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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Shareholder engagement and participation

WEDNESDAY, 16 APRIL 2008

SYDNEY

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JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 16 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, Mr Keenan, Mr Ripoll and Mr Robert

Terms of reference for the inquiry:

To inquire into and report on:

The 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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STORY, Mr John Douglas, Chairman, Australian Institute of Company Directors 55

Committee met at 9.59 am

ABRAHAM, Mr Peter Brooking, Member, Legislation Review Committee, Chartered Secretaries Australia

SHEEHY, Mr Tim, Chief Executive, Chartered Secretaries Australia

CHAIR (Mr Ripoll)—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 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 that privilege. The committee prefers to hear evidence in public but it may agree to take evidence confidentially, if needed. The committee may still publish confidential evidence at a later date, and it will consult with the witnesses concerned before this takes place.

I welcome our first witnesses. Would you like to make some opening remarks in support of your evidence?

Mr Sheehy—Thank you. Chartered Secretaries Australia obviously welcomes the opportunity to comment in this hearing on the engagement and participation of shareholders. All of our members are involved in the governance, corporate administration and compliance with the Corporations Act in both listed and unlisted companies. I think it is widely acknowledged that our members play a key role in the formal linkage between shareholders, the board and management. We support legislative and other initiatives that enhance shareholder engagement and participation to the extent that they assist shareholders in achieving their objectives. But it is also important to ensure that engagement and participation is balanced with a structure for efficient management and decision making in a company.

As an overarching comment, we believe there are no substantial legislative or regulatory barriers to the effective engagement of shareholders. We recognise that there are always areas for improvement—there is no denial of that—but we do not recommend any significant regulatory change. Having said that, we also note current developments in the market—it is hard to ignore them—surrounding the issues of margin lending, disclosure and short selling, particularly in regard to margin loans held by directors and senior executives. In a recent survey that we conducted of our members, which was reported in the press about two weeks ago, it is clear that there is a call from the market for greater clarity as to when a director or an executive should disclose when they hold shares tied to a margin loan. It appears that the current continuous disclosure definition of materiality under listing rule 3.1 is inadequate and that the market requires greater clarification.

I would now like to take the opportunity to highlight a couple of specific areas in our own submission, principally from item 3 of the original terms of reference: ‘Best practice in corporate governance mechanisms’. The conduct of annual general meetings is an integral part of the company secretary’s role, and we have commented widely on ways to improve the effectiveness of AGMs over a sustained period of time. Our submission quotes the falling attendance at

AGMs. Every two years, we undertake a major survey of governance practices, as quoted in our submission, and the latest survey, which I am holding in my hand, was released on Monday of this week. I would like to update the committee on the numbers that we put into our submission. Our submission has entries from 2001, 2003 and 2005, and I am now able to add 2007.

The number of AGMs attracting 300 or more shareholders has fallen from 35.7 per cent in 2001 down to 11.1 per cent in 2007. The number of AGMs attracting fewer than 100 shareholders has risen from 23.2 per cent in 2001 to a near doubling of 41.3 per cent in 2007. This is a sustained trend over a considerable period of time, and it is going in only one direction.

The suggestions in our submission on improving the effectiveness in AGMs revolve around reinvigorating the deliberative process of an AGM—it has become too mechanical and the issues around deliberating the pros and cons of issues have all been lost—separating the formal and informal sections of the meeting and changing the voting process to make it more relevant as opposed to a fate accompli. In the first week of May this year, we will be releasing a discussion paper suggesting structural changes to how AGMs operate so that the trend which I have just referred to can be reversed.

We are also advocating a move to direct voting as a way to improve the connection between shareholders and their company. While the intention to lodge a proxy has a role—and we acknowledge that—it is no longer necessary to appoint an intermediary. We have developed a how-to kit for companies that wish to implement direct voting, and we are encouraged to see that the likes of Telstra, Woolworths and Westpac have already taken this initiative on board.

Before I leave the theme of the AGM, I would like to take this opportunity to remind the committee to recommend the adoption of changes to the 100-member rule that has been around for far too long. These changes have received bipartisan support and support from all major business groups and the Australian Shareholders Association. I believe the issue will soon reach a 10-year anniversary of being on the table. I urge this committee to strongly recommend the change put forward by the previous government that a special general meeting can only be called with the support of five per cent of shareholders.

I will now move to item 2 of the terms of reference of the committee: 'Engagement by institutional shareholders'. We also note in this regard that there are no legislative or regulatory barriers to the ability of institutional shareholders to engage and participate. We can point to no significant issues of concern and would oppose any suggestion that regulation may be required in this area. However, we note that proxy advisory services can wield significant influence on how institutional shareholders respond to companies and the information they report. We recognise that proxy advisory services play an important role; however, we believe there is a need for greater transparency in the decision-making processes that those advisory services undertake, as well as standards and methodology. Further, we believe that governance would be improved if proxy advisory services were to engage with the companies they report on, particularly if they are about to make an adverse finding on a company. We believe that the report of the proxy advisory service should be made available to the company, at least to check for factual errors before it is released to the general public.

Finally, I would like to turn to my colleague to discuss a matter that was technically not part of the terms of reference of this inquiry but did form part of our submission, as we see it as an

important area for encouraging shareholder participation and engagement. I turn now to Mr Peter Abraham, who is a pivotal member of our Legislation Review Committee and was an active participant in developing our submission.

Mr Abraham—Shareholders have no privacy rights in relation to the assets they hold in the form of shares in public companies. The impact of this is only on mum and dad shareholders. The larger institutional shareholders almost invariably hold through custodians or through nominees. So the practical outcome of that is that anyone can find out how many shares their next-door neighbour has, but they probably cannot find out how many shares AMP holds in a particular company.

The provisions relating to this are an anachronism. They were established long ago in the days when groups of gentlemen needed to get together to discuss proposals for companies. It has clearly been superseded by technology and by communications. It goes without saying that these provisions were introduced before there was any concept of privacy legislation, and they appear to have fallen through the cracks in the privacy legislation.

In the experience of members of Chartered Secretaries Australia, including my personal experience as Company Secretary of Rinker Group Ltd and, prior to that, CSR Ltd, the overwhelming practical application of the section of the Corporations Act providing access to the register for anyone interested is to enable bottom-fishers like David Tweed and broking firms touting for business to get a guaranteed mailing list. It distressed me greatly to hand over Rinker's register and the personal details of our shareholders to David Tweed's company when I knew what he was going to do to them. This distress was reinforced when I then got the phone calls from our shareholders who mistakenly thought Rinker was supporting Tweed's under-priced offer for their shares because we had provided names and addresses to him. Our shareholders were seriously disengaged by that experience.

