been concentrating on, and the other is lending shares for voting purposes, which can materially affect acquisitions, company decisions, elections of directors, remuneration issues and so on. I want to ask you on notice, given that it is under review in your own organisation, if perhaps you could advise the committee following Friday's meeting what the view of ASFA is with respect to those two areas.

Mr Clare—I understand your request and I will take it back to our directors this week.

Senator MURRAY—Thank you, I appreciate that. I want to come back to this matter of holding shares in trust. I am a great fan of the practice of funds of all types, which is almost universal I think, of offering investment options to their members and they choose a strategy or by default—I think something like 45 per cent are by default—the fund chooses whatever strategy they think suits. That principle of informed consent, in my view, should be extended in the voting area. Let me put this proposition to you: has ASFA considered or would it think it useful to consider getting the consent of its superannuant members to have voting options? For instance, a voting option could be that it is at the discretion of the fund. A voting option could be that the superannuant says to the fund, 'I give you authority to vote for me on any matter,' which is a positive consent, 'or on material matters or on election of directors,' and so on and so forth. You see where I am going with this. I do not know of any fund which actually gets the consent of its base members, its superannuants and so on, its unit holders, for voting activity of the kind that is just assumed by funds.

Mr Clare—Certainly in the self-managed superannuation fund sector, where the members and the trustees are the same, it is up to those members and trustees to make that decision.

Senator MURRAY—I am referring to your members.

Mr Clare—They are included. We do have some of them amongst our members and the advisers. It is certainly true that APRA-regulated superannuation funds do not have that process with superannuation fund members. Whether they can is not a clear issue to me, given what APRA expects trustees to do. There has been a fairly long and at times convoluted exchange between the regulator and funds, even about the exercise of investment choice by members. I am not sure whether APRA would say that having member direction at the level you are talking about is consistent with the way the Superannuation Industry (Supervision) Act and the responsibilities of trustees interact. But, apart from that, there is no specific position of ASFA on whether what you are suggesting is a desirable practice. It is not something that has been considered. But, looking at the mechanics of it, member engagement is very challenging. Even on things like investment choice, I think the incidence of going with the default arrangement is actually quite high in most funds.

Senator MURRAY—I gave you a figure of 45 per cent. Is that inaccurate?

Mr Clare—Depending on the type of fund, for many group arrangements where the employer enrols the member, the default arrangement may occur in 90 per cent of circumstances. When you have a financial planner involved, their involvement leads to what could be seen as a more active choice by the fund member on an individual basis, but very often it is a balanced portfolio that the adviser has helped put together.

Senator MURRAY—I put the proposition to you that your industry, your members, have quite rightly said to their superannuation contributors, their members: 'Here's a range of investment options. You choose. If you do not choose, we'll choose one for you.' If 90 per cent—to go with the highest figure—choose the default option, that is fair enough in my view; they have been asked. The problem with the vote is that they have never been asked. Let us come back to a principle issue which I am concerned about, which is lending shares to someone

else to exercise a vote, which neither the fund nor the member might have agreed with—just giving away a blank cheque. I think it is absolutely wrong in principle. I would expect the fund to be asking members: 'Are you happy that we lend shares for voting?' I would also expect them to be asking members: 'Are you happy that we lend shares for market profit-making purposes?' I just think there is a missing area of consent here. I do not think it is mala fides on the part of ASFA; I do not think anybody has thought about it. That is why I am putting these questions to you. Have you ever heard these questions raised before in your organisation—about informed consent of members as to the exercise of the vote in their shares?

Mr Clare—It is not an issue that has come up before, as far as I am aware. Equally, in terms of managed funds generally in Australia, there is certainly investment choice when people enter into those arrangements, because it is outside the compulsory superannuation system when people invest in a managed fund. I am not aware of any circumstance, either here or overseas, where that question is put to the unit holder—what their position on voting in any underlying shares is, or lending arrangements. I understand what you are putting forward, but it is not something that has happened within Australia as a live issue, or in other jurisdictions, to my knowledge. But I am quite willing to be corrected on that.

Senator MURRAY—If shares have been lent and people lose vast swathes of their superannuation funds and there was no specific legal authority to act on that basis, there may be a problem.

Mr Clare—I think trustees have the legal authority to have the management of the assets of the fund, and that is what they do in a very responsible manner. They do consider whether they should lend shares for reward and, when they do that, they look at the risk-and-return profile, and they will look at the range of—

Senator MURRAY—Let me challenge your remark. Trustees have that power because consent has been given by the unit holder or the superannuant—

Mr Clare—No—

Senator MURRAY—because, in general, those people have been offered an option, and the trustee is working against that option. Can you tell me whether in your experience—and you might not know, because you have so many members—the company constitutions or the fund constitutions specifically say that the trustee or the custodian or the fund manager, whatever terminology it is, is allowed to exercise the votes of the shares as they see fit and to lend the shares, whether for profit making or for voting purposes?

Mr Clare—Basically, in terms of the legal framework for the operation of superannuation funds, it is a trust situation, where there is a trustee, and there are also codified trustee duties and requirements through the SI(S) Act. There are also APRA licensing requirements relating to behaviours of boards. So the authority for investment behaviour comes from the trust deed—

Senator MURRAY—And voting behaviour?

Mr Clare—Yes. As we have put in our submission, the voting rights are part of the property ownership of the shares. The ability to make investments and to carry on the activity and

business of the superannuation fund comes from the trust deed, as regulated by SI(S) and also subject to the investment strategy that APRA requires each fund to have. There are also risk management strategies that superannuation funds are required to have. That is where the authority for dealing with the assets comes from. The superannuation fund members have certain rights that basically come from the trust deed. There are also various legislative frameworks, including the superannuation guarantee, in terms of vesting and other aspects, and SI(S), which mean that trust deeds have to deal with certain things, particularly in regard to member rights. But it comes from that legal framework rather than the exercise of a member contracting, as I understand the legal framework.

Senator MURRAY—So the consequence of what you have said is that, if the trustees have that power, if they have lent shares in a reckless manner which results in the loss of shareholder value then they are liable to a class action by unit holders and superannuants?

Mr Clare—I do not give legal advice on such matters.

Senator MURRAY—But you concede—

Mr Clare—It is for others to examine it, and it is for any individual superannuation fund member to consider what legal rights they would have, but I would see the links as being very tenuous for such a potential action. I am not aware of—

Senator MURRAY—I am sorry to interrupt you; I am conscious that I have an appointment at a quarter to one. I am suggesting to you not only that informed consent is the right of a superannuant, a unit holder and so on and is an essential element of the extension of share ownership but also that it is a protective device for custodians, managers, boards and so on in that the consent which is already given, for instance, to investment portfolios is a clear mandate to those people as to how to invest their money. Informed consent with respect to voting would be a clear mandate in turn, and I say there has been no clear mandate—there is not a clear mandate for this lending of shares on the basis that we have discussed or for not exercising a vote.

Mr Clare—I understand the argument that you are making: that the way the system works at the moment is not derived from the process that you have described. Whether it should be is a matter that is basically for the parliament to decide. The mechanics of getting that informed consent, either in general or on specific issues, would be challenging.

Senator MURRAY—I am sorry about this, but I have some departmental people I must meet. I will conclude on this basis: if there are any further thoughts that you have or that ASFA has arising from my questioning or that of my colleagues, we would be very happy to receive a further submission—because I know we have raised issues that were not covered in your submission.

Mr Clare—I think that the matters that you have raised came to public debate some time after our submission went in. As I said, it is an issue under active consideration. I see it in the agenda for our board this week, and so once our association has a position we will certainly be communicating it to the committee.

CHAIR—Thank you, Mr Clare.

Proceedings suspended from 12.45 pm to 1.54 pm

JOHNSTON, Mr Christopher Lloyd, Nominated Spokesperson, Family Business Australia

TAYLOR, Mrs Philippa, Chief Executive Officer, Family Business Australia

CHAIR—Welcome. I invite you to give us a brief introductory statement in terms of your submission. That would be helpful.

Mr Johnston—In addition to our written submission, we would like to refer to two important Family Business surveys that were done in 2006 and 2007. The first was called the *MGI family and private business survey 2006* and the second was the *KPMG and Family Business Australia survey of family business needs 2007*. The first key point that came out of these surveys was that the family business sector is a major component of the Australian economy. In 2003 the value of Australian family businesses was estimated to be more than five times the ASX market capitalisation, and the majority of the Australian private sector workforce is employed by family businesses. Most Australian family businesses are either 100 per cent family owned or are controlled by one family. Family companies are unique in that their owners have a common familial relationship and the identity of their future owners can be predicted with reasonable certainty.

Survey evidence suggests a number of things: firstly, that a majority of Australian family businesses owned by the second generation or beyond intend to remain family owned. There is some evidence that this intent strengthens with the number of generational transitions. Although a high proportion of family business proprietors regard succession planning as important and have a will, many fail to differentiate between active and passive beneficiaries of their estates—that is, they do not make the distinction between those who work in the business and those who do not. Here are some relevant statistics for Australian family businesses: 36 per cent have a formal structure for shareholder engagement, 38 per cent have a formal family assembly, only 17 per cent have a family constitution and 47 per cent have a formal board of directors.

I will now move to our submission. Broadly, the evidence suggests that, while family businesses comprise a significant part of the Australian economy and are generally committed to their continuation for the long term, there is scope to improve the manner and the effect of the interaction of the three recognised systems of family businesses—that is, the family system, the business system and the ownership system. The existence of these three systems of the family business is important to shareholder engagement. Shareholders grow up within the system of the business-owning family, so they are exposed to the business informally and, if formal structures such as family forums or family councils exist, they may be educated formally about the business before becoming owners. In other words, engagement often occurs before they become owners. Of course, there are also separate forums specifically for shareholders in the traditional form, as with non-family companies.

The body of knowledge about these best-practice structures and processes has been devised relatively recently—in the last 30 to 40 years—and comes mainly from America. One of Family Business Australia's main purposes is to disseminate this knowledge, but this is a huge task. An important part of this work is to raise awareness about the specific issues relevant to being a shareholder in a family business. As well as improving the way Australian family businesses

conduct their business, we believe their operating environment could also be improved to make them more productive contributors to our economy. Typically, they are very private—just like the family members who own them. With the progression of family businesses through the generations, part ownership is something many family members will aspire to, which will increasingly lead to more family businesses having more than 50 shareholders. We believe there is conflict between the necessity for companies with 50 shareholders to become unlisted public companies and the existence of pre-emptive rights which ensure that the ownership of family companies remains with the owning family.

As unlisted public companies they are exposed to greater public disclosure and have regulatory and reporting requirements which we contend serve the needs of listed companies but are an unnecessary impost on private companies and something their members dislike. We propose that the limit on the number of members of proprietary companies be increased to 300. We also believe that the AIFRS financial reporting requirements are excessively complex for the needs of most family businesses and represent a barrier to shareholder engagement as a result.

Again under the theme of privacy, many family business shareholders disapprove of the presence of non-member proxies at shareholder meetings. We would prefer that companies whose constitutions include pre-emptive rights be able to restrict proxyholders to other members, elected directors or legal representatives rather than 'a person' as provided in the act. Given the unique composition of the owners of family businesses, we also believe that specific takeover provisions should apply to any company whose constitution includes pre-emptive rights and that any bid should first be subject to approval by shareholders holding 75 per cent of the issued capital of the company. Our rationale is that responding to attempted takeovers is extremely costly and disruptive, and evidence suggests that hostile bids for unlisted family companies rarely succeed.

Section 140(2)(c) of the Corporations Act provides that present shareholders may adopt provisions which they are not themselves required to adhere to in the event they are more restrictive than the pre-existing provision. Given that most family company share registers are relatively stable, this can create a sense of the haves and the have-nots between old and new shareholders. This tension is not conducive to a healthy shareholder environment. Those are the main points of our submission and supplement our written submission previously tendered.

CHAIR—Thank you very much. Your submission is very detailed and comprehensive and covers a whole range of areas. I will start with the issue of the number of shareholders. You make reference to section 113 in removing the 50 shareholder rule and drawing a line at permitting companies to have about 300 shareholders. I would like you to explain that a bit further. I understand you to be saying that there needs to be a larger interpretation of what is a small business.

Mr Johnston—Yes.

CHAIR—Are you referring to individual shareholders?

Mr Johnston—Yes. My belief is that the act provides that those working in the business, the executives of the business, are not included in the number of 50. Our experience—I have got to say it is anecdotal—is that there are a number of family businesses now that, purely because of

the succession of the generations, are getting to the stage where, with shareholder spread, they are just meeting or exceeding 50 shareholders without there really being any benefit in becoming an unlisted public company, which they are required to do once they reach 50 shareholders. In fact a number are instituting structures within their shareholders to keep under the 50 shareholder number, which I think it is fair to say creates beneficial shareholder unrest within the business simply because they are seeking to avoid this threshold. We would contend that, with the country as old as it is and with a number of family businesses getting to the stage where they are reaching this threshold, perhaps it is time to have a look at this rule and see what service it actually performs.

CHAIR—Have you come up with an optimum figure? Was the 300 perhaps a suggested figure? Have you done any research on it?

Mr Johnston—We have not done any specific research on it. It is a number that I understand has previously been spoken about and, I think, really we would say that we are putting that number on the table as a suggestion, something perhaps for further investigation as to where an effective threshold might be specifically struck. But certainly we feel 50 is a very low number.

CHAIR—Have you raised these issues anywhere else—in any forums, with government or with the department at all in the past?

Mr Johnston—No, only within our own forums within FBA—not with government, no.

CHAIR—And is it the view of your membership that 50 is just too small a number?

Mrs Taylor—Too low, yes.

Mr Johnston—Yes.