There are guaranteed access provisions in the Corporations Act for bona fide communications in the case of takeover offers, member proposed resolutions and statements at annual general meetings. There are substantial shareholder provisions requiring disclosure when a shareholder obtains five per cent of a company's shares. Clearly these are appropriate, need to be maintained and are a bona fide use of the register. However, if a general access provision is necessary, we respectfully submit that a proper purpose test, as per recent UK legislation, be introduced to enable companies trying to do the right thing to approach ASIC or the court to test the bona fides of those wishing to access the personal, private information of their shareholders.

CHAIR—Thank you. I also thank you for the submission you have made; it is very detailed and comprehensive. I note in your submission that you talk in broad terms about the general system of governance being robust and good. You are not necessarily advocating that there be further regulation or more conditions imposed on either companies or shareholders. What mechanisms would you suggest to try and improve the current system without regulating? Is it an issue of industry-soft regulation? Is it an issue of a voluntary compliance mechanism? What systems do you think would work to achieve some of those goals?

Mr Abraham—In my experience, it is actually about the engagement with shareholders. Companies trying to do the right thing actually want to engage with shareholders. To the extent that companies see practices that other companies are employing and which appear to be

working, most companies—and certainly companies trying to do the right thing—query whether companies not trying to do the right thing are actually going to effectively do what is wished of them anyway, even if you do legislate. It really is an ongoing process of learning what other technologies and mechanisms are available for engaging with shareholders. In my experiences at CSR and Rinker, we were always on the lookout for things and got involved with groups like Chartered Secretaries to learn best practice from others. Generally we find that when things are formally legislated—and clearly there are exceptions, and principle based legislation is a great way to go—and black-letter-law regulated they tend to produce the wrong outcomes. Companies trying to do the right thing continue to do the right thing and companies who do not particularly want to try and do the right thing will always find a way to weasel out of it, so I do not know that there is a net gain in black-letter legislation.

Mr Sheehy—The direct voting initiative that we commenced proposing in 2006 is an example of something which requires no change to the Corporations Act. We thoroughly researched what it would take for a company to implement moving away from a proxy system and moving to an absentee vote like we have in federal and state elections. It really only required the companies to make a change, in some cases, to their constitutions—and that was it. This is an example of something which removes an intermediary. Many retail shareholders have no idea that, if they appoint a proxy and that proxy is not the chair of the meeting, their proxy is not obliged to exercise their intention. Direct voting removes all the problems with that; there is no need to change the act. This is an example of a way that we can encourage better engagement and a better relationship and not involve regulatory change. The companies that have taken that up have done so entirely involuntarily, and there is a longer list than what I have just chosen to iterate here—and that encourages us.

CHAIR—Is it a case of educating the companies on what options are now available that would produce a better outcome for shareholders, or is it a case of educating shareholders as to what ought to be a better system for them, so that they put pressure on the companies? Which one is it? Or is it a combination of both?

Mr Abraham—I think it is both.

Mr Sheehy—If you do not have both halves of the equation playing their role then you do not have the dialogue. In order for the dialogue to be effective, both halves have to be there. So participation by shareholders is of equal importance to disclosure by companies.

CHAIR—What I am trying to determine here is where you need to actually focus the energy of trying to provide that better information. Do you do it by getting more engagement directly from shareholders themselves to put the pressure on upstream and say, ‘We need this information’ or ‘We need it done in this way.’ Or is it more a case of companies themselves taking it on board and saying, ‘We’re going to provide all of the engagement tools so that shareholders become more engaged.’ I am just trying get a bit of a distinction between the two as to where you might start first.

Mr Abraham—From a practical perspective, it probably needs to be from the company because the institutional shareholders have already got their lines of communication. If they are uncomfortable about something or they want some information, the institutional shareholders are big enough and ugly enough to contact the company directly and require that information. The

spread of mum and dad shareholders is so wide that trying to somehow engage them individually in making representations, other than through bodies such as the Australian Shareholders Association, would be an extraordinarily difficult task. I also think that the lack of engagement and the declining AGM numbers are possibly a reflection of how companies have performed in recent times as well. Typically, I always expected a big roll-up at the AGM not when we handed in a great result but rather when things were not going so well. I think it is a reflection of that as well. The current economic decline or the change in the fortunes of companies will of itself lead to a lot more engagement in the next AGM season.

CHAIR—I agree with you. What you are really saying is that the onus has to be on the company wanting to achieve this, wanting to have the greatest shareholder engagement. If that is something they choose to do then there are mechanisms available now without further regulation and without further changes to the Corporations Act. You said there are a number of companies that are currently using electronic voting or are not using the proxy system so there is much more direct voting, and that a number of companies have taken it up of their own initiative. What percentages are we talking about? Is it significant?

Mr Sheehy—No. To be honest, it is small and it is largely the top 50 companies. Typically they are the early adopters anyway. It is an example of how many companies want to be on the front foot. To the best of my knowledge there would be roughly a dozen companies that have taken it up.

CHAIR—In the end, very few have voluntarily taken up what is available under the current act.

Mr Sheehy—Of course, but it is early days. We only really put out the how-to kit in the first quarter of last year. It does involve going to members in most cases to make a change to the constitution. It has been taken up by companies which tend to have the larger retail-shareholding base.

CHAIR—Finally, even though it is early days, could you explain for our benefit just what would be holding back companies. From what I have heard in evidence so far, this would be a positive for a company. It would have a better public image, a better shareholder image and would find that there is actually a value incentive attached to those sorts of behaviours. What is holding back other companies from going down that path?

Mr Abraham—From a practical viewpoint, in most cases to establish a framework where you can have direct voting you are likely to need to change your constitution. Changing your constitution is usually a fairly big deal. It is a special resolution. Ordinarily—and certainly Rinker was looking at doing the same thing as well—we would tend to wait until we had a group of things that were not urgent but were in the category of ‘good things to do but not pressing’ to put a resolution maybe next year or the year after next.

CHAIR—But it is not necessarily needed, as a change in the constitution; it could be done by companies if that is silent within their constitution in terms of voting.

Mr Abraham—Certainly most of the constitutions of the larger companies that I am familiar with do not directly facilitate direct voting. They allow for people voting in person at meetings or appointing a proxy but they do not specifically provide for—

CHAIR—That would then require constitutional change?