CHAIR—Listening to what you are saying about the differences between family owned businesses—their requirements as compared to other companies—what do you see as the major difference that should perhaps distinguish between different reporting requirements and different obligations? Where would you draw a defining line for what should be less reporting or less obligation? What sort of framework would you work around?

Mr Johnston—I think the point of view that we would come from is that essentially family businesses are typified by having that common familial relationship. Typically they have pre-emptive rights in their constitutions; they are essentially private businesses. So they are not in the public domain as, say, listed public companies are, where reporting requirements are necessary for, for instance, investors from the public to consider whether they should invest in this company or not. They are a much more tightly held style of company and it is felt that particularly the new provisions under AIFRS are so complex that, in fact, the reports that you are required to provide can almost become uninterpretable by the ordinary family shareholder, who sees themselves as a custodian of the family business. They simply want to understand the basics of, for instance, the financials of this business. I think it is fair to say that the regimes that we have now are really designed more for a company that is in the public domain and has the sort of information that might be required for sophisticated investors.

CHAIR—Could it not be argued, though, that by the same principle that reporting and analysis then provides the family company with the necessary information to know its own status and to understand fully how it is being directed? Wouldn't that be of some benefit?

Mr Johnston—I think the difficulty is, if I can cite my own experience, we find that when we hold our own annual general meeting it is actually the chairman's report, which is virtually reporting management reports, that is the information that is more readily accepted by the shareholders because it actually gets to the underlying detail of what is going on in the business. The formal reports actually aggregate a whole lot of the information and do not get the detail that we would normally provide in a chairman's report, which, of course, is not required under the law—that extra detail, I mean.

CHAIR—The reason I asked that question was that I was thinking that, if you want to move to a model that has, say, 300 unique shareholders, that is still a substantial number of people and that, because it is a family business, you would get 100 per cent contribution or participation but within that group somebody may not want that sort of detail or that sort of detail becomes more of a prerequisite of what everyone else is doing because of the detailed analysis and information provision. Again, it is treading between the two worlds of small family business—where, I would agree, you probably would not need the sort of level of detail—and the higher end, with many more shareholders, where that does then become a requirement even though, in a sense, it is not ordinary shareholders.

Mr Johnston—I think one of the checks and balances for that may well be that you retain what I understand to be an existing provision in that, if shareholders actually require that information, it is up to the company to provide it. If companies elect to provide a simpler form report—if I can call it that—and the members agree that that is the sort of report they want, our view would be that it makes sense to permit that sort of report to be presented. But, certainly, I agree that you need the checks and balances so that, if the people want the more complex report, it should be necessary to provide it.

Senator MURRAY—Mr Johnston, you raise some very interesting issues. I have personally been studying and have put out a couple of papers on how better to regulate and report on what legal form should be used for not-for-profits and small for-profits, and I have been interested in the closely held concept. It seems to me that 50 shareholders is not closely held.

Mr Johnston—I just missed the critical point.

Senator MURRAY—The critical point is that 50 shareholders is not closely held. Classically, the closely held concept is around four but up to 10 shareholders or members. That, to me, means that you are talking about an intermediate number who should not be subject to the stringent reporting requirements open to much larger shareholdings. As you know, there is a public interest in the affairs of small companies with respect to suppliers, creditors and others. In law, there are different concessions or requirements for companies resulting from their capital and their turnover for tax purposes and the number of employers for, for instance, industrial relations purposes. Do you think we would be better off approaching your proposition from the point of view of size of operation rather than numbers of shareholders, for instance? Assume there is a private company with 15 members and they are turning over $300 million. You might think that they should be subject to reporting. Do you think if there is merit in your proposition

the idea of the size of the company—not the number of shareholders but capital turnover—should be extended into Corporations Law, so that below a certain size you are automatically subject to less stringent requirements?

Mr Johnston—I think there is some merit in that argument, particularly, as you mention, from the point of view of other stakeholders—third-party stakeholders. I would agree that they may, for instance, be interested in particular information about a company with which they trade, which might be quite a large company albeit with a very small shareholding. Certainly that would seem to be a reasonable argument.

Senator MURRAY—I think you make a valid point. I think the Corporations Law tries to be all things to all people. Most of all it is designed with big issues in mind. This committee cannot solve those problems, but it is open to the committee to recommend to government that a holistic examination of this issue be pursued—not for profits, profits, family companies, small business—and with a specific cross-portfolio reference, so tax definitions and industrial relations definitions are taken into account. So you try to find a commonality, if that is appropriate. Would that sort of approach by the committee meet your broad intention or are you married to your 300-shareholder kind of concept?

Mr Johnston—I would still say that the shareholder threshold is something that needs to be looked at. Obviously, the size issue, which is going to be probably a measure of capital base, profitability, number of employees—

Senator MURRAY—Revenue.

Mr Johnston—Yes, and revenue. That is probably a relevant alternative way of looking at it.

Senator MURRAY—The chair asked you—and I think it is a good question because it goes right to the heart of your recommendation—how you selected your threshold. If I understood your answer, it is arbitrary. Do you have anecdotal evidence that 300 seems about right, based upon your experience across companies? Or is it merely a good number that you selected?

Mr Johnston—It is a number that I understand has been mentioned before. I do not remember the specific rationale behind that number, except that it is within the scope of what I would regard and what I understand that others would regard as a reasonably small business from the point of view of the number of shareholders and it represents a reasonable lift from the present number of 50. I mentioned, for instance, a couple of these surveys that are done. Without having discussed this with our CEO, perhaps a couple of these things could be questions that we look at being addressed in future surveys. These are quite frequent surveys of family businesses and some specific answers to these questions may be able to be achieved.

Senator MURRAY—I am going to ask you an odd question, which is perhaps not unusual for me. Does the law actually matter?

Mr ROBERT—In short, yes.

Senator MURRAY—I know that answer, but I put this to you. Over time I have read quite extensive reports and examinations from ASIC of major companies, whether they are financial

statements, complying with specific accounting standards requirements, checking fundraising prospectuses are done properly et cetera. I do not read much about them digging into the details of what goes on with the actual reporting of small family companies—in other words, pretty well you can do what you like because nobody is watching you. That is my assumption. Does ASIC, regulators or anyone pay any attention to what family companies report and what they do or do not do?

Mr Johnston—I do not specifically have the answer to that. Being a director of an unlisted family company, I certainly make sure that we abide by all of the rules. Also, being a fellow of the Australian Institute of Company Directors, I think it would be imprudent not to. But to answer your question, from a reasonable sample of family businesses, no, I actually do not have the answer to that.

Mrs Taylor—As an organisation we certainly promote compliance as one of the best practice models.

Senator MURRAY—I assume that people do the right thing because it is the right thing to do. I also assume that the regulator is not on your case. Is that a reasonable assumption, given what you know about family businesses?

Mrs Taylor—I would argue that, yes, it is not on our case, but we still have the onerous responsibility of complying whether or not it is on our case. We would much rather have some of the legislation changed so that, whilst we are preaching compliance, we are not having to practise what we do not believe is appropriate.

Senator MURRAY—The point of my remarks is that if the regulator is not on your case, because it does not have the resources and is directing its energies to large markets and large corporations, that reinforces your point that you should not have to do what you do not need to do, which is not really the subject of regulatory concern. Is that right?

Mr Johnston—Yes, but I do not think that is a reason to do other than what the law says we should do.

Senator MURRAY—I am not suggesting that, but what I am suggesting is that law really matters—people are around, making sure you are complying. If law does not really matter, then people are not as concerned.

Mrs Taylor—Do not make laws that you do not enforce.

Mr KEENAN—I am wondering whether it might be possible to give us a little more detail about the people you are representing. I would be interested to know the number of businesses, for instance.

Mrs Taylor—Family Business Australia was founded in 1999 and our founding chairman was David Smorgon. We have about 2,000 family business members currently. We are a national organisation based in Melbourne but we have offices in all states and in the ACT. We run regular workshops and seminars, and one of our fundamental points of difference is that we use family business owners and operators to do lot of the teaching. In other words, we use people who have

'walked the talk'—is the term—because we do find that a lot of family businesses are fairly reticent about using advisers and consultants but are far more inclined to listen to people who have actually lived the experiences of running and owning a family business. We are extremely active and we have an active membership. I know lots of organisations have larger memberships but I would say that 40 per cent of our members are active. We have committees around the country so that we keep in touch with grassroots needs. Mr Johnston was a board member of Family Business Australia for approximately six years and is now the head of our education subcommittee. He has been asked by the national board to represent FBA on this issue.

Mr ROBERT—Mr Johnston, you have made a recommendation here with respect to proxy voting and your desire to disallow proxyholders to be other than a member of the company or indeed a member's power of attorney. I read into that that you would not like to see anyone—Joe Blow off the street, to take an extreme example—coming in and holding a proxy form or multiple proxy forms. What is your aversion in this respect?

Mr Johnston—We have some experience of proxyholders having been appointed to create mischief in shareholders' meetings, largely arising, once again, from familial relationships of the owners of family businesses, and it has really been more about dealing with a family spat than actually correctly representing a member of the company who is not present at a meeting. That is not to say that another member could not do that same sort of act, but the experience has been more with people from outside the membership being appointed a proxy with a particular purpose like this in mind. I think the other issue with this is just the very private nature of family businesses and the owners just wanting to keep the business of the company private to the members of the company and not to have it and the conduct of its meetings open to others outside that group.

Mr ROBERT—An unintended consequence of your recommendation may be that a family member would not then be able to ask their best man or a very close friend to come along and represent them; they would have to pay a fee to an attorney—I hope there are no lawyers in the room. Is that a reasonable thing—to deny a family member and to allow a close friend to represent them, in good faith?

Mr Johnston—The protection that we would seek would be for the members of the company. If that is going to make it a bit difficult for some then that needs to be faced. Further to that, my point was really about enabling companies to change their constitutions to allow for this provision. If the majority of the members of the company do not agree with what is being put before you, then I do not see it being enacted. It is to allow the members of the company to have that discretion.

Mr ROBERT—One of your recommendations is to create an environment to encourage family meetings to discuss succession planning. I am cognisant of the statistics you read out before with respect to less than half of the companies having a formal board of directors—many get together around the kitchen table and a whole range of things in between. How are you proposing that an environment be created? And what are you looking for from government?

Mr Johnston—That is probably beyond the bounds of government. It is really a matter of putting before you the sorts of structures and processes that Family Business Australia is putting before its members, such as family forums and family constitutions. These structures enable

family businesses to perform these sorts of functions. The task is before us to try and make family businesses aware of these structures, which we feel can be very productive to the family business sector.

Mrs Taylor—Mr Roberts, you were asking about the environment. That is really pertinent to the point that I made earlier. We know that government made a large amount of money available, for example, for education in succession planning. Family Business Australia put in a submission for some of those funds, but we were unlucky and did not receive anything. However, we have had individuals who did win amounts of money coming to us as an organisation and asking whether we would put our members into rooms so that they could teach them.

Mr ROBERT—Ironic, isn't it!

Mrs Taylor—It is ironic. But the point of difference is that we will have the experts. We have a very close affiliation with the Australian Centre for Family Business, which is based at Bond University. Currently, that has one of the largest bodies of knowledge on family business in the world. With that affiliation we have a lot of expertise and a lot of knowledge. If we rolled an academic into a room to address family businesses, we would not get the family businesses in the room. We would have to say, 'Come and listen to Lindsay Fox of Linfox talking about his succession.' People will come because they want to hear Lindsay's story, but we would have the experts who would be doing the teaching. I can almost guarantee you that, if you ran workshop after workshop and called it a succession planning workshop and invited family businesses to attend, they would not go. That has been our experience.

CHAIR—Following on from the discussion but back-pedalling a little bit, in terms of proxy voting, wouldn't the guiding principle be that the wishes of the shareholder are carried out—that, at their discretion, regardless of who carries out their wishes, their vote is carried out in the manner that they want? Wouldn't that be the guiding principle—whether or not it is a family member, an attorney or anyone else, in the end, the intent would be that it is the wishes of that shareholder?

Mr Johnston—That is a reasonable point, but my point and what sits behind the proposition is that the higher-level decision should be made by all of the members of the company as to what they feel is a reasonable protocol for all of the members of the company to abide by.

CHAIR—I understand the point you make. You set my mind racing with the example of someone who might want to cause some mischief. Of course, I immediately thought that, if you really wanted to cause some mischief, you would use your own rule—let us say, constitutional rule—of appointing a lawyer and getting them to come in and cause some mischief. But, in the end, the point is that the proxy system and delegating that vote to someone else is about having that person carry out your wishes and that, regardless of who they are, in essence they only exist as a carrier and are not the person voting. The person who is actually voting is the original shareholder but through someone else. I found that, even with your explanation, that would be unnecessary as long your wishes as a shareholder were carried out.

Mr Johnston—The distinction I would make between the type of mischievous proxyholder that I am talking about and, say, the legal representative is that one would expect the legal

representative to actually represent the member in a professional manner. I do not think any family business would have a problem with that. What I am talking about is mischief that is actually outside the bounds of what a normal proxyholder should do.

CHAIR—I understand what you are saying. Yes, sure. That is fine.

Mr ROBERT—Mr Johnston, you spoke about your family business best practice guide; are you able to provide a copy of that to the committee? You refer to it four or five times in the submission—for example, best practice encourages unlisted family companies to 'consider the benefits of a non-representative style' and so on. It would be good if we could have a look at that. That would give more context to your submission.

Mr Johnston—Certainly.

Mr ROBERT—If there are any commercial-in-confidence issues, I am sure we can take care of that, Chair. As I just said, in your submission you encourage family companies to consider the benefits of a non-representative governance board which includes a non-executive director. Do you mean an independent director with no voting rights on the board?

Mr Johnston—No.

Mr ROBERT—So it would be a non-executive director who can vote?

Mr Johnston—Yes, a non-executive director who can vote, and an independent non-executive director at that—someone who is quite independent of the family. That is part of our best practice proposition.

Mr ROBERT—Can I assume that you have presented that to your 2,000 members—that your best practice guide has gone out to them?

Mrs Taylor—Yes.

Mr Johnston—Yes, it certainly has.

Mr ROBERT—What has been the response from your membership to that recommendation in the best practice guide to put a non-executive director on their boards?

Mr Johnston—The response generally, I think, is that this is good practice, that they understand the benefit that can be had from having such a person on their boards. One of the real challenges is finding people who are capable and prepared to act in this role. That is part of the whole challenge we have of totally professionalising the family business so that the family business then has the sort of integrity, if I can call it that, that makes it attractive to the type of person we are talking about and means that they are attracted to such a directorship.

Mr ROBERT—What about the shareholders? Generally the shareholders of family companies are kids, cousins, aunts et cetera. Even if it is anecdotal, what has been their response to that recommendation? Or are there any examples you can give where shareholders in a company have responded in a positive or negative way to a non-executive independent director?

Mrs Taylor—Let me go back to your first question about how our membership has accepted this. There will always be a percentage of our members who do not yet see the need for independent directors and who in fact have got fairly loose governance. That is one of our challenges—to educate them in the processes to cope with the day when they will need them. We argue that if you put the building blocks in place early and get into good habits early it is going to make life a lot easier. Very often, one of the greatest challenges to having independent directors is dad or mum, who are used to being boss and are used to—

Mr ROBERT—Control.

Mrs Taylor—Yes, control. So it is softly, softly—and using our members. We had a terrific Victorian property development company that was prepared to talk about this process, and they put up graphs and showed what happened to their turnover and bottom line once they followed the best practice model. That is an incredibly powerful lesson for those family businesses who have been a bit reluctant or hesitant to embrace it.

Mr ROBERT—Thank you.

CHAIR—I thank you very much for your evidence today.

Mrs Taylor—Thank you.

Mr Johnston—Thank you.

[2.35 pm]

LAWRENCE, Mr Martin, Lead Analyst, Australia/New Zealand, RiskMetrics (Australia) Group Pty Ltd

PAATSCH, Mr Dean, Director, Asia Pacific, RiskMetrics (Australia) Group Pty Ltd

CHAIR—I welcome the next witnesses, who are from the RiskMetrics Group. Would you like to make some brief comments to support your evidence?

Mr Lawrence—Thank you very much for the invitation to attend this hearing. I would just like to start off by saying that my colleague, Dean Paatsch, did appear earlier in support of IFSA's submission on the voting roundtable. We really have nothing further on that to add to IFSA's submission or to the discussion this morning.

RiskMetrics, which was formerly known in Australia as ISS Australia, is a provider of corporate governance research to institutional investors. We have about 2,000 institutional investor clients around the world across our various businesses. In Australia, we are best known for providing advice to institutional shareholders of listed companies about how to vote their shares. In terms of the committee's terms of reference for this inquiry, we consider that there are very few areas that require change in terms of engagement between shareholders of listed companies and listed companies. The existing system appears to be working well. That said, by way of an opening statement, I would like to make five brief points, addressing areas where perhaps the system is not working as well as it could, before moving on to take questions.

The first point is to do with section 672 of the Corporations Act. This section presently allows agents, working on behalf of the management of listed companies, to demand that custodians holding shares on behalf of institutional investors disclose the voting intentions of their clients—that is, the beneficial owners—to companies prior to the vote occurring. This is a separate issue to the entirely appropriate desire of companies to know exactly which shareholders sit behind the custodians listed on the register of shareholders. There appears to be no compelling reason as to why the management of listed companies should be able to compel custodians to reveal this information, and it may discourage institutional investors from engaging with listed companies or voting their shares for fear that they may lose access to the company if they are known to have voted against management.

The second point is related to the first. At the same time as companies are seeking more information from shareholders, when it comes to a listed company's own register of beneficial owners, there is a lack of clarity over the cost that shareholders must pay to inspect a copy of the register of beneficial owners. That register is freely available to any shareholder in the United States. There are anecdotal stories of companies charging substantial amounts to cover reasonable costs when people have asked to inspect this beneficial owners register.

The third point relates to voting on the remuneration report resolution. This provision has substantially increased dialogue and engagement between listed companies and their shareholders. Many companies now, as a matter of course, will engage with their key

shareholders and bodies such as ours prior to the AGM to discuss remuneration and broader governance issues. At present, however, the very directors and key management personnel whose remuneration the resolution concerns are able to vote on the remuneration report. It is unsurprising that they usually vote in favour. These management votes obscure the purpose of the remuneration report, which is designed to allow shareholders to express their views on director and executive remuneration.

The last two points relate to the ASX's oversight of listed companies. The first also relates to executive remuneration. The ASX has removed the only binding vote on executive remuneration in Australia—listing rule 10.14. This rule used to require grants of shares to directors under an employee incentive scheme to be approved by shareholders. Since a change to this rule in October 2005, no approval is required so long as the company acquires the shares to be given on market—that is, no approval is needed to use shareholders' money to acquire company shares for the benefit of executive directors.

The final point relates to externally managed entities that are listed on the ASX. These are not the traditional listed property trust kind of vehicle. These usually invest in infrastructure and have appeared over the past decade. They are unique creations—they are Australia's gift to the world of corporate structuring—and they have required significant waivers from the ASX listing rules in order to list. Key features include management contracts that are long term and impossible to break and special voting shares that give the manager the power to control the board, despite the fact that the manager will often own less than 10 per cent of the voting securities on issue. These entities, because they effectively disempower security holders, pose major challenges to shareholder engagement in Australia. That said, I am happy to take questions on the contents of our submission, anything we have just said or anything that is in the committee's mind.

CHAIR—Thank you very much. Thank you for a very detailed submission and a very good, brief opening statement as well. Just to start off with the issue of the long-term undisclosed management agreements, how do you see that effectively being organised to lessen the capacity of organisations to go into very long run undisclosed contracts now? What sort of change would you bring forward?

Mr Lawrence—The ASX has these agreements. If you are listing on the ASX, you are required to lodge a copy of this management agreement with the ASX prior to listing, along with the constitutions of the entities, the most recent set of accounts, as I understand it—there is a whole bunch of documents. These management agreements are lodged with the ASX. The ASX in its wisdom has decided that this information should not be disclosed, and the sponsors of these entities, which are typically investment banks, are also very keen for these management agreements not to be disclosed. Simply disclose them.

Senator MURRAY—Is ASIC complicit in that?

Mr Paatsch—No, it is something that is very much a product of the listing rules. The prospectuses require only summaries of the key terms of those management agreements, but it is our contention that investors would be fully informed were ASX to require the listed entity to disclose those management agreements.

Mr ROBERT—Have you raised this with the ASX?

Mr Lawrence—Yes, we have.

Mr ROBERT—And what is their response?

Mr Paatsch—'It is not the current practice of the ASX to disclose these agreements.'

Mr KEENAN—What is the rationale for that though?

Mr Lawrence—Because it is not the current practice of the ASX to disclose these.

Mr KEENAN—But there must be something beyond that.

Mr Lawrence—The entities themselves say that these are commercial-in-confidence, despite the fact that they are the key documents when it comes to the power of the manager over the listed entity. For these kinds of entities, they are more important than the constitution itself. These documents are typically available to inspect in the product disclosure stage, the prospectus stage, but you have to go their offices to inspect them.

Mr Paatsch—It is quite notable that this type of entity has been free of corporate activity, even though they are trading at substantial discounts to NTA, and the risk imposed with perhaps having to pay out those management agreements, even if you remove the manager, is a key reason why corporate activity is not targeted at some of those entities. We are all for the free flow of capital. We believe that, if investors knew that you would have to pay out 25 years worth of management fees even though you have removed them, people would be able to factor that in at the point of investing in the company, not after the event.

Mr ROBERT—If you did not see the PDS at the initial IPO stage, will the current information made available to you tell you the length of time of the management agreement and the remuneration of the management team?

Mr Lawrence—Typically you do not get to see the remuneration of the management team. The actual management team—so the executives—will be working for a wholly owned subsidiary of the investment bank that is the sponsor, the external manager. You do not get to see their remuneration. You will get to see the remuneration of the directors who are on the board. The directors are often the executive directors of the sponsoring investment bank, so they say, 'We can't apportion what part of their remuneration is due to this.' You are told exactly what the external manager can be paid under the terms of the management agreement, so there will be a base fee and a performance fee. That is not the end of the story, though, because the sponsoring entity is an investment bank. These entities tend to undertake an awful lot of corporate transactions. They tend to buy a lot of stuff. They tend to need to finance a lot of debt and raise a lot of capital. It is incredible with what regularity the sponsoring investment bank is the investment bank that is used.

Mr ROBERT—In your experience —and I am also happy to accept anecdotal evidence—what percentage of IPOs that include this are coming through?

Mr Lawrence—Of the top 200 right now, about 10 per cent of them would fall into this class of entity. There are fewer of them coming through now because market conditions have changed somewhat, debt is not as easy to get and people are not quite so willing to throw money at anything.

Mr ROBERT—What is your view of the impact of this nondisclosure on IPOs?

Mr Paatsch—Not on IPOs but on the ongoing management of the entity: it does provide a barrier to takeovers because you do not know what the effect of removing the manager will be. It may trigger pre-emptive rights, poison pills or the payout of management fees, so that is not a good thing.

Mr ROBERT—But isn't that a good thing if you are one of the managers?

Mr Lawrence—It is a great thing if you are a manager. It has always been very easy to work out in whose interests these things are, but for security holders unrelated to the manager it is somewhat more difficult.

Mr Paatsch—But I think in a more general sense it is the precedent value that it creates. We did some research, maybe 18 months ago, that looked at the number of waivers granted by the ASX by weight of numbers of waivers and also by the effect. It is quite clear that the existing listing rules are not well designed for this type of entity in mind because there are so many waivers granted to them. It is almost as if they are in a separate class.

Mr Lawrence—I would like to add a point as to management agreements. Requiring the disclosure of these management agreements is not some kind of ratbag government's idea. If you want to list one of these things in the United States, you have got no option; you have to disclose it. We have examined the one that is disclosed in the United States. I guess the question is this: does the fact of disclosure change the contents? We don't know; we can't say.

Mr ROBERT—Do you have an opinion as to why in October 2005 the ASX changed their mind? I remind you that you are obviously under privilege.

Mr Lawrence—On Listing Rule10.14?

Mr ROBERT—Yes.

Mr Paatsch—It is a separate issue.

Mr Lawrence—A little bit of a background story: the ASX put out a discussion paper for changes to its listing rules, which it invariably does when it changes its listing rules. The discussion paper canvassed changing Listing Rule10.14, because as it stood at that time that would technically capture it. If you are a non-executive director and you agree to sacrifice 10 per cent of your fees into acquiring shares in the company—which groups like ours and our clients love because the directors' interests get aligned with shareholders'—you are technically caught by that provision. The original revision to Listing Rule 10.14 was framed as a sort of guidance revision, to remove the need for non-executive director fee salary sacrifice schemes to be approved. The final listing rule removed the need to get anything approved as long as it was

acquired on market. The ASX had been granting waivers to that effect for at least seven years prior to changing that listing rule. I would not like to speculate as to why.

Mr Paatsch—It was a surprise.

Mr ROBERT—Why didn't the ASX provide an adjunct listing rule or provide a subcategory B to the listing rule?

Mr Paatsch—I don't think I would be best placed to answer that, but it was a surprise to major institutional investors that this exemption, when it was finally published, was so wide. In fact, we did not really notice the full import of it until the middle of 2006, when we started for the very first time to see, in the remuneration reports that were required by the Corporations Act, that these large grants had actually happened and the terms on which they had happened. If you have a look back over the last two years at some of the biggest 'against votes' on the remuneration reports that have been well publicised, you will see there is a common feature. That is that many of those were bought on market. The very first time that shareholders found out about them was six to 12 months after the event, finding that these things had been granted on very concessional terms.

CHAIR—Do you know what the driving force was behind this change from the ASX?

Mr Lawrence—I do know the rationale. I do not know what the driving force was. The rationale provided by the ASX has been that Listing Rule 10.14 is solely concerned with dilution and that if the shares are required on market then there is no dilution, so what are you worried about? I guess the issue that Listing Rule 10, which deals with transactions with related parties, deals with is the ability of people who are directors and key management people, because of the privileged and powerful position they occupy, to gain control over the company on terms not available to other shareholders. To our mind, and to the minds of most of our clients, there is no difference between issuing them new shares or using the company's money to buy shares and giving them to them.

Mr Paatsch—We are really concerned about a nightmare scenario where, say, a smaller listed company raises money in a general placement and, having forewarning of, say, a great drilling result, uses some of that general placement money to buy shares on market for its key executive team. That is a nightmare governance scenario where, effectively, shareholders' money is underwriting insider trading. In the current scenario, we think that basically you should not be able to buy those shares on market without shareholder approval for genuine insiders like that. We just think it is a fundamental governance precept that is being ignored.

Mr Lawrence—The ASX, as I understand it, received some negative feedback from various institutional investors and bodies such as us, and when it reviewed the Corporate Governance Council principles it also put in there a statement saying, 'Anyone who has got a view on listing rule 1014, would you let us know.' Every single submission on behalf of the management of listed companies—and I use the distinction advisedly—and those who advise the management of listed companies was in favour of retaining the current rule. Every submission made on behalf of investors was against the retention of the current rule. As I understand it, the ASX is meant to be in discussions with Treasury, I think, over this issue, but we have not heard anything. Presumably the ASX has other things on its mind.