Mr Abraham—Correct. And then if you are at the point where you have a few other things you would say, 'Okay. It is worth our while to put a formal motion to members to amend the constitution,' but you would query whether you would do it just for that. I do not know if the members of the committee are familiar with the circumstances that actually kicked off our interest in direct voting. There was a fairly well-known case a few years ago where somebody who was vested with a lot of proxies decided to cherry pick the way those proxies were voted and conveniently did not vote those that were opposed to a particular motion and miraculously did vote all those that were in favour. That was clearly the wrong that we saw as needing to be addressed.

Mr KEENAN—I want to follow up on the point that you were making before and to come at it in a different way, I suppose. Really, I am wondering whether there are things that government might have done in the past to almost overregulate this area. We are always looking at ways that we might want to regulate or reregulate. I am wondering whether in the past there are things that we have done to engender shareholder participation that actually have not been that helpful, even though the intent might have been good. I do not have anything in mind here. I am just seeking your views about whether we have done things, because we are legislators and we like to legislate, with the intent of helping out in this area that actually have not proved to be that helpful.

Mr Abraham—Look at the size of companies' annual reports. Look at how daunting annual reports have become for shareholders. I think that is a classic. I actually think remuneration reports are a really good thing, but the detail that is required to be provided in remuneration reports now—speaking as the author of ours for a few years—makes them really hard to write and makes it even harder for somebody who is not an expert in that area to understand. I do not know what the answer to that is, but certainly it is one of the things where people think: 'This would be a good thing to have. Let's require that in the directors' report.' This has just built and built over the years without somebody taking a step back and saying, 'What have we created here in these annual reports? Are they becoming pretty impenetrable to the average shareholder who feels as though they are perhaps not qualified to engage with the company?' That is certainly something that I see has been an unwanted outcome of continued regulation over the years.

Mr KEENAN—And what is contained within these reports is explicitly legislatively for in the Corporations Acts, is it?

Mr Abraham—Correct.

Mr KEENAN—And that has been added. Was there any particular instance when this occurred or has this just been added to over time?

Mr Abraham—This has been added to over time. If you track the provision in the Corporations Act that sets out what is required in the directors' report—and that is the main provision where this information comes in—you will see that over the last 10 years there have been a whole lot of bolt-ons. You get subsections BBA, and all the rest of it, that have been dropped in there. I do not actually disagree with any of them in themselves. It is just that the process over the years has bolted more and more on, so there is more and more information. It is becoming more and more technical and hence less and less open to shareholders to penetrate.

Mr KEENAN—That is right. Disclosure is not the same as transparency. In fact in many ways more disclosure can actually limit transparency.

Mr Abraham—Correct.

Mr KEENAN—I think that is an important point for us to consider as a committee. I want to move on to the issue of privacy of shareholders. Besides the obvious one about the David Tweeds of this world—and I think obviously everyone here would find that morally repugnant—what is the problem with people having access? Does it matter if you know how many shares your neighbour owns in BHP?

Mr Abraham—All of my details were in the annual report each year anyway, but speaking hypothetically I do not think it is anybody else's business to know. Certainly it seems to be the underlying tenet of the privacy legislation that has been introduced that it is not other people's business to know how many shares you might hold—maybe for an MP it is!

Senator MURRAY—Don't go there!

Mr KEENAN—We have our own mechanisms for dealing with that!

Mr Abraham—I will back right away from that! If Joe Public holds his assets in a particular form then his next-door neighbours cannot stickybeak him, but if he happens to hold his assets in the form of shares in public companies then anybody can. I do not know what utility is served by it. I have only ever had one request for details of the register that I thought was bona fide, that I thought was for a proper purpose, and I took it to the board and the board endorsed it. It was a charity, probably seven or eight years ago. They wanted the details of shareholders who held small holdings. They wrote to those shareholders, saying: 'If you'd like to donate those shares to charity'—they had a choice of the Heart Foundation, the Salvation Army and a couple of others—'then here is an opportunity to do that. You'll get a tax deduction for making that donation and you don't have to go through brokers and all the rest of it.' It was an opportunity for small shareholders to make a donation. It was very open, on the face of it, that it was a donation and they would get a tax deduction. We thought that was an appropriate request for the register and the company provided the register willingly in those circumstances.

On other occasions it has been Tweed or his like, or brokers, who write to shareholders, saying: 'Here is a free broker's report on this company. If you'd like more details then contact us and we'd be happy to put you on our mailing list.' Clearly it is just not appropriate. We have moved beyond that, and the Corporations Act has not caught up.

Mr Sheehy—I should add that, in pressing this issue over the last several months, we have been faced with the counterargument that, when you engage with a public company, you know that your details are going to be public. I do not think that argument holds water anymore. Our argument is that it is inconsistent with the privacy values of our society. Just because you have invested in a public company does not mean you also know that all of your details will be made public.

Mr Abraham—And the sophisticated investors do not have their details published anyway, because they have a custodian or a nominee holding their shares.

CHAIR—You said that only in the one case, the case of that charitable organisation, was there a bona fide reason to access the list. Is there not enough coverage within the Corporations Act to make a determination as to what is bona fide? Is it completely open?

Mr Abraham—The Corporations Act says you cannot do it if it is not relevant to the shareholding. There is not a 'bona fides' test.

CHAIR—My question was about whether there was a test and how you make that determination.

Mr Abraham—There is a relevance test, not a bona fides test.

Mr KEENAN—If that is the case then, besides the David Tweeds of this world and the brokers touting for business, who would oppose us making this change? I suppose I am asking you to make the opposite case. I am just curious about it.

Mr Abraham—I do not know.

Mr ROBERT—On page 2 of your submission you recommend that this committee should 'review the total sum of mandated information that is sent to shareholders and check whether there is ongoing justification for the information to be mandated'. What information do you believe should not be mandated?

Mr Sheehy—I think we are referring there to the depth of information that goes out. I do not think we had any specific piece of information—it was more looking at the totality of what is provided. The extent of disclosure, we think, is sometimes too great. However, there was not a particular item we had an eye on.

Mr ROBERT—Keep in mind that, if we were to review it, we would go through the same process as we are now. We would invite submissions, we would be here, you would be at the same table and I would probably ask you the same question—'What do you think should not be mandated?' So do you have any ideas at all?

Mr Sheehy—There are certainly issues around product disclosure statements, which we think have become far too lengthy. There ought to be a reduction in the amount of information in them. We have touched a little bit on remuneration reports. We are not suggesting that remuneration reports be deleted entirely, but the extent of the detail in them has gone beyond most people's utility.