CHAIR—That is why I asked the question about the driving force behind it—to get some understanding or idea of where the push was coming from. Do you have any idea about that? Does it come from specific directors or a particular company?

Mr Paatsch—We do not know. The point is that the loophole has been open for quite a long time—and if you go back and have a look at the very high 'against' votes, and they are all out there for everyone to see, there is a common theme there—so it is like telling your wife that you moved in with your mistress six months ago. The shareholders are going to be very upset when they find out that you actually granted these things on concessional terms; of course they are going to be upset. There are some companies that buy on market voluntarily and in advance put them up for shareholder approval, Qantas being one example.

Mr Lawrence—There are a number of them. There are a lot of companies that are aware they do not need to seek approval but are uncomfortable about not seeking approval. One of them said to me, 'We've got nothing to hide, so why shouldn't we?'

CHAIR—This might lead us to seek the view of the ASX on specifically where this has arisen. I might, while we have the opportunity under the direction of Senator Murray, ask the secretary to seek some advice from the ASX on that particular exemption ruling—

Senator MURRAY—And ASIC.

CHAIR—Yes, from ASIC and the ASX—and on what brought this about and their rationale behind it. We will pursue that, so thank you for that.

Mr KEENAN—I would like to return to the issue of the infrastructure vehicles. I am just trying to work out why it is infrastructure in particular that has got these, if you like, special rules. There must be a rationale. Is it because these management agreements are with governments as a general rule?

Mr Lawrence—No. To give you an idea, Transurban invests in toll roads, much like one of these entities. It functions perfectly well as an internally managed entity with a board that investors can sack if they do not think they are doing a good job. It does not really appear to hold it back from buying toll roads and dealing with infrastructure assets. We think it started with infrastructure simply because at first it was a bit of a seller's market for infrastructure. It was very hard to get access to it. It was a big, lumpy asset, and you could not go out and buy the asset. If you were a superannuation fund or a fund manager you would think, 'Well, I'm not going to buy the whole toll road because, gee, that's just so illiquid.' Then suddenly someone came along and parcelled these things up and said: 'Look at this—you can get a little bit of this infrastructure asset. You can get exposure to the sector.' It is also fair to say that the model has evolved over time. The earlier versions of the model, while investor unfriendly, were more investor friendly than the most recent. The two most recent versions of the model that have listed in Australia actually include a specific clause that if you somehow managed to remove the manager they would keep getting paid anyway for 20 years—it triggers underlying fee agreements that get kicked in.

Mr Paatsch—But you should be clear that it is not just infrastructure funds.

Mr Lawrence—It is where it started.

Mr Paatsch—It is where it started. There are other externally managed entities whereby there is a disconnection between the interests of the manager in governance terms and the interests of the underlying security holder.

Mr KEENAN—But it started in infrastructure because at that time that was flavour of the month and consumers were prepared to wear it—is that your view?

Mr Lawrence—That would be a speculation, but it seems the most logical explanation. Infrastructure as an asset class has got broader. It still tends to get called infrastructure, but I think that now the trolleys at the airport that you put a couple of bucks in, and that kind of stuff, are beginning to get called infrastructure.

Mr KEENAN—I am just curious. I assume that, if you go to the ASX and you say you want to list something but you need waivers on all these rules, you need to actually provide a rationale for why that might be the case and they do not just grant it automatically.

Mr Paatsch—Only recently has the waiver register become public so that the reasons that the waivers have been granted are now starting to become available to the public in a more timely fashion.

Mr Lawrence—I should add that the ASX, in terms of telling people it has granted waivers, is actually ahead of the New York Stock Exchange and the London Stock Exchange. They just do not tell you. The ASX at least tells you; it happens after the event. The rationale that is provided is often laughable. For the committee’s interest, I can forward a couple of examples.

Mr KEENAN—Yes, we would be interested.

Senator MURRAY—It seems a basic principle, doesn’t it, that a private ruling is inappropriate for a public market.

Mr Paatsch—Yes, there would be an open inference. There are certain things where, as corporate structures develop, some sort of central discretion does, of course, make sense, but just look at the sheer quantum of waivers. Here is a very good example: we saw some waivers to this Listing Rule 10.14 happening—before the exemption came into place—whereby the ASX was giving exemption from shareholder approval to a sign-on grant of equity to a CEO because, whilst that CEO was to become the director the next day, on the day he arrived he was not a director and was thus exempt from the rule. We think that sort of thing is ridiculous.

Mr Lawrence—It was about 2½ per cent of the company.

Mr Paatsch—It was 2½ per cent of the company. Having the ASX fully disclose their reasons for waivers is a great thing, but having more consistency and robustness in that process is also desirable.

Mr Lawrence—We are unaware of how many requests for waivers get knocked back. From our search of the waiver register, I think, we found six knock-backs out of several thousand

requests but, that said, before the ASX tells you it is not giving you the waiver it actually says, 'Would you like to withdraw it?'

Mr KEENAN—I see. So it is a very clubby arrangement.

Mr Paatsch—We do not know.

Mr ROBERT—What is the basis for the ASX setting a management agreement expiry period of 10 years? Why 10 years? Ten years would still seem an extraordinarily long period of time in a current market space.

Mr Lawrence—I guess it is better than 25.

Mr Paatsch—It is probably not actually a long time. The promoter takes significant risk in being able to get one of these entities in operation, so 10 years is probably pretty reasonable. We are not necessarily hung up on that. Investors can price the risk of their agents capturing them; that is fine as long as all of the information is on the public record. So, whether it is 10 years or 20 years, who cares? But you want to know if you can get rid of the manager, what you have to pay them, if there are pre-emptive rights and if the assets that you own stay in that entity or not—are they diluted?

Mr ROBERT—Apart from the management agreement, what else in an IPO—and subsequently—is not fully disclosed?

Mr Lawrence—To be honest, one particular sponsor of these entities does tell you a lot of stuff. There is a lot of information available; you almost drown in information. One of the things that is not disclosed—and we think it is in the management agreement but we do not know—is exactly how you terminate managers. What happens? Say you do not like what is happening and you think the manager is doing a bad job. You get a bunch of shareholders together and move a resolution to sack this manager, which the managed investment provisions of the Corporations Act empower you to do. These things, however, are not just unit trusts; they have got a company stapled to them, often one domiciled in Bermuda, that is obviously outside the managed investment scheme provisions. You just do not know what the consequence of sacking them will be.

Mr ROBERT—It is probably fair to assume that a management agreement would include provisions for termination.

Mr Lawrence—I am sure it deals with termination, but how is the question and how much.

Mr ROBERT—So you believe the only things that are not disclosed in the IPO and subsequently are the management agreement and how that agreement is terminated.

Mr Lawrence—Which is presumably contained in the management agreement. The other thing that would be helpful to disclose is any employment of the parent to do investment banking work—and some of them do actually have exclusive investment banking agreements with their parent as well, so you cannot sack them from that either. With others it is nominally open, but they do not ever appear to use anybody else. They say that the independent directors—who often

can be just removed at the whim of the manager, but they are nominally independent—must review the engagement of the sponsor in an investment banking capacity and must be satisfied the fees are on arms-length terms. It would be fascinating to know whether they ever ask any other investment bank to pitch because at the moment that is what you get—that much. We have seen one investment banking fee schedule which would lead us to suggest that maybe the fee arrangements are not arms-length, but we do not know. We could not make a generalisation.

Mr Paatsch—I do not think that is open to us to make.

Mr Lawrence—We do not have the information. But for an investment bank, the beauty of these things is that they are a captive client.

Senator MURRAY—On the same point of the infrastructure agreement model, shall we call it, I want to use this term in a specific meaning—that is, in terms of competition law. Do you consider the practice to be 'anticompetitive'?

Mr Paatsch—I understand the import of your question. I guess our fundamental concern is that the entrenchment provisions, if they exist, run counter to a whole bunch of other precepts.

Senator MURRAY—Let me put it to you differently. The essence of a market is that it is open and fair and that no-one has an advantage over another unless that is predisclosed. So, for instance, you can get two classes of shareholders, which is typical of AWB, or you can get preferential shares and so on. It is not that common these days, but it used to be. This seems to me to be a preferential arrangement which is not fully disclosed to the market and therefore strikes me as an anticompetitive device.

Mr Paatsch—It can be. It certainly subverts both the intention of the takeovers law and the Managed Investments Act. To the extent that that is anticompetitive, yes, I would agree.

Senator MURRAY—With respect to item 6 of your submission, you refer to your recommendation that parliament should amend section 250R of the Corporations Act by essentially excluding those who will benefit from a remuneration vote from voting on the resolution. It seems to me that that is a particularly important issue where you get publicly listed companies with a small shareholder base.

Mr Lawrence—With many retail shareholders, if I take your point.

Senator MURRAY—Yes. In Perth, for those small cap mining resource companies, really, if the directors vote on the resolution, it passes. So it is particularly important with respect to them.

Mr Lawrence—It is. I would absolutely agree with that.

Senator MURRAY—Did you design this recommendation with that in mind or just as a general principle?

Mr Lawrence—There have been a number of instances where things have passed, where the remuneration report has been voted up, it has been approved, where it would not have been had shareholders associated with directors and key management personnel not voted.

Senator MURRAY—They are small caps with less than 100 shareholders.

Mr Lawrence—Some of them are very large caps.

Senator MURRAY—The problem would not matter at all with Telstra, for instance, where they have 600 million shares or something. It does not matter much what those executives do.

Mr Paatsch—I cannot think of the name of the company, but we were first drawn to be alive to an alternative possibility here when one company said that they, in their voting exclusion statements, excluded votes by directors.

Mr Lawrence—It was actually a company called Babcock & Brown Environmental Investments Ltd. They have never done that again. I think they were labouring under a misapprehension. I think they assumed they could not vote and received legal advice that they could. They have never done it again. That was what gave us the idea.

Senator MURRAY—As you can see, your submission has raised a lot of interest in the committee. I want to ask you about some things you have not written about. You give advice on voting, and therefore you give advice on voting for directors.

Mr Paatsch—Yes.

Senator MURRAY—Politicians take a great deal of interest in voting out of self-interest and the mechanics of the voting procedure in our electoral act are singularly well-designed to avoid anyone, if possible, having one over anyone else. The consequence is that Australia has a very good, fair and well-run democratic voting system. I have never seen anywhere—perhaps one does exist—an analysis of company constitutions which analyses the mechanics by which the nominations of directors are brought forward and decided on and by which preselections occur, to use a politician's language. It seems to me that what you address is the end of the process. 'Here are the directors; which one should you vote for?' I am interested in opening it up so you do not get clubs and so that you have best practice constitutional provisions. Do you have a view on all that? Do you want to come back to us with a view on all that? Do you have any experience you could perhaps share with us?

Mr Paatsch—I guess we could give you a couple of brain dumps, if you like, on some of the provisions that operate. Firstly, I will give you the facts. I think that as politicians you would be very proud of the fact that, if you are an incumbent director on an Australian ASX300 company, you are likely to be returned with roughly 96 per cent of the vote on average.

Mr Lawrence—If they got 51 per cent, they would die of shock.

Mr Paatsch—That is right.

Mr ROBERT—Is that while your company is performing well?

Mr Paatsch—No. This is across the board.

Mr Lawrence—In the final director election of HIH and OneTel, I think the incumbents were returned with more than 95 per cent—

Mr Paatsch—That is right.

Mr Lawrence—and the companies were not performing well at that stage.

Mr ROBERT—So the institutions need to have a good, hard look at themselves.

Mr Lawrence—With OneTel in particular there was the problem of the Packer and Murdoch shareholding. That probably obscured it a bit. I assume that they voted for the incumbents. From the outside, it is a very hard thing for an institutional shareholder to work out, for each individual director, the answer to the question, 'Is this individual director a great guy on a board that is a dud?' It is very hard sitting on the outside. I suspect you are going to see some examples in the next 12 months of certain people who have been associated with companies, maybe audit committees and things, where they are not going to get overwhelming support.

Senator MURRAY—Bearing in mind that political parties are the least regulated entities you can imagine, the process of throwing up people to eventually be voted on and having the vote occur is extremely hotly contested and very well watched. My question to you is this: is there a need for a proper examination of a sample of company constitutions from an AEC type of approach, if I may put it that way, to see whether the process is best practice?

Mr Lawrence—I do not think you would have to look at very many company constitutions because they are all written by about four law firms. Typically, the nomination of directors is dealt with scantily, if at all, in a constitution. The deadline for nominations will typically be 45 business days before the meeting. Any shareholder may nominate. Some of them have stopped referring to the required majority to get on the board because it is in the Corporations Act.

Mr Paatsch—It is the no vacancy rule, effectively, which is the most substantial impediment to people standing by way of a genuine contest. What happens there is that a company's constitution will say, 'We can have up to 10 directors,' but the board will make a policy that says, 'We are only going to have five.' Then I nominate, for example, you, Senator Murray, to stand for the board. You stand for the board and the board makes the decision that there is no vacancy. You are still put forward for election but in order to defeat an incumbent you have to get a supermajority, basically—you have to score more absolute votes than they do to win, which is very tough.

Senator MURRAY—Are you two familiar with the constitutional provisions that you outlined—the four typical proformas, if you like?

Mr Paatsch—Yes, we look at these things.

Mr Lawrence—Yes, every time a company puts up its constitution.

Senator MURRAY—Would you be willing to put in a supplementary submission critiquing those for us?

Mr Paatsch—On the nomination ones?

Senator MURRAY—On any aspect.

Mr Paatsch—We can take a look at it.