Mr Abraham—I think we have certainly taken a step in the right direction now that hardcopy annual reports do not have to be sent to all shareholders. The trick now is to move on to the next stage, where we go from having this dense, technically correct but very difficult to understand wad of information that arrives in shareholders' letterboxes to finding a way where that information is available to anybody who may wish to actually research it, so they can get on the web and the information is there. There then could actually be a freeing-up of how the company communicates with shareholders—whether they send them a glossy leaflet or something that summarises what has happened in the year. That would actually enable companies to engage with their shareholders in the way they think is appropriate, without necessarily taking away the information that needs to be available to the public should people take the trouble to go looking for it.

Mr ROBERT—If you are happy to provide it, we are certainly happy to receive another submission from you, however short, considering what areas of the mandatory reporting you would like to see either gotten rid of or simplified. That would give you time to research it in more depth, rather than putting you on the spot.

Mr Abraham—Okay, thank you.

Mr ROBERT—On page 5 of your submission, you say:

CSA notes that the concise report was originally introduced into the Corporations Act to facilitate—

a range of communications—

... but that increased regulation saw the concise report increase dramatically in length—

which, I suggest, would no longer make it concise—

such that it no longer met the needs of shareholders.

That is a fairly strong statement; if a concise report no longer meets the needs, that is something we should look at. Are you in a position to say why it no longer meets the needs?

Mr Abraham—Basically, a concise report these days is an annual report without the notes to the accounts—without the notes to the financial statements. All of the other requirements in the Corporations Act relating to the directors report, which is where the bulk of information comes in, still need to be put in a concise report. Basically it is the notes to the accounts that are missing; all the rest of the stuff is there. The concise report has grown as there have been all these bolt-ons to the requirement for a directors report. Concise reports tend to be thick, weighty documents. Ideally they would be eight or 12 pages stapled together so that shareholders could get a quick understanding of how the year has gone.

Mr ROBERT—What would you recommend the concise report contain?

Mr Abraham—I think we have moved beyond concise reports. I think we are at a point where the information required in the annual report should—absolutely—be available, but it should not be mandated that it be sent to all shareholders. The information should be there so

that anyone who wants to find anything can find it. In terms of the communications with shareholders, the concise report is neither one thing nor the other. There should be a freeing-up of companies' communication with shareholders. They need to be able to say, 'The annual report's here. Here are what we consider to be the highlights.' That would be something that shareholders could readily come to grips with.

Mr ROBERT—Doesn't the legislation allow a company to send out a one-, two- or three-page letter with a range of highlights of the AGM—or isn't the information on the website?

Mr Abraham—In very recent times we are getting to that point, and I think that is appropriate.

Mr ROBERT—Could we, heaven forbid, take away a bit of legislation and get rid of the concise report?

Mr Abraham—I certainly see no reason why we could not do that. I think the concise report has had its day.

Mr Sheehy—Last year, when the previous government was putting forward the changes to the opt-in opt-out rules on annual reports, we took the opportunity to urge that there should be no further tampering with the concise report. As Peter has said, we think it has had its day. As more and more companies become more sophisticated in portraying the information electronically, the easier it will be for shareholders to access it. The concise report has had its day, and any further tampering with it would be a waste of time.

Mr ROBERT—You would not like to tamper with it, other than to—

Mr Sheehy—Delete it.

Mr ROBERT—On page 11 of your submission you quite rightly speak of the poor attendance at AGMs, and you have given the 2007 figures. I note from the footnote that this is research that has been done on only the top 200 companies.

Mr Abraham—That is correct.

Mr ROBERT—Your table has nothing to do with the capitalised value of the company. It simply says that, in general, if an AGM gets more than 300 people its numbers are declining and if it gets fewer than 300 people its numbers are increasing—irrespective of the size of the company. Why do you think this trend is occurring?

Mr Sheehy—The sample in both the examples we have given is just the top 200 companies. We have aggregated them. We have not then split them up into, say, the top 50 and from 51 to 100 or anything.

Mr ROBERT—So why do you think the trend is happening?

Mr Abraham—I think what is presented in that table is slightly different. We are saying that the number of companies in the top 200 which have 300 people or more turning up to their

AGMs has significantly decreased. The large attendances are falling and the really small attendances are increasing.

Mr ROBERT—That is correct regardless of the capitalised value of the company.

Mr Sheehy—That is right.

Mr Abraham—Bear in mind that these are in the top 200, so they are significant companies.

Mr ROBERT—The question is why? It has nothing to do with the capitalised value of the company.

Mr Sheehy—No, it does not. We think it has to do with what the shareholder perceives they will get out of attending an AGM. AGMs are no longer the forum to deliberate issues that are on the agenda to be voted on. One reason is that the vast majority of proxies are lodged before the meeting even commences and the chair is sitting there with them and people know the outcome is already decided so there is no point in deliberating any more.

Mr Abraham—Continuous disclosure has also meant that people are not going to learn anything new at the AGM.

Mr ROBERT—In your professional view, what should the future of corporate AGMs be?

Mr Sheehy—Our organisation has asked the question—as a cliche—is the AGM dead?

Mr ROBERT—Is it relevant.

Mr Sheehy—Is it relevant. There is still, amongst all of the people in our reference groups and so forth, a desire to keep the AGM. It is broken and sick but there is not the support to get rid of it. It is still seen by those involved in sitting up the front as an opportunity to face the shareholders. Most people want to improve the effectiveness of the AGM as opposed to getting rid of it. It is still the vehicle to engage with retail shareholders, and it is still worth having, but they do want to see its effectiveness improved.

Mr Abraham—But I also think it is a function of the performance of companies in recent years. Attendance will go down as performance improves.

Mr ROBERT—What is the basis of your disagreement with section 249D, the 100-member rule, and what do you propose instead?

Mr Sheehy—There are two parts to section 249. With regard to the part that has to do with calling a special or extraordinary general meeting where there are up 100 shareholders, it is possible, if you take one extreme, that each shareholder could hold just one share. You could have 100 people with 100 shares calling a meeting for a very large company. So it is about the costs associated with holding a meeting for a resolution which most likely would have no chance of success.

Mr ROBERT—Has that ever occurred?

Mr Sheehy—It has occurred. But it also needs to always be seen in the light of the other part of section 249, where we are not opposed to 100 shareholders putting a resolution on the agenda of an annual general meeting. So, where there is a forum already set up, we have no objection whatever to keeping the law the way it is. What we are asking for is that, if you are asking a company to convene a special meeting and go through the expense, there should at least be some likelihood of that resolution passing, so we turn to the five per cent of shareholders as being the trigger. Then at least there are enough people so that it has a likelihood of succeeding.