Senator MURRAY—The interest of the committee, and my personal interest, is in making sure that quality people of the best ability and variety are available to be directors of public boards. That is in the public interest. The question is: is there anything in the system which is resistant to that outcome?

Mr Lawrence—Off the top of my head, other than the no vacancy rule, I do not think that the problem is necessarily with the nuts and bolts mechanics. The problem may reside more in cultural factors, such as the difficulty of winning board endorsement and the difficulty of winning over institutions to vote against an incumbent.

Mr Paatsch—We do not have a culture in Australia of having proxy fights, which is very much the case in the US. We are seeing the first one in a public company at the moment in Western Australia with the WAN board, but it is a very unusual proxy fight. The Seven camp is not putting up a full slate; they are not their candidates. It is very unusual.

Senator MURRAY—It is fascinating.

Mr Lawrence—It is.

Mr Paatsch—Typically, what you see in the states is a proxy fight where someone comes along and says, 'This mob are no good; elect all five of us.'

Mr Lawrence—That is partly a reflection, though, of one of the things that makes the Australian system much better than the United States system, which is that directors of US companies are effectively impossible to remove.

Senator MURRAY—Let me put this suggestion to you and see how you react to it. You recall the origins of corporate governance and the resistance that went on. Eventually, the ASX, ASIC and a bunch of concerned organisations, institutions and companies got together and produced corporate governance principles which, by and large, are very practical, very effective and very well accepted. They are a kind of best practice model, and they have been adopted in the best of companies—not in all companies. When you come back to us with fuller thoughts on this particular issue, I will ask you whether you think that sort of review and examination of the director election process should occur. Could a body of practically involved market participants who have good principles and motives devise a better way of ensuring maximum quality is available on our boards? That would address issues such as the no vacancy rule, the rigging which goes on and the ability of poor boards to perpetuate themselves.

Mr Paatsch—Perhaps we could look at some of the political parties for inspiration.

Senator MURRAY—Yes.

Mr Lawrence—If I could throw in one idea there—and it is off the top of my head, so take it as that—it is fascinating that, as I understand it, the Australian Electoral Commission conducts federal elections and union elections, but company elections are run by the people who are elected.

Mr Paatsch—Just to further that: while we would not necessarily think that the AEC or someone independent should run every election, there ought to be a provision in the event of a very closely contested vote that you can hit a hot button and get a third party to have a look at it. That is something that was not the subject of our submission, but it is something I would commend to the committee's attention.

Senator MURRAY—So you are suggesting a review process which is not judicial or court based but an arbitration of sorts?

Mr Lawrence—No, an election is just conducted by an independent arbiter.

Mr Paatsch—At the moment, the only recourse you have is to complain to ASIC. I have made several of those complaints where results are very close or at least warrant a second look. It is very tough. Often you will find that the companies or their agents destroy the proxy forms very soon after the event. There is a provision in the UK whereby a certain number of shareholders, if they are concerned with a result, can request that somebody independent have a look at it. So, if you combine that with the earlier submission, it is worth a look.

Senator MURRAY—I will conclude on this point: please, if you would, give it some greater thought. I would assist you by asking you to examine—and you could ring up the AEC to get the actual bits and pieces so you can see—the checks and balances which exist in our system of democratic voting and in your system of corporate democratic voting—

Mr Paatsch—Sure.

Senator MURRAY—which includes the ability to dispute a return, the ability to recount, that votes must be kept, the contestability, the openness of it et cetera.

Mr Lawrence—There is a very interesting academic paper which may be of interest to you. It was published in the United States but its findings are roughly analogous here. It is called *Management always wins the close ones*. It observed that, on a random distribution of corporate election results in the United States, no management proposal has ever been beaten 50.1 per cent to 49.9 per cent but that many, many management proposals have won 50.1 per cent to 49.9 per cent. It concluded that a random explanation cannot account for it.

Senator MURRAY—Thank you.

CHAIR—I think we could probably go on for a while. There are quite a few more questions, but given the time I thank you both very much for your evidence and answers to our questions. We will be in contact with you if there is anything more that we need, but thank you.

Mr Lawrence—Our pleasure.

[3.17 pm]

O'SULLIVAN, Mr Michael, President, Australian Council of Superannuation Investors

SPATHIS, Mr Phillip Arthur, Executive Officer, Australian Council of Superannuation Investors

CHAIR—I welcome our next witnesses and thank you for appearing before the committee. If you wish to make a brief opening statement, you are welcome to do so.

Mr O'Sullivan—I will just introduce ACSI. I do not know whether members of the committee are familiar with it, but it is an organisation of 41 not-for-profit superannuation funds which was formed in 2001 to pay attention to corporate governance in the companies in which we invest. We do general corporate governance research for our members, we provide proxy voting advice to our members, we engage with companies on behalf of our members and we interact as far as possible with like-minded bodies around the world to assist with cross-border work on the same sorts of subjects.

The other thing that I might say about us is that we have a view as superannuation funds that we are long-term investors and therefore we are very much interested in sustainability and how long companies can sustain themselves in this kind of market or in any kind of market. So we have more recently tried to interest ourselves much more in the environmental and social performance of companies as well as their governance performance because we really see the first two as essentially a subset of governance itself and as part of the general responsibility of boards and of the company. I will ask my colleague Mr Spathis to deal quickly with the things to which we have referred in our submission and we would be happy to answer questions. Our submission was made to you after a great deal of interest was occasioned by what has happened in the markets with stock lending and short-selling. If it is of any interest to the committee to discuss that, we are happy to discuss it, but we did not include it in the submission because at the time it was not sufficiently notorious.

CHAIR—Thank you. If time permits we will get around to that as well.

Mr Spathis—I will endeavour to be very brief and will just amplify some key points of our submission. I make the point that since our inception in 2001 we have believed in a balanced approach in corporate governance. We think we have struck a reasonable sort of balance between black-letter law and principle based provisions through the Corporations Act and the ASX listing rules. However, there are some reforms that are worthy of follow-up and recognition.

Very quickly on voting, we do regard voting as a critical and tangible expression of shareholder interests in a company. For that reason as an organisation we encourage our members to exercise all of their votes all of the time. It is for that reason that in the investment community we have been able to lift the overall voting levels from a dismal 30 per cent a few years ago to about 60 per cent today.

CHAIR—That is with your 42 super fund members?

Mr Spathis—Correct. We reiterate our support of IFSA's submission with respect to improving the integrity of the voting regime, being a member of the IFSA Proxy Voting Roundtable. In particular we support measures to improve the integrity of the voting system by encouraging electronic proxy voting in order to enhance the end-to-end proxy voting system. We do support measures to introduce a clear audit trail to identify and verify the number of votes received and the number of votes lodged and the manner in which those votes were exercised. I can only amplify that point. I would also refer you to the part in our submission that refers to the recent introduction of a power in the UK for members to require an independent report on a poll pursuant to section 342 of the UK Companies Act.

In relation to the question of whether institutional shareholders are able to engage or participate in the affairs of a company, we do make the point that the introduction of the non-binding shareholder vote on remuneration has been one of the major catalysts for engagement between institutional shareholders and company boards. It provides a basis for companies to explain their rationale towards remuneration. This, when coupled with the ASX Corporate Governance Council's if not, why not disclosure regime, has sown the seeds for a more robust debate on remuneration. However, again, there is room for improvement. We refer to annual reports. We would encourage that companies be required to include in their annual reports information about their remuneration consultants, including an indication of which remuneration consultants have been appointed, by whom and the nature of the services that are provided. There are a number of companies that already do this, but we believe that this should be stock standard in order to make very clear any perceived or actual conflicts in place.

We also refer in our submission to the exclusion of interested directors and executives in voting on remuneration reports. We support the view that, in order to get a much clearer understanding about the level of support in relation to the remuneration that applies, directors and executives who are beneficiaries of these remuneration arrangements should be excluded from participating in the vote. That gives us a much clearer litmus test and a true level of support in relation to the arrangements that apply to them.

We can only amplify the points that were made in the previous submission in relation to the ASX listing rules on 10.14. We are concerned about the implications post October 2005 with respect to the amendments to the ASX listing rule that effectively took away a binding vote that was available to shareholders in circumstances where shares were bought on market, even if the company itself was using company funds. So we believe that dilution is not the only issue that is of concern to shareholders. If we want to check the veracity of the remuneration arrangements, we need to be able to have a say as to the performance hurdles that apply, the vesting arrangements and other relevant aspects. We do believe that that issue should be properly reviewed. ACSI, together with other investor groups, has submitted to the ASX that the current version of 10.14 should be revised to require shareholder approval of any acquisition of securities by a director outside of a genuine salary sacrifice arrangement. Again, I amplify the point that a number of companies, despite the fact that 10.14 allows for circumventing a shareholder vote, ignore this possibility and in the interests of good corporate governance engage and seek shareholder approval in relation to this. I think some of those companies include Qantas, PaperlinX and Worsley Parsons.

Finally, our submission also makes reference to potential impediments to collective action by institutional shareholders. There have been occasions over the last few years where, clearly, in

order to be able to effect any improvements to corporate governance, you needed a group of investors to be able to work collectively on issues with respect to companies. Those issues in relation to corporate governance do not only relate to matters that arise at a general meeting; we are quite often required to be able to talk amongst ourselves in between general meetings. However, there are some issues that arise in the context of the Corporations Act—some of the substantial shareholding and takeover provisions that could be triggered in circumstances where certain thresholds are exceeded as a consequence of a group of investors actually getting together and discussing governance issues in between company meetings.

ASIC recognised some of these impediments and introduced the class order to allow investors to meet and enter into an agreement on governance matters that relate to a general meeting. There exists a limitation to the class order, in that not all corporate governance issues arise in the context of a general meeting. Essentially, what we would be looking at is reviewing arrangements to encourage discussions between investors on governance issues between such meetings. Again, further refinements in this regard may be warranted in order to encourage further dialogue and improvements between meetings.

Senator MURRAY—I note that you support electronic proxy voting and the implementation of direct voting. There is one issue that I want to check with you. Do you believe that proxy votes should not be capable of being destroyed for a period? If you agree with that, what period would you suggest?

Mr O'Sullivan—We were fortunate to hear the immediately preceding discussion, and we understand that the electoral arrangements and preservations between parliamentary elections, for example, and corporate elections are very different. But I would have thought a similar period, like seven years, would not be unreasonable—certainly no less than the term. Seven years would seem to be not an unreasonable time to keep records which are largely electronic anyway and therefore very easy to keep. I must say that that is not a matter that ACSI has discussed and thought about all that much, but I think that is a reasonable response to the question.

CHAIR—Just to be clear on that: there is no requirement to hold them at all at present.

Mr O'Sullivan—Not that I am aware of. As I understand it, usually the elections are conducted by auditors and others who are engaged for the purpose of conducting them, and they act in good faith. I do not think they have any—

CHAIR—No, there is no mechanism available.

Mr O'Sullivan—to hold on to records for any length of time.

Senator MURRAY—I will ask you this question on notice, because I think it is important for you to, if you can, get some input from your constituent members. Do you think it would be a useful addition to corporate practice if there were the opportunity for recounts if there is a dispute and if there were some sort of dispute mechanism with respect to the election of directors or key material votes? Could you take that on notice and come back to us.

Mr O'Sullivan—Yes.

Senator MURRAY—Your submission refers to a proper purpose test which they introduced in the United Kingdom. The United Kingdom avoided a definition being attached to that—and I can understand why, because it is a fairly hard thing to do. However, you have jumped that barrier and said that there should be a definition. So then the question is, okay, you are so smart, what is the definition?

Mr O'Sullivan—I will leave that to my distinguished colleague.

Mr Spathis—We actually looked at the explanatory memo to get some clarity around the issue. We have put a call in to one of our like-minded organisations in the UK to get an understanding of how that legislation, which was introduced late last year, or how that aspect of it has transpired since its introduction. So I can include in our fuller response some feedback from that organisation. I did bring the explanatory memo with me, because I had the same question about how they dealt with the definition of proper purpose. Again, there was not all that much there but I will endeavour to come back to you.

Senator MURRAY—Again drawing a parallel with the electoral roll, there has been real concern on privacy grounds as to that being publicly available, and over time it has become less publicly available. Of course, people are entitled to be privately registered so that their addresses and names do not appear on the register. If that approach were adopted—namely, if there were to be a non-disclosable portion of the register—a special-purpose test would not be needed. In my view, a special-purpose test or exclusion from public display is appropriate for individuals but not for entities. Could you give that some thought, if you have not already, and come back to the committee on whether you think that is a meaningful alternative?

Mr Spathis—Yes.

Senator MURRAY—As you know, the share sharks that are out there that make offers to little old ladies for half the share value do not get very far with corporate entities—though with some they do, unfortunately, but mostly they are targeting individuals. I have no formed view, but it does seem to me that that is an alternative approach.

Mr O'Sullivan—We agree with that but our problem is a little bit the opposite: that the companies say to us that we are not really aware of which superannuation funds own how much of what because you are all in there as custodially owned. We are in favour of them having as much transparency as possible without having to spend money to find out exactly who their institutional shareholders are and who the ultimate beneficiaries are. So we are kind of in favour of unpacking the institutional side. But I understand your point—and we sympathise with the retail end—about the need to keep other people's privacy sufficiently secure that they do not suffer from those sharks that you refer to.

Senator MURRAY—Maybe there are two dimensions to this. I am glad you explained that. Perhaps less onus where it matters least—because, frankly, a little old lady's shares do not matter much unless she happens to be the mother of a media mogul, and then they matter a great deal!

Mr O'Sullivan—Or a constituent.

Senator MURRAY—The substantial shareholders at the other end you do need to unpack.