Mr ROBERT—So your recommendations there would be that, in the first part of 249D, 100 shareholders can call for a motion on an AGM but only five per cent of the total value of the stock can actually call an EGM?

Mr Sheehy—Correct.

Mr Abraham—Yes, that is it.

Mr Sheehy—That was put forward last year by the government, and I think at the state attorney-general level it came to a halt.

Mr ROBERT—My final question is: what is the basis of your recommendations with respect to proxy advisory services? You read out in your opening statement a range of recommendations regarding them. What is the basis of those?

Mr Abraham—I guess from a practical viewpoint it is really frustrating for a company, in terms of its engagement with its institutional shareholders, to find that there is a report on the company that the company has not had any input into, and has not seen, that is extraordinarily influential in terms of how those institutional shareholders are going to vote on a particular motion at your annual general meeting. Then, after some considerable digging, you manage to find what they have recommended—and this has actually happened to us—find that there are significant errors of fact in the report, then contact the advisory service and point out those errors of fact. To give them their due in one case, they went out the next day and published a correction clarifying it, because they had just clearly got it wrong. In another case, they dig their toes in and entrench—defend what is difficult to defend. So we are all about transparency in all phases of these processes, except that, where there are recommendations that may well be adverse to the company, the company has got no opportunity at all to see those recommendations or to comment on them or to seek to have them corrected.

Mr ROBERT—How is that different to the media that might want to stitch up a firm—not that politicians would know anything about being stitched up by the media!

Mr Sheehy—The media is not necessarily holding itself out as a participant in improving the good governance of Australian corporations. Proxy advisory services are there as an integral part of the corporate scene, and they are there to advise principally institutional shareholders on how to vote, and that makes them an active participant. If we are all after good governance, then transparency up front is the way to get there.

Senator MURRAY—The great advantage of modern technology is the opportunities it offers you. I believe that transparency and disclosure on websites electronically mean that you are then

able to reduce the paper based material and the time based material that is provided. There is no reason, to me, for information that is presently required to be provided for annual reports not to be provided on a continuous disclosure basis, because many of those matters actually change between AGMs. They are not AGM determined.

One of the things we need to know from people like you—and I would like to ask you to come back to us on this question—so that we do not have to have another review, which is the point Mr Robert made, and so that we can make a recommendation, is whether it is possible to take the intent of the legislation and consider that an electronic intent. You would have an expansive report, which is also continuously changing and being updated by the company as it is able to; otherwise, the formal reporting for purposes of an AGM is very limited indeed. That takes the concept of a concise or short-form report, but it rarely says that all it is is a mechanism for discussing strategic or key issues at the AGM, and anything else, if you want it, is on the website.

Mr Abraham—To clarify, Senator, you are referring to the current provision, the listing rule 3.1 requirement, which relates to the material effect on price or value of a company, and proposing a threshold below that so that there would basically be a regular updating of information relating to the company that would be available on its website, even in cases where it is not material to the price or value of the securities.

Senator MURRAY—I am saying that the onerous obligations on public corporations to report should be maintained and in fact should be enhanced—namely, that the continuous disclosure concept apply to everything but that it is entirely electronic. You then say separately that it is what is necessary for the obligatory interaction with shareholders at the AGM. Forget the concept of weighty documents and the cost of printing and all those glossy photographs. If you want to put that on your website that is your business. The AGM gets down to the real deal, the real business.

Mr Sheehy—It is not really an issue of the manner in which you communicate the information—paper or electronic. I take your point that electronic takes away the issue of timeliness. What we want to go away and think about is the question of what is in and what is out.

Senator MURRAY—That is right.

Mr Sheehy—That is what it is about.

Senator MURRAY—That was Mr Robert's question; it was a very good question. In your response—and I mean it respectfully and not in a lawyer's sense, with respect, but genuinely—you were thinking in a channel: here is what the law says; here is what is happening. There is a disconnect. You have not thought through an easy solution, which to me is that you comply with the accounting standards requirements and the essential public interest components which are captured in Corporations Law electronically and continuously, and that ties back to the regulator's requirements—ASX. The interaction with the shareholders in the annual sense, in a time base sense, is much more precise, much more focused and much less onerous and complex. Perhaps you could come back with some further thoughts on that.

Mr Sheehy—Okay.

Senator MURRAY—From experience, a review process such as the one you envisage would mean that we would be looking at that in a couple of years time. I think you might have some answers now which we can usefully put forward.

In relation to the privacy protection access to the share register, I think we are once again guilty of not thinking creatively enough with technology. Basically, you can write programs to produce whatever outcome you want. I want to ask you some questions with respect to this. There are two entirely different areas—one requiring more disclosure and one requiring more privacy. I want to know in two respects how you react. We have recommendations before us now to open up registers so that people hidden behind nominees, derivatives, hedge funds et cetera will be unpicked and exposed so that material share domination or power will be exposed. This is for greater disclosure, and I do not think you have dealt with that.

At the other end is the issue of the grandma being intimidated by some share predator. If you are going to the British solution, you have then got the definitional problem about proper purpose tests and all of that. It gets difficult, and in the end it comes back to the required judgement of those who hold the register. That is what the British legislation effect is. The other question I want to ask you is: are there other mechanisms to do it? For instance, you do not need to show someone on the public register who is an individual below a certain shareholding size—you would obviously want to keep it for the company—or addresses need not be shown for nonentities—that is, people who do not have a corporate structure, like some old lady holding shares in her own name or maybe without her name appearing, or something like that mechanism. Is there another way to do it besides going to a proper purpose test, which I think will still result in either having to create a definition, which is difficult, as the English have found, or in further judgement by the register holder? Can you answer those two aspects.

Mr Abraham—I guess the starting point for me is to understand what is being served by making that information public and to ask to whom it will be made public. Certainly, in the case of companies knowing who is on their own register, I can understand it is extraordinarily difficult to trace through umpteen layers, as Rinker found out. When we were being taken over we wanted to regularly analyse our register to see who our shareholders were. It is a tough gig, and the delay between when you actually initiate those tracing notices and when you finally get useful information back generally means that the game has moved on anyway. In terms of a company understanding who its owners are, I think it is entirely appropriate that a company be able to dig through people trying to hide behind nominees and custodians. In terms of any member of the public wanting to know the details of the shareholders, when indeed they are not going to find out who the real shareholders are anyway—they are only really going to find out the mums and dads unless they embark on that sort of action—I am just not sure what is served by it.