Mr O'Sullivan—We actually think it would benefit us more in our endeavours if companies understood just how much of their register is owned by superannuation funds.

Senator MURRAY—You mentioned that you were in the audience for some or all of the previous witnesses' interactions with the committee. I do not want to repeat or go through the discussion I had with them on the election of directors, but I wonder if you have any views on that that you might like to put to the committee once you have had a look at the *Hansard* of the interchanges with those witnesses and whether you might assist us in that area. My own opinion is that the three thorniest issues that require a vote are these: directors' remuneration, which we have discussed; the election of directors, which I think you have discussed far too little; and changes to company constitutions which materially affect the future of those companies.

Mr Spathis—I would make just one observation with respect to your point. Off the top of my head, having read many of the constitutions and some of the nomination processes, I do not think the broadening of the gene pool or the problems relating to broadening the gene pool relate to any technical impediments.

Senator MURRAY—That was the point of the previous witnesses.

Mr Spathis—That is right.

Senator MURRAY—They said the mechanics are not the issue.

Mr Spathis—It belies the fact that, in the last year or two, 70 per cent of new appointments to S&P/ASX 100 companies are directors who already occupy a directorship in another S&P/ASX 100 company. I think the issue really goes to the heart of how hard and how far a company is looking beyond the usual suspects to make a real effort to broaden the gene pool. I think that is the real challenge. There was some mention of 'the club'; I think the club is well and truly alive, and when you look at stats like that it only reinforces that point. We do encourage companies to go beyond the usual suspects, although they generally do a good job, and look for a range of skill sets. For instance, if you look at the composition of the boards of companies in the S&P/ASX 100, only nine per cent of directorships are occupied by women.

Senator MURRAY—My request to you, Mr Spathis—and it is a request; only do it if you feel so inclined—is to provide the committee with some ways in which improvements can be made. I suggested one on the corporate governance principles model was a proper and practical interaction of market participants to address this issue, but you may have other views. I would appreciate it if you came through with that.

Mr Spathis—Sure.

Senator MURRAY—We had earlier witnesses, whom you may not have heard, who were from Family Business Australia, essentially putting the proposition that the Corporations Act is too complex and onerous for certain forms of companies presently covered by it. I agree with that for other companies as well, such as small for-profits and small not-for-profits. The provisions which relate to equity, reporting and so on have bigger market participants in mind. I would like to ask you whether effective shareholder interaction, which was the point of Family Business Australia's submission, would be enhanced if different classes were developed within

the Corporations Act, with perhaps less and more flexible reporting for smaller unlisted companies.

Mr O'Sullivan—Smaller unlisted companies?

Senator MURRAY—Yes.

Mr O'Sullivan—I guess almost everything we have said and prepared is related to listed entities, not unlisted ones. We are invested in the unlisted market, so we have an interest in it—

Senator MURRAY—I assumed you were. That is why I asked you the question.

Mr O'Sullivan—It is absolutely true to say that the governance issues are quite difficult in the unlisted market because of how powerfully held the companies are by their founders or the families who started them. As for whether what you propose is a solution, I am not really—

Senator MURRAY—I am asking you because the proposition was put to us by a witness.

Mr O'Sullivan—I think the answer is we do not know. We have not considered it and we ought not to say too much if we have not considered something. We are happy to consider it and perhaps come back to you if we can look later on at the record of what was said by that organisation, but we did not hear them on that.

Senator MURRAY—Look in the *Hansard* record for Family Business Australia, and the number of the submission, which would be on the website, is 3.

Mr O'Sullivan—Thank you. I think that is the better thing for us to do. From the sound of the name of the organisation, our penetration of those companies would be very tiny.

Mr KEENAN—Senator Murray touched on this, but I want to be a little more explicit. With the last group that was giving evidence we were talking about the 10.14 rule about equity based remuneration, and we asked a question about whether there was some rationale for the ASX changing that rule in 2005. I am just wondering whether you could shed any light on that.

Mr O'Sullivan—We think that they were lobbied to change it on the basis that it did not have a dilutory effect and therefore was not relevant. Our point is that it came in coexistent with the development of voting—albeit non-binding—on remuneration and greater scrutiny of remuneration and that it was inconsistent. From our point of view it is an inconsistent thing to do. It is kind of retrograde to everything else that was happening. It is true that it is not dilutory, but that is not the only game in town.

Mr Spathis—But there is a view amongst many directors that shareholders really should not have any say in relation to remuneration or even share incentives. I think this falls consistently with that sort of approach and view. It does concern us that we have now got many companies who are using the 10.14 loophole. We do not want to be put in a position where we are throwing the baby out with the bathwater and having to vote down remuneration reports which may generally be underpinned by reasonable principles but which, at the same time, allow for companies to avoid a binding vote on such a key component of a share incentive. So we are in a

bind. There is no evidence to suggest that, even before the amendment to 10.14, that provision—the binding vote—was abused by shareholders. The evidence would show that, almost 100 per cent of the time, any remuneration or share incentive arrangements that were underpinned by stretching performance hurdles were overwhelmingly supported. So I think it was an overreaction.

Mr KEENAN—Was it common for executive remuneration to be voted down? Does it ever happen?

Mr Spathis—We have had some remuneration reports that have been voted down, of course. We had some significant votes against in Telstra and AGL last year and in a number of other companies the year before. Happily, we have been able to engage with a lot of companies and address issues of disclosure in substance in relation to some of those issues. But no; there is not a great history of voting against. But there is greater scrutiny than there has ever been.

Mr KEENAN—So you think that, even though it does not happen, the environment has changed?

Mr Spathis—Yes.

Mr KEENAN—I assume that your member funds would often be very substantial shareholders in a combined way in some of the big companies around Australia, and that would mean that these companies are really forced to engage with you about these things.

Mr Spathis—The more enlightened companies do engage well before the AGM. They engage with shareholder groups and go to issues of design, transparency and so forth, and they actually look for views and opinions. Our approach to remuneration is very transparent. We have developed a set of corporate governance guidelines that are really aimed not at contradicting the main tenets of the Corporations Act or the ASX listing rules but at actually providing some reasonable supplements to these sorts of provisions to make it very clear to the chairmen of the top ASX/S&P 200 companies what approach we would usually take on such issues as remuneration. So there should be no surprises about where we come from. We do endeavour to be very transparent in our policy and our approach. But there are still some directors and some companies who think that this should be out of the arm of effective shareholder scrutiny, and I think that that will be challenged.

Mr KEENAN—I know that ACSI are experts in corporate governance. I am just wondering in a general way how you would rate the environment in Australia against that of the US and the UK. How much opportunity is there for shareholder interaction in companies here as opposed to some of our major overseas competitors?

Mr O'Sullivan—In the last several years, we have become members of the International Corporate Governance Network. As I think you know, we are on the Board of Governors of that body. That has given us a reasonable perch from which to look at other jurisdictions. So I think it is reasonable to say that Australia is very good; it has a very good standard of governance. That does not mean, as we have seen more recently, that everybody practises what they preach as well as they might but, nevertheless, the preaching is good and the standards are generally high. The

policing is generally good—sometimes it misses, but it is generally good. It is on a par at least with the UK; it is much better than the US.

The big difference between here and the US is that shareholders here have rights that they do not have in the US. Redress is possible here before things get really bad and even after they happen, whereas in the United States the only real redress is the class action, which is a long time after the event, punitive and only occasionally does a repair job—that is, in some cases the settlement of a class action will include the financial penalty and undertakings about future governance, but that is still relatively rare compared to just a punitive penalty. People go to jail in the US, which is a good thing. Eventually, they track them down and eventually they go to jail. But we think our situation is better. That is a long answer to a short question.

Mr KEENAN—I appreciate it.

Mr Spathis—The only additional point would be having the right set of laws. That is a critical and very important platform but, as one very senior director put to me, no matter how thick you may make the Corporations Act, unless you deal with the dishonesty and incompetence from the boardroom down, you will never get a healthy corporate governance regime in any corporation. So I think there is an interaction between good laws and a strong ethical practise that comes from the boardroom down—it is set from the top down. From our perspective, our role is to more or less make sure that directors are aware that they are being observed. A combination of both regulators and more active investors creates a more transparent and more robust environment in that regard.

Mr ROBERT—Is there a statutory compliance on companies to have shareholder non-binding remuneration votes or is that optional for them?

Mr O'Sullivan—No, it is binding.

Mr ROBERT—So every AGM of major companies should have a shareholder non-binding remuneration vote?

Mr O'Sullivan—Yes.

Mr ROBERT—One of the issues you raised in your submission was that directors and executives should not participate in that vote, in that the results may be skewed. In a typical vote, how many people are voting? How many votes are being cast?

Mr O'Sullivan—It would be an enormous variety—from a very large company where the holdings of the directors would be a relatively small percentage to a smaller company where the holdings of the directors could be almost a majority or a majority.

Mr ROBERT—So, in some cases, the directors are voting themselves in with little scrutiny because of their substantial shareholdings?

Mr O'Sullivan—I think it is an important principle that it be separate. It is like a related party transaction—in effect, you should separate yourself from voting for your own remuneration. You are very unlikely to vote against it since you formulated it. Even if we take the risk that we lose

some votes against it, we are happy that people do not vote for it. It is a genuine decision by the shareholders who are the disinterested parties—the only ones, really, in the vote.

Mr ROBERT—Mr Spathis, you gave examples before with respect to AGL and Telstra where there was a non-binding remuneration vote. What was the result of those two votes?

Mr O'Sullivan—In the case of Telstra, two-thirds—66 per cent—voted against the remuneration policy put forward by the board. The spokesperson—who is a person that we know very well—and chairman of the remuneration committee said that that was the fault of the proxy advisers, of whom you have just recently heard, rather than there being any defect in the remuneration policy. In the case of AGL, they accepted the criticism and changed it.

Mr ROBERT—So, in Telstra, two-thirds of the voters—that is, two-thirds of the company—

Mr O'Sullivan—Two-thirds of the votes cast in the election, if you like.

Mr ROBERT—decided against it, and management still went on with their remuneration?

Mr O'Sullivan—And shot the messenger.

Mr ROBERT—How awkward!

Mr KEENAN—Is there a precedent for that anywhere else in Australian corporate history?

Mr O'Sullivan—There is a very short history of remuneration votes, so no. With every other adverse remuneration vote—which has not been anything like two-thirds—I think I am right in saying that the company has taken it as something that they ought to acknowledge and rectify. At the moment, the exception is Telstra—although we have had some discussions with Telstra since then and we hope to resolve our differences with them between now and their next general meeting.

Mr ROBERT—Just on that point, considering the somewhat disdain with which shareholders were held in that regard, as the majority of shareholders—a clear majority—expressed their concern and it was overlooked, and as the shareholders of course have the opportunity to vote out that board of directors and vote a new one in, did the shareholders in this instance adopt to move in that way at all?

Mr O'Sullivan—In sequence, the vote occurs at a general meeting simultaneously, as those directors have been re-elected. This year is when the issue that you have raised could be tested. We will be interested to see what happens, but I think there are a number of institutional investors—I would not say excluding all superannuation funds but mostly outside of the superannuation side—who were very brave about non-binding votes for remuneration who may be less brave about tipping out the directors of Telstra in a period when Telstra is such a key player in what might be major government policy delivery and a lot of other issues. But your point is a very valid one. Our colleagues in the United Kingdom say that, if that ever happened in the UK—and it did happen with GlaxoSmithKline—automatically the pension funds would vote against the directors the following year. But it is a very new experience for us. We should

say on the record that our ambition is to resolve the issues with Telstra rather than advocate for the tipping out of all the directors.

Mr ROBERT—The committee should watch this with some interest.

CHAIR—Just to flesh this out a bit more, if a binding vote were in place and that 66 per cent, having been a majority, therefore meant the remuneration package was not accepted, what would be the default position in that case?

Mr O'Sullivan—If it were binding?

CHAIR—If it were binding, what would be the default position? What happens in other jurisdictions? What does it revert to? Does it stay where it is or are there options for the directors?

Mr O'Sullivan—I do not think there are any jurisdictions where there is a binding vote. Is that right?

Mr Spathis—I am not certain. If, for example, there was a binding vote in relation to share incentive and share option schemes and a majority vote against, that would go down.

CHAIR—I am specifically thinking of remuneration packages, though, because that affects the operation of the company. If there were to be—and I suppose I am playing a bit of a devil's advocate here—a binding vote, there would have to be a default position; otherwise the company would almost cease to operate. There would have to be either a default position or an option B where, in the case of a binding vote, you would have to vote for one of the options. There would have to be an outcome. My point is that you could not have no outcome; you would have to have an outcome.

Mr O'Sullivan—If there were a binding vote—and there is no sign that there ever will be; and no-one at the minute is advocating for a binding vote—I think people would put it forward in the form of an amendment to the current scheme, so that, if the amendment were to be defeated, the existing scheme would be the default. But, because it is not an amendment to the existing scheme now and it is simply putting forward an expression of view by the shareholders, it is probably not expressed as an amendment. But I think people would very quickly adapt to the amendment formula if there was a binding—

CHAIR—That is what I was thinking. I was thinking about the quick adapters to any rule that is put in place. Anyway, it is not an issue; it is not the case at the moment.

Mr Spathis—I have been advised that, in the Netherlands, in circumstances where a binding vote results in the proposition being defeated, then effectively the company reverts to its prior policy, as it applied. It may be a bit different, though, when you have got a new executive that has basically just accepted a new contract. But, again, the norm, as I understand it, in the Netherlands is that it reverts to prior policy.

Senator MURRAY—I have written minority reports and have had a lot to say on that topic, which you can look up if you wish to. I want to ask a question arising from Mr Robert's

questions. I will use Telstra as a hypothetical example. They have done something that the institutional shareholders do not like, which is to not accept a non-binding vote, so the next year they want to try to vote the directors out. What happens if the directors decide there is no vacancy on the board? Then you get the supermajority problem, don't you?

Mr O'Sullivan—Each director who is due for election puts themselves forward, whether or not there is a vacancy. It is possible to vote against those who are up for election whether there is a vacancy or not. If they were defeated, then there would be a vacancy. That is as I understand it.

Senator MURRAY—But it is harder where a director is not up for election, isn't it?

Mr O'Sullivan—It is. But it is different in the sense that you would not have another candidate to direct your vote to. You would simply direct your vote against a candidate.

Senator MURRAY—The reason I explore this is that this to me exposes a weakness. Let us assume it is a small board of five directors and that only two are up for re-election and three are not. If you vote three out you could have a real problem because the board would not be functional. You would have a proper election for the two to be replaced and the other three would be gone. That is why I think it is a problem.

Mr O'Sullivan—We looked at this in the case of the National Australia Bank when one of the directors, some time ago after the forex problem, proposed that all of the directors be dismissed at the same time, leaving only the managing executive director as the sole member of the board, and it was for him to make arrangements for the election of replacements. That apparently was the legal position; he would have constituted the board to the extent of having a kind of a caretaker role until he could reconstitute a new board. That was the advice we got at that time. So it is possible—I am not suggesting it is desirable—to vote against people without having someone to replace them immediately to hand. There are two different things to ask institutional shareholders to do: one is to vote against the existing directors, which is a big ask for many of them; the other is to vote in favour of that particular person whom you have selected as the best available. So, you may disagree on the second and therefore not do the first. In any event, we are not at this point saying that that is what should happen in Telstra. I am merely relaying that that is what the people in the UK would do to solve that problem—asked by Mr Robert.

Mr Spathis—The day may well come where, if we have more facilitative collective action provisions, we may even have institutional investors running candidates in order to avoid that extreme scenario with respect to a distressed company and a distressed board.

Mr ROBERT—You raised in your submission to us that you would like to see the remuneration consultants named within the reporting process. Why particularly the remuneration consultants? I note your paragraph that would be asking them if they had any conflicts of interest, or otherwise, to bring those forth. But, considering that companies use a whole raft of consultants, why particularly are the remuneration consultants to be named?

Mr Spathis—It goes to the heart of conflicts of interest when, essentially, these remuneration consultants are giving advice about what pay should apply to executives and directors. We effectively want to unpeel the onion and understand whether there is any prior connection between any of those executives and directors in relation to those 'rem' consultants.

Mr ROBERT—Surely we can safely assume that the directors are not going to appoint a bunch of consultants who recommend that salaries go down. So right from the start, by virtue of their appointment, the result they are going to come back with will have salaries going up. So there is an inherent basis of conflict of interest by virtue of their appointment.

Mr O'Sullivan—It depends on who hired them—whether they are hired by management, the board or the board remuneration committee. That should be made clear: who are they consulting to? That is really the main reason, I think.

Mr Spathis—There are companies like BHP Billiton and Iluka that are already disclosing that information. And, yes, I do share your view—there would not be a spiral downwards in relation to executive pay.

Mr ROBERT—But Mr O'Sullivan said that the point may be that, if the board was hiring the consultants to review the management team, that would be a very different thing to the management team hiring the consultants for themselves.

Mr O'Sullivan—I think it is better for it to be very clear who hired them and who is paying them and so on—well, the company is paying them. But, on whose behalf were they hired? Because if management hire them to consult and report to the board then, really, it is management reporting its view of future remuneration to the board.

Mr ROBERT—As opposed to the board hiring it to do a top-down review?

Mr O'Sullivan—Yes. And in the best of all worlds it would be the responsibility of the board remuneration committee to control that situation and not to be subject to management initiatives. That is not always the case, though.

CHAIR—Gentlemen, I thank you very much for the time you have given us.

Mr O'Sullivan—We will come back to you on those questions. Thank you, Mr Chair.

[4.01 pm]

BRINE, Mr Matthew, Acting General Manager, Corporations and Financial Services Division, Department of the Treasury

FRASER, Mr Bede, Manager, Corporations and Financial Services Division, Department of the Treasury

HACKETT, Mr Greg, Policy Adviser, Governance and Insolvency Unit, Corporations and Financial Services Division, Department of the Treasury

KLJAKOVIC, Ms Marian, Manager, Corporations and Financial Services Division, Department of the Treasury

RAM, Ms Ronita, Policy Analyst, Corporate Reporting and Accountability Unit, Corporations and Financial Services Division, Department of the Treasury

CHAIR—Welcome. I now invite you to make any opening remarks in support of your submission.

Mr Brine—Thank you for the opportunity to speak to Treasury's submission to the inquiry. The engagement and participation of shareholders in the companies in which they invest is an important part of Australia's corporate governance framework. Our submission presents one framework for considering the issues that arise in this area. In short, shareholder engagement and participation is presented as a way to address the agency costs associated with the corporate structure which result from the separation of ownership and control. Shareholder oversight of corporate boards provides incentives for directors to pursue profit-making activities and to improve the value of shareholders' investment into the longer term. In addition, investors are more likely to contribute capital for new projects where they have clearly defined rights, including the right to influence management decisions on key issues.

Our submission notes that Australia's corporate governance regime includes not only the rules under corporate law but also a range of private sector co-regulatory and self-regulatory initiatives. There is always a difficult question here as to which issues should be resolved by companies and shareholders through the company constitution, which issues should be left to industry standards, and which issues should be addressed through regulation. Recent observations by the IMF as part of its Financial Sector Assessment Program suggest that our corporate governance regime is delivering good outcomes. But, of course, there is always room for improvement.

Our submission concludes with the observation that future reforms should reflect the evolution of the market. I would like to make some brief observations about this. Some international commentators have identified a trend described as 'de-retailisation', whereby retail investors are moving towards indirect ownership of listed shares through superannuation and other managed funds. To some extent, we can see this trend in Australia. Household investment was 22 per cent of total investments in the listed sector in 2006-07, down from 28 per cent in 1988-89. The trend

increase in household investment in the listed sector appears to be slowing. In comparison, the total levels of domestic institutional investment—including investments by banks, life and other insurance companies, pension funds and other financial intermediaries—have increased from 25 per cent in 1988-89 to 38 per cent in 2006-07. In addition, foreign investment in the listed sector was 33 per cent in 2006-07, and much of that investment is held through institutions.

Taking this into account the corporate governance framework must be flexible enough to negotiate the differing requirements of different types of shareholders and their relative prominence in the market at any one time. The focus of regulating the framework may need to adapt, along with changes in the market make-up. However, the data suggests that it is still the case that a substantial proportion of Australian shares are held directly by retail investors. In light of this, a key concern of the regulatory framework should be to encourage retail shareholders to access, understand and exercise their membership rights.

Looking forward, the Treasury, in partnership with the Australian National University, has commenced a study investigating the impact of corporate governance on firm financial performance. While our results are at a preliminary stage and further work still needs to be carried out, I thought it would be useful to share some of the initial findings. The study has indicated that companies complying with the ASX best practice principle that companies should have a majority of independent directors on the board outperformed non-compliant companies in areas such as earnings per share and dividend yield and also had higher market capitalisation. In addition, companies who established and structured their audit committee in line with the ASX principles experienced higher return on assets, earnings per share and sales growth. Similar positive relationships were identified for those companies who established nomination and remuneration committees. These results appear to be consistent over the three-year time period in which the research was conducted. Though preliminary in nature, these findings are consistent with the hypothesis that a well-structured board with the right people appointed will play an important role in improving outcomes for shareholders in a market like Australia’s.

We are also planning a research project with the University of Canberra examining how our corporate governance regime might better support the performance of small business. This project will seek to identify the needs of small business and how these might be best addressed through regulatory and non-regulatory means. For example, one option could be including a replaceable rule or a standard constitution for proprietary companies introducing alternative dispute resolution techniques as a method for resolving a deadlock between shareholders and shareholders or management.

In conclusion we would suggest that Australia’s corporate regime is generally sound, but we are conscious of the need for ongoing review and improvement and we have a number of projects underway to gather data in this area to inform future reform exercises. Thank you very much.

CHAIR—Thank you, Mr Brine. I note that your opening remarks about the arrangements you now have with the ANU and the University of Canberra are not included in your submission. I gather that is just a timing issue, as your submission is about six months old, considering the election was held in between hearings.

Mr Brine—That is correct.

CHAIR—Thank you for noting that for us. When you have information to hand on that we would certainly be very interested in it. We would really appreciate it if you could forward that to the secretariat.

Mr Brine—Yes.

CHAIR—I think your submission refers to the record cut-off date being moved to five days before proxy appointment cut-off dates to avoid last minute reconciliations.

Mr Brine—I am not sure that we addressed that issue.

CHAIR—Sorry, I misread it; IFSA made that suggestion. I was going to ask whether you had a view on the five-day cut-off, to give more time for reconciliation, counting of votes and making sure that the process was sound.

Mr Brine—That is not an issue that has been raised with us outside the context of this review. We can certainly see the arguments that they have put forward for it. If that assists in the auditing of meeting processes, it may be a very valuable reform. One issue we would be interested in exploring would be the extent to which that might reduce flexibility for companies or for shareholders, and that is not an issue that we have been able to consult with them on.

CHAIR—This is not something you have investigated or looked into specifically?

Mr Brine—Not recently, no.

CHAIR—And you do not see any specific problems?

Mr Brine—No, and it is certainly not an issue that has been raised with us directly.

CHAIR—The other question that has come up in our inquiry goes to the issue of the 100-member rule and whether that is the most effective model or whether there is a better model. I was wondering if you could make a brief comment about that and maybe give us the view of Treasury.

Mr Brine—There are a number of arguments for and against the rule in its current design. I think the main argument that has been raised against the rule is that it is inconsistent with the way in which shareholders express their views in the meeting, which is by casting votes, generally with the votes determined by the number of shares held rather than the number of shareholders casting the votes. You may have a situation where the 100 members calling the meeting have only a very small proportion of the votes that will be cast at the meeting, and there is a significant cost imposed on the company and, through it, all the other shareholders to conduct a meeting to canvass an issue which is of interest to only a very small proportion of shareholders. There is a related issue: some suggest that means that the provision is open to abuse or vexatious use for special interest groups. I think that is the key argument against it.

Other observations are that it fails to recognise the size difference between companies and we do not see similar rules in comparable jurisdictions. I think the OECD suggests that this type of rule is appropriate for jurisdictions with an emerging corporate governance culture, where there

are no ex post rights—for example, if there were no oppression remedies or no stable courts that you could take those oppression remedies to.

Having said all that, the arguments for retaining the rule are that it is simple, that it is easy for shareholders to understand. There is also an argument that the rule facilitates shareholder participation in company decision making and it gives a small group of shareholders who have a legitimate concern a real and credible means of having that concern raised with the management and the directors of the company and getting a response to their concern. Another observation is that there is no evidence of widespread abuse of the rule. I think those would be the main arguments.

You would be aware of the recent history; that is, that the previous government attempted to remove that rule, leaving only the five per cent threshold. That proposal went to the Ministerial Council for Corporations twice and it failed to obtain the agreement of state attorneys-general. In both cases they unanimously declined to offer support for that. Recently, the minister, Senator Sherry, indicated at the last meeting of MINCO that he would like this issue reconsidered. He has asked Commonwealth officials, in consultation with our state counterparts, to put together a discussion paper that identifies all the options and the pros and cons of those options and that will, hopefully, move the debate forward.

Mr ROBERT—What are the impediments to putting in place an electronic voting platform that is available online with a proxy voting messaging standard? I believe there is an international standards organisation or ISO standard based on SWIFTNet. Without mandating technology, what are the issues with respect to putting in place an electronic voting capability for large and small retail and institutional investors?

Mr Brine—Do you mean a direct voting mechanism rather than the appointment of proxies?

Mr ROBERT—Both, so that I as an individual could vote, grandma could vote—heaven help us all—and a large institution could vote as a block or indeed vote on behalf of numerous small blocks that they actually hold a management capability for, by either voting directly or lodging their proxies for vote.

Mr Brine—Our long-time understanding is that there has been no legal obstacle to the adoption of direct voting mechanisms by Australian companies. We have liaised with Chartered Secretaries Australia on this issue for a number of years, and they have put out advice to companies containing some draft provisions they might include in their constitution to facilitate direct voting. I think it is correct to say that there has not been a great take-up of that initiative. It may be that companies are more comfortable with the traditional approaches to corporate decision making. We are not aware of any regulatory obstacles to the development of that type of framework.

Mr Hackett—The CLERP 9 Act contained amendments to allow proxies to be lodged electronically, so in one way we have dealt with what was a perceived obstacle in the law. It is a matter now for companies to adopt this new method. This is not a mandated requirement; it is a facilitative requirement.

Mr ROBERT—The Australian Stock Exchange states:

Timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest.

So, in short, companies must make a timely disclosure to all investors regarding information that may have an issue on the security value. We are led to believe that, in many instances, companies will have a teleconference or other type of medium only with institutional investors and will only inform institutional investors that a teleconference will occur that will provide information that has had a direct influence on security value. On face value, it would seem that many retail investors are being denied this information, and that may be in contradiction of the ASX statement that 'timely disclosure must be made' to all investors. One thing that was put before the committee was the ability for companies, via the internet or online technologies, to stream a teleconference to allow everyone the opportunity—not just those invited. Do you have a view on that?

Mr Brine—I might ask Ms Kljakovic to make some comments on the disclosure of information that might have a material impact on price.