Senator MURRAY—I accept that argument. My question to you is: what do you do about it? You are suggesting to us a legislative change. My answer to you is: that may be so, but is it the wrong legislative change? Plainly, if an individual holds five per cent of a company, if you believe that they should have that as a criterion, they should be shown. But should the legislation simply say that no individual below a certain size need be on the public register or, if an individual below a certain size is to be on the public register, the address need not be shown? I

think there are technological ways to resolve the problem that are an alternative to the proper purpose test.

Mr Abraham—I think we would be open to that. I agree. We have gone down a particular route. If we can achieve the same outcome, which is essentially to protect the mum and dad shareholders from people who are not trying to look after them, in other ways we would certainly be supportive.

Mr Sheehy—You have proposed a different solution, and we would want to look at that but we also would not want people not to be notified about things, for example, like a takeover. There are very strict provisions in the act with regard to takeovers, and in those situations we believe all shareholders should be contacted. So it is not that we are asking—

Senator MURRAY—I am sorry. I will interrupt, Mr Sheehy. I am not suggesting that a company register should not be full. That is not what I am suggesting.

Mr Abraham—It is what is available to the public.

Senator MURRAY—I am talking about the register that is available to the public, so it would not affect that point.

Mr Sheehy—Let us consider that.

Senator MURRAY—Could you come back to us?

Mr Sheehy—Yes.

Senator MURRAY—The next thing I want to ask you about is electronic communication with shareholders. I think you are too generous—implicitly, not explicitly—about motives. If my historical memory is right, it took from 1832 till 1922 for the franchise to be properly extended in Great Britain, and in Australia there was a great struggle for women and Indigenous affairs. There is always a resistance by those who control and hold power to give up power, and greater shareholder participation is seen by some executives and boards as a threat to their discretion. With respect to electronic communication, I accept that the law now allows for direct voting to occur and greater shareholder engagement. I wonder if there is not a device already available which has been used in other instances which you might think about—that is, whether the ASX or ASIC or a conjunction of the two should not adopt an 'if not, why not' approach to electronic communication and, in particular, to direct voting. That is a device they have used in corporate governance matters. They have simply put public companies on notice that they expect them to do this, and if they are not going to they want to know why not. I think that is really open to us. So perhaps you could think about that and come back to us on that suggestion.

Mr Sheehy—Yes.

Senator MURRAY—That does not require a law change. It just requires the regulators to get off their jacksies. The next thing I want to test with you is this business of the physical AGM. Again, I would contest your view. There are small caps—for instance, my state of Western Australia—with limited numbers of shareholders where the dominant shareholding is

represented by the board and the executive management, and the rest of the shareholders are pretty powerless. The only time that they can exercise an accountability role is at a physical AGM, so I think at the lower end, in fact, AGMs are probably more important, strangely enough, that at the upper end.

The second proposition I would put to you is that our practice does not take enough account of the global and international nature of our companies and the size of our country. Why should a Sydney investor or a Swiss investor not be able to participate in a Perth AGM if they can? We have had recommendations that a virtual AGM facility should be created, that modern technology allows for that for mass conferencing and interaction, and direct voting is part of that. If you do not have an immediate reaction to those comments perhaps you would come back to us. You might be able to answer the question straightaway. The two points are: whether you accept that AGMs have a real need at the small publicly listed level and, secondly, whether the alternative to the physical AGM is to enhance the opportunities for virtual AGMs.

Mr Sheehy—I will address the first point about the smaller companies. We did some research last year which is leading to the discussion paper I mentioned earlier. It will be released in early May. One of the things which we suggested that came out of that research—and we used the word 'suggest'; I do not want to play semantics—was: maybe we do not need to have mandatory AGMs for the smaller companies.

I think it is fair to say that we got a lot of pushback on that issue, which is not reflected here. But in feedback it was not a popular suggestion, and so we are no longer proposing it. We have gotten strong feedback all the way along from all sizes of companies that they—be they directors or chairs or participants—want to see the AGM continue, they want to see it more effective and they want to see it for all sizes of companies. So I think that is one suggestion that will no longer be a suggestion, for the very reasons that you said: it is often the only opportunity, and the shareholders need that opportunity, particularly if there are times which are difficult.

Senator MURRAY—One thing I would add to this conversation: bad companies do bad things, and good companies do great things, and bad companies are known to hold their AGMs in inconvenient places at inconvenient times because they have got a crooked intent. Basically, that is my view. The virtual AGM overcomes that, because the joy of virtual AGMs is that people will operate from their lounge or their home with a Skype facility in front of them—or from Switzerland or England or wherever else there are shareholders of our companies—and interact. Do you accept that point?

Mr Abraham—In my previous life while Rinker was still a listed company, the chartered secretaries looked very hard in our discussion groups at how we could do this. I guess there are a couple of issues. Firstly, I am not sure the technology is there yet. One of the concerns of a couple of companies that tried it was: if the line goes down, is your meeting still valid? There are a bunch of issues like that. But there are practical issues as well. For instance, imagine you have got 300 people in the hall, and there are people wanting to ask questions, and you have people queued up in their lounge rooms wanting to ask questions. Just purely the mechanics of actually managing that process, of trying to be fair to everybody without giving undue priority to the people who are doing it online, raises technical issues in trying to manage the logistics and be fair. What we did was webcast our AGM, including the question and answer sessions, and gave people an opportunity to submit questions in advance of the meeting so that they could be

answered at the meeting. If it can be done comfortably, successfully and safely then I think there are a whole bunch of companies that will be keen to take it up, but at this stage I am just not sure that the technology is quite safe enough for us if we try to do it in real time. We were particularly concerned about whether we would still have a valid meeting if members were participating in the meeting and the communication line had gone down and they could no longer participate. So there were issues like that. I am sure they will be overcome in time, but there are drawbacks at the moment that make people who are conservative by nature just a bit concerned.

Senator MURRAY—I have asked you to come back to us on a number of matters, and of course it is up to you whether you do and in what form. We have been asked to look at enhancing the ability of people to engage in AGMs, and virtual AGMs have been offered as a solution. If you have any further thoughts beyond what you have expressed to us—and I presume in that paper in May some of those thoughts will already have been established—perhaps it would be helpful if you would provide the committee with them.

My next area of questioning concerns the nomination and preselection of directors. The great benefit of committees like this is that you get input from informed people. One thing that has struck me, and I am still not sure if it is true in the full sense, is that the corporate governance principles established through the ASX-ASIC process focus on governance but not engagement. The concept of shareholder engagement has not been fully embraced by regulators and others in the sense that this inquiry is looking at. In the engagement process people are able to contest elections for directors. It seems to me that board-supported directors go through a preselection process—people hunt for a likely candidate, they decide who the candidate is and they support them; that is a preselection process—but outside nominees such as Stephen Mayne just pop up and go into the mix. You already have a preselection process but, if it is in the best interests of public companies and society to maximise the gene pool and ensure the best talent is available and so on, does the process of best-practice selections deserve the sort of practical approach that was taken to corporate governance and resolved outside the legislation? Let me tell you exactly what I mean. If you go back 10 or 15 years, people's view of corporate governance was that the nomination of director candidates is dealt with in a company's constitution and should not be regulated. The attitude was that corporate governance is a matter for the company itself. That attitude changed—with much resistance. What happened was that ASIC, the ASX, the institutions and the major companies sat around a table and came up with a very practical, workable and accepted system which is now embedded in our—

Mr Abraham—Chartered Secretaries was actually one of the participants in that.

Senator MURRAY—Excellent—and a big kiss on the forehead for everyone involved, because it is an excellent outcome. Would that process be worth while for examining the issues of full shareholder engagement, including the nomination and preselection of directors—the processes which are in company constitutions which determine how an election should be run and so on and so forth? I have seen no real examination of that issue.

Mr Abraham—With regard to a preselection process, what a good board will do if it sees a succession planning issue is look at the skills and talents of the incumbents, where the company is going, what the gaps are and what sort of person would ideally fit those gaps.

Senator MURRAY—You have the board in mind.

Mr Abraham—Absolutely.

Senator MURRAY—That is what the board already does. I have the shareholders in mind.

Mr Abraham—The board members are the representatives of shareholders; it goes to the competency of the directors to do that.

Senator MURRAY—There is a perception that in certain companies the process is less than desirable—either the company constitution is inadequate or the board is rigged in some way and perpetuates a club-like culture. By the way, this is not an inference for all publicly listed companies; I am talking about some companies. The HIH board, for instance, was an awful example of the very worst set up. Rather than having a legislative imprimatur, is there a way to examine these issues through a process similar to that which resulted in the corporate governance principles, and is it necessary to do so?

Mr Abraham—I struggle with that. It implicitly says that people who have been elected by shareholders are not doing their job properly in the first place, and, if they are not doing their job properly in relation to succession planning for the board, we should query in what other ways they are not doing their job properly. It really says the directors are incompetent and we should take—

Senator MURRAY—No. It says: 'As with corporate governance'. Before corporate governance principles came in, there were terrific companies that were doing the right thing and never needed to change. What corporate governance principles did was deepen that ability and culture. There are already boards which are operating superbly with superb directors. We are not talking about directors as a class; we are talking about where the weakest boards, the weakest companies, the most rigged situations exist and the only time those issues are addressed is when there is a market fracture of some sort or a company collapse. Is it necessary or useful to produce a corporate governance type process which does not involve legislation but involves market participants, the ASX and ASIC—people like you—sitting around a table and asking how they can maximise or deepen best practice for director elections?

Mr Abraham—The corporate governance principles have certainly taken that approach, at least to some extent. There is a requirement in the principles to disclose how a board's performance is evaluated and there are requirements to disclose information about the nominations committee and the process for appointing directors. So there is certainly a disclosure requirement relating to how that works. I will not pretend that companies with bad directors with bad motives do not have the opportunity to whitewash that, just as they have the opportunity to whitewash a whole bunch of things, but at least there is a disclosure requirement and shareholders do get to vote on individual directors at least every three years. Short of having a fundamental change in the authority of a director, I struggle to see where else that could be taken.

Mr Sheehy—The industry participants—the corporate governance council, for example—have in a way dealt with this. Fundamentally, we believe it is the role of the board to undertake that function. That is why the guidelines talk about the need for a nomination committee, the other disclosures and so forth. All that comes back to: it is the board's role. We will always find examples that do not go according to plan, but overall the corporate governance council dealt

with board selection. It is part of one of its principles and it does believe the board is in the best position to do that.

CHAIR—Notwithstanding the right of every shareholder, regardless of the size of their shareholding, to have access to information and the right to vote and so on, is there a point at which a shareholder is too small to automatically have information sent to them, rather than just posting general information on the board?

Mr Abraham—That is a slippery slope.

CHAIR—So, regardless of size, everybody should have access to all information?

Mr Abraham—Correct. If you are a shareholder you should have access to what everybody else has access to.

CHAIR—Thank you for your evidence and participation today.

Proceedings suspended from 11.14 am to 11.46 am

DOHERTY, Miss Claire, Policy and Research Manager, Australian Shareholders Association

CHAIR—Welcome. I invite you to make an opening statement in relation to your submission.

Miss Doherty—The terms of reference asked participants to identify barriers to shareholder engagement. One of the most significant barriers the Australian Shareholders Association sees, particularly for retail investors, is the incredible diversity of investors. They have different levels of understanding, education and desire to be involved in the process. One way that companies can overcome that is by effective communication and by understanding exactly who their shareholders are and how to communicate best with them. They can do that by embracing best practice.

The Australian Shareholders Association does not see that there is a legislative silver bullet to resolve issues of shareholder participation and engagement but, obviously, there are ways that companies can embrace best practice. We identify a number of best practice examples of communication with shareholders in our submission. In particular, the ASA is concerned that many companies see communication with shareholders as an exercise of limiting risk rather than an attempt to fully inform shareholders about issues in relation to their companies. The other issue in terms of communication, which is getting a lot of airtime at the moment, is the issue of disclosure. Again, the ASA feels that it is very important, in order to engage shareholders, that companies are fully compliant with their duties to disclose material information to shareholders including change of substantial shareholders interests.

Since the ASA submitted to the inquiry in writing, there has been a period of intense volatility in the markets. It has thrown up a number of issues that concern retail shareholders which they feel are largely out of their control. Those include things like unregulated short selling, securities lending, the effect of director margin lending and market rumours. During this period, since Christmas, three brokers have collapsed and there have been articles in the press questioning whether the regulators should have been aware of the risks that those brokers were courting. In addition, it has become clear that disclosure requirements under the Corporations Act and the listing rules have been ignored by a number of participants or complied with well out of time.

For retail shareholders who have a limited insiders' view these issues of lack of disclosure, the techniques which many participants in the market are using in order to gain an advantage, smack of advantages lying with vested interests. It seems as though there is not a level playing field. For retail shareholders it is difficult to engage in a process where you feel that you do not have a level playing field.