Ms Kljakovic—To the extent that that information would have a material impact on price, the company has an obligation to disclose it to the market. It could do that through submitting it to the ASX or, if it was able to, it could stream it to other investors. I could see that would be useful in disseminating the information, but the primary obligation would be to inform the ASX so that the entire market is made aware of it.

Mr ROBERT—So what about the current provisions where companies are disclosing it only to institutional investors? The evidence presented to the committee makes it very clear that information going only to institutional investors had a direct and material consequence upon the share price.

Ms Kljakovic—On the face of it, that would appear to be a breach of the listing rules and of the act. If it was simply background information it might not be objectionable but, if it was price sensitive information, it should have been disclosed to the ASX.

Mr ROBERT—So, following a teleconference with institutional investors, if the share prices were to halve, we could assume on face value that perhaps something more tangible was discussed in such a conference?

Ms Kljakovic—It would certainly bear investigation by the appropriate authorities.

Mr ROBERT—It would, wouldn't it?

Senator MURRAY—I would just like to return to the electronic voting issue. It seems to me that the law, if it does not actively facilitate it, certainly does not oppose the introduction of electronic voting. But it also seems to me that there are company boards and management who like the old system, because it gave them more power and more control. Short of mandating, they must introduce it. If you did not want to go that far, the halfway stop is the 'if not, why not' approach, which is a regulatory device, if you like. Do you think it would be appropriate for ASIC to examine whether they should ask companies the 'if not, why not' question?

Mr Brine—I am not sure it would be appropriate for ASIC. Perhaps the ASX could consider that in their listing rules, because they have an existing 'if not, why not' mechanism, and I think those principles already invite companies to establish a policy to encourage shareholder participation in the general meeting and disclose that policy publicly. So it seems that the current listing rules provide flexibility for companies to try to do what is most appropriate to their circumstances. I am not sure if they have addressed this particular issue of whether or not this should be included in their governance principles. I guess ultimately that would be a question for the ASX and their Corporate Governance Council.

Senator MURRAY—But it is a valid option for them to consider, isn't it?

Mr Brine—Yes. But I think ultimately we cannot get too far away from the fact that there is an obligation on directors to consider these issues. Company funds are expended on annual general meetings and company directors should be cognisant of their obligation to act in the best interest of the company, with due care and diligence. One would expect that they should be considering alternatives like this.

Senator MURRAY—Mr Brine, Mr Hackett correctly raised the CLERP 9 legislation and its facilitative effect in this area. I participated both in the inquiry and in the debate, but I have forgotten the reasons it was not mandated. Do you have any record of that?

Mr Brine—I was around at that time. I am not sure that the issue of mandating was ever put on the table, as it were, by Treasury or by any of the groups that were making submissions. I think the view that was put to the committee and to us was that there were uncertainties about the law and if those uncertainties were removed then this practice would grow naturally.

Senator MURRAY—Of course, technology has moved on. It is much easier now, even for the smallest operation to do this. Do not come back if there is no answer, but if Treasury has a view on the mandating issue could they provide it to us?

Mr Brine—Yes.

Senator MURRAY—Thank you. I want to move on to what I describe as informed consent. Mr Hackett has been present through the discussion but the rest of you have not, so I will explain briefly my view. My view is that most investment and superannuation funds of whatever style and variety effectively hold shares directly or indirectly in trust on behalf of those who have given them money. If I may say so, I think that trust is emphasised when it is a consequence of a compulsory superannuation scheme, because there is not a matter of choice or was not originally a matter of choice. I have been very attracted by the informed consent which relates to investment options. You have five investment options and you can choose one. If you do not choose one, there is a default option, which is described. Although many people might not understand that fully, it is to my mind informed consent because you must tick one otherwise there is a default position.

It seems to me that recent events with respect to share lending, both for profit taking and voting purposes, have highlighted the problems where people have not given informed consent to certain behaviour by investment funds, which includes lending their shares for whatever purpose or voting their shares in a way for whatever purpose. My question to you—because it

was not covered in your submission—is whether Treasury have given any thought to that matter and come to a view or whether that is still part of the internal policy assessment of what is going on, which you will provide the minister and therefore you cannot provide us.

Mr Brine—I think it is fair to say that that issue is floating around in the mix with the range of issues that we are monitoring and exploring in the context of current market developments. The state of our thinking at the current time is that these issues do fall to determination by the super funds trustees under their fiduciary obligations. They are under fiduciary and statutory obligations to deal with the funds in a way which best promotes the ultimate beneficiaries, the investors in the super funds. We would argue that that fiduciary obligation would involve trustees reviewing the appropriateness of investment practices, such as scrip lending, and redetermining those policies from time to time as market conditions change.

Senator MURRAY—I might be being unfair and unkind to those representative organisations, but my impression is that they have not given much thought to the consent side of issues. They have given thought to disclosure and what would be better practice, given the weaknesses which have been observed in existing practice, but they have not given any thought to the consent side of it. It seems to me the precedent of informed consent that has been shown in the investment strategy could be carried through to other material consents, even if they are consents by default—a default option—which relate to voting matters or issues like whether the right to property should be able to be given to somebody else without your direct consent to that policy. All I want from you—because I understand the restrictions on your answers, given your current review—is an assurance that the consent aspect will form part of Treasury's overall review and advice to the minister.

Mr Brine—I think we can give that undertaking.

Senator MURRAY—Thank you.

Mr KEENAN—We have had some discussion in today's hearing about executive remuneration, and I was wondering if the government has ever considered whether it is appropriate for executives to vote on their own remuneration.

Mr Brine—I might ask Mr Fraser to handle this question.

Mr Fraser—Mr Keenan, as you would be aware, the non-binding vote was introduced as part of the CLERP 9 reforms. I think it provides a valuable opportunity for shareholders to raise concerns directly with the management of the company. I think we have had some evidence in the previous submissions about the benefits of the non-binding vote. It is also fair to say that those submissions have also raised some concerns about executives voting on their own remuneration packages as part of this non-binding vote. It is not an issue that has been raised with Treasury, and the government has not put forward a position on it to date, but it is probably an issue that needs to be examined into the future. At this stage we would note that the directors have an overriding responsibility to act in the best interests of the company, and that could include any non-binding vote on the remuneration report.

Mr KEENAN—Yes. In a sense, the case of Telstra that was raised by Mr Robert puts us in some uncharted territory. Previous evidence suggested that it has been the practice that, if this

thing was voted down even though it was non-binding, that message was listened to, I suppose; but we have an instance with Telstra where that might not necessarily be the case at the moment. When the ASX does change its listing rules, do they refer to Treasury before they do that? What is the mechanism for the ASX to contact Treasury when they are doing that, if they contact you at all?

Ms Kljakovic—The normal procedure would be for the ASX to make an amendment to its rules then lodge a copy of that amendment with ASIC. A copy would be forwarded to the minister. The minister has the power to disallow the rules within 28 days, so he would decide whether to exercise that power after hearing recommendations from ASIC.

Mr KEENAN—So the Treasurer can disallow changes to ASX listing rules?

Ms Kljakovic—That is correct.

Mr KEENAN—That is interesting. Thank you.

Mr ROBERT—Family Business Australia—and let us call them the voice of the unlisted family companies and, indeed, the smaller proprietary companies that make up pretty much 96 per cent of incorporated entities within the country—take issue with the 50-shareholder rule under section 113. They say that, as families or family companies have grown and evolved, there are family units—aunts, uncles, grandchildren and other family members—who are now shareholders in second- and third-generation companies. Many of them may not be working in the business; they are not directors but simply shareholders. That family grouping has grown to more than 50, with 50 of course being the magic number which moves you from the business from proprietary unlisted to the public company space. Family Business Australia's contention was that the number of shareholders should be extended from 50 to a higher number to take account of that second- and third-generation growth of families. Mr Fraser, have you previously been alerted to this concern, and what might be the unintended consequences of making a change from 50 to a higher number?

Mr Fraser—That is another issue that has not been raised directly with Treasury.

Mr ROBERT—Not been raised?

Ms Kljakovic—It was raised once with our unit.

Mr Fraser—Okay. I suppose the reasoning for the 50 is that the more dispersed the ownership the greater the potential for governance issues, in contrast with closely held companies. As for consequences, if you are thinking of having more owners, more diverse ownership, then there are calls for having greater transparency and as a result those companies would fall into the requirements for unlisted companies, which would require financial reports to be produced.

Mr ROBERT—That is working on the assumption that, if the number were increased from 50 to 100 but still within a family unit, there is a greater ownership and therefore a greater responsibility for reporting; yet the ownership is still held, in many cases, by that discrete family unit.

Mr Fraser—Yes, I was making that assumption. I suppose, though, that the greater the number of members in the company the greater the potential would be for the company to be larger and, even if it were a proprietary company, it might be over the tests for being a large proprietary company, which at the moment are $25 million for revenue and $12½ million. So the broader the membership the greater the number of members the greater the likelihood that the company is going to be large in any event, in which case moving to proprietary companies would not necessarily alleviate any reporting responsibilities.

Mr ROBERT—How long has the number of shareholders rule been 50 within the Corporations Act?

Mr Fraser—I do not have that information, but my understanding is it has been in for a long time.

Mr ROBERT—Could you come back to us on how long it has been in the act. Also, what was the reasoning behind the number 50—what was the basis for choosing 50 in the first place? My final question is to Ms Kljakovic. You said this concern was raised in your unit once; was it a discussion around the water cooler or was it a discussion of substance?

Ms Kljakovic—We were approached by someone on behalf of a company that had more than 50 members and was considering whether it would be possible to have the law changed or whether it should restructure its affairs. It was a very general sort of approach which went no further.

Mr ROBERT—What was Treasury's consideration at that time?

Ms Kljakovic—At that time there had only been the one inquiry. We did not see a great impetus to change the existing position.

Mr ROBERT—And when was the inquiry made?

Ms Kljakovic—I could put the exact date in with the other written advice we are providing.

Mr ROBERT—Mr Fraser, you talked about the unintended consequences and said that, as the number grows and the shareholding widens, there is a need for greater reporting because the numbers are greater—which I certainly accept. However, is that a significant unintended consequence and, more importantly, are there any other unintended consequences that Treasury would be aware of that would prohibit the government looking from 50 to a larger number?

Mr Fraser—I do not think there would be any other, but we would have to examine that. As Marian noted, there have not been a number of submissions raised to the Treasury on this issue. So it has not been an issue that has been identified as a major concern for these types of businesses.

Mr ROBERT—Keeping in mind that these types of businesses are generally small with parents who probably do not even know that Treasury exists—

Senator MURRAY—I have a follow-up to that question. Mr Fraser, in responding to the particular issue of the 50 threshold, one of the alternatives I asked Family Business Australia whether they would consider was not having regard to the number of shareholders at all but having regard to capital revenue and perhaps profitability. Personally, I would focus on capital and revenue and perhaps the number of employees because you then start to make a commonality between tax law, which is governed by the size of the business and gives concessions, workplace law, which does the same—up to 20 for small business—and there might be other laws that I am not of a mind. In that way, the size of the company is relevant to its real size not to the number of shareholders—because you could have 15 shareholders in a company of $300 million, in which case I think there should be reporting.

Mr Fraser—That is exactly the case for proprietary companies. Companies with fewer than 50 members are subject to those size thresholds, so there is only a very small percentage of those propriety companies that are required to report.

Senator MURRAY—So the question, if I may summarise it, is whether 50 could be done away with altogether and another measure brought in to rationalise these matters across different laws which determine different reporting levels, different tax advantages and so on.

Mr Brine—Just thinking that through now, I suspect the 50-member rule—while, obviously, an arbitrary line in the sand—is trying to provide an indicator of when the free-rider problems might begin to arise. If you have a very small group of shareholders, oversight and control management are relatively easy. You would imagine that, once the shareholder group grows beyond a certain size, management has a certain degree of autonomy and each shareholder incurs costs, they may not want to do that. I suspect that is some of the thinking behind the public test as well as a large and small proprietary test. We can address that in the written comments.

Senator MURRAY—My attitude is that you need a definition below which more flexible and less onerous reporting is allowed and above which more onerous and more stringent reporting is required. Really, how that is decided is a matter for government policy to develop, but I think the point of the discussion we had with them and we are having with you now is for there to be an open-mindedness about this issue.

Mr Fraser—Arguably, we do already have that with accounting standards, where there is potential for smaller companies, even if they are reporting, to have less onerous reporting requirements. Internationally, the International Accounting Standards Board is looking at developing a standard specifically for small- and medium-size enterprises, which might fit this sort of category.

Mr ROBERT—With respect to executive remuneration, which I am sure is the topic of the day, there is some concern that, at present, directors or executives who are also shareholders are actually entitled to vote on their remuneration within the non-binding vote. Considering that companies range from some at the bottom end of the scale, where the executives are the majority, right up to, dare I say, the Telstra example where there are 600 million shares or thereabouts, does Treasury have a view on whether executives who are also shareholders should be able to vote in the non-binding remuneration vote?

Mr Fraser—I think we touched on this briefly before. It is not an issue that has been raised with Treasury and it is not an issue that the government has made a policy decision on. We are aware that there is potential there, but I think in relation to most companies, the holdings of the executives and the directors are going to be very small relative to the holdings of the rest of the shareholders, particularly in those large listed companies.

CHAIR—I might conclude on one final question in terms of the Financial Literacy Foundation. I note that it has been going for a number of years now and there have been a number of programs around that foundation. Could you remark on the success of that program and whether there has been any reporting on the measurement of that success?

Mr Brine—I might take that question on notice if that is all right.

CHAIR—Yes, that would be fine. As there are no further questions, I thank Treasury for their submission and evidence today and for appearing before the committee.

Committee adjourned at 4.41 pm