CHAIR—Thank you, Miss Doherty. In your association's experience, what are your members demanding of the companies that they invest in? What are they requiring from those companies in terms of their expectation as to the way they should participate in or engage with those companies? The context is that some very small shareholders often do not want any involvement or engagement. They are quite happy to purchase shares, on the basis that the particular company is doing well or that they support the activities of the company, and reap whatever the benefits

might be. They do not necessarily want to engage. From what you understand, at what level do small shareholders want to be involved?

Miss Doherty—I think it goes back to the diversity of interests. It is very difficult to lump small or large retail shareholders into any particular pigeonhole. We have diversity even among our members. We have members who are highly involved with the association and are highly involved with the companies that they invest in. Then we have other members who see their membership as a sort of insurance. If they need someone to talk to, they can ring us. But they are not engaged on a regular basis with us or with the companies that they are involved in. This is the difficulty as to where companies pitch their engagement with shareholders. They need to perhaps think about what is the level of communication that the person who is least involved wants and what is the level of communication that the person who is most involved wants and then try to find some way of dealing with that.

The difficulty with giving shareholders too much information is that they will not read any of it. This is what frequently seems to happen with documents that are sent to shareholders to communicate with them: they are too voluminous, the language is legalistic. Shareholders look at them but give up before reading them. A lot of our members ring us to ask us to explain to them things that they have been sent by companies, which is something that we can do to a certain extent. However, I think you would have seen in our submission that, while people ask for advice as to schemes of arrangement, we really cannot start to give advice because it depends on people's private circumstances. Such documents can be extremely complex. So the difficulty for companies is to find a level at which to pitch to people so that they simply do not lose interest because of the volume.

CHAIR—Does the association have for its membership and for the companies that it is involved with a benchmark as to the level that it is pitched at? Is there some sort of a benchmark whereby you say, 'These are the minimum requirements that we would expect that every single individual shareholder, no matter what the size of the shareholding that they have in any company, would need to have'? Obviously, a lot of information is available through websites, through company announcements and through the Australian Stock Exchange. But at what level do you see a company needing to communicate directly with a shareholder? What is the benchmark there?

Miss Doherty—We do not have a benchmark. Our position is that each company really needs to look at their individual situation. It depends on their business—some companies' business is incredibly complex; other companies' business is much simpler. It is really a matter of their trying to look at what their business is, who their shareholders are and what type of mix of shareholders they have and finding a way to pitch it. A lot of shareholders still do not have access to things like the internet or are not confident as to the way they manoeuvre around it. We get a lot of calls from members—and we take calls from nonmembers as well—who want to understand something but simply do not know how to get into the company to ask the right questions.

I spend a lot of days just looking up websites, and saying, 'Here's the telephone number for investor relations; that's who you should speak to. Ring them.' Sometimes it is a bit obscure. It depends upon the company. Some companies have great websites for investor relations, they

have ‘Frequently asked questions’ and I can find the answers quite quickly for members who ring. Others are obscure, and it is difficult to know who to contact.

CHAIR—Has your association had more contact and more questions from people regarding, let’s say, newer issues that have hit the media of short selling, naked short selling, vote lending, vote renting, proxy votes and directors remuneration? Have those issues been raised in the last few months with your association?

Miss Doherty—Directors remuneration is one of the key issues for our members and always has been. It is a very important issue to them; that is nothing new. We have had a lot of queries around issues which have come out of recent events.

CHAIR—Is that through a lack of understanding, that people do not understand what those issues are?

Miss Doherty—I think a lot of is a lack of understanding. Many members have rung, and asked, ‘What’s going on; what’s this I’ve read in the paper?’ just looking for some clarity. Other people—some members, some nonmembers—have sent us helpful suggestions about how some of these issues might be resolved, basically asking us when we make submissions to think about various resolutions to these issues, especially around the issue of covered short selling. We have had a few helpful suggestions on that.

CHAIR—Has your association got any particular policy on that?

Miss Doherty—I think it will be completed by early next week. But I can speak to that generally, in any event, if you want to ask questions about it.

CHAIR—If you could, just to give us some idea of your association’s perspective.

Miss Doherty—Our position on short selling is—and was before Treasury moved to start investigating—that the loophole in the Corporations Act is the problem and needs to be closed. You may have seen a media release that we put out just before Treasury moved to start investigating, and it was along those lines. We would hope that if those covered short sales, which are covered by securities lending agreements, are brought within the regulation and are required to be disclosed or subject to regulation around pricing, in the same way that naked short sales pricing is regulated, that should resolve many of the issues. We do not imagine that retail shareholders will necessarily worry about looking at the disclosure of those sales. Obviously, the ASX publishes that every day. But it is an issue and it is information that ASX and ASIC need. If they are aware of the volume of covered short sales and who is making those sales, it is much easier for them to investigate anomalies.

CHAIR—You referred to the loophole in the Corporations Act and the circumstances in recent months. Is it a failure of the market, individual companies or is it a failure of the act specifically? Where do you see that failure?

Miss Doherty—I think it is a failure of the act specifically.

CHAIR—But short selling is not a new issue?

Miss Doherty—No.

CHAIR—It has been around for many years? But it has never been raised, let's say, as a public issue in the way it has in recent months because of some very high-profile, let's say, failings or incidents?

Miss Doherty—No.

CHAIR—Why was it not so much an issue previously? Short selling, naked short selling and a whole range of other practices were allowed to continue and no-one had raised them. It is only now that there are some very high-profile cases and some big losses that we are seeing this matter now being raised.

Miss Doherty—It has received publicity because there have been high-profile cases. Retail, ordinary shareholders have suddenly become aware of the difficulty, that perhaps it affects them and they have only become aware of that because it has been covered in the media. That is why it has now become an issue. Also, we have come from a period of being in a bull market to being in a bear market. Suddenly, people are making losses and there is the question: why is that happening? This is one of the things that are having fingers pointed at it.

CHAIR—It is certainly high profile at the moment, but there is a very small percentage of companies or shares that fit into this category that are actually being affected. It is not a market wide issue or problem; it is only a small percentage. Do you have some idea of the percentage?

Miss Doherty—No, we do not. If you look at the figures that ASX prints for short selling, you will see that the ones where there are quite high volumes are not necessarily companies which are in the press as being affected by it. At the end of the day, companies which have been affected by it probably had some substantial issues of their own already.

CHAIR—This is the point I am driving at: whether it is a market failure, a company failure or a Corporations Act failure?

Miss Doherty—It is a nasty conglomeration of all of those things. At the end of the day, I think short sellers, in a sense, are the bottom dwellers. You really need that initial distress which comes from other causes.

CHAIR—They are taking advantage of circumstances being created by the companies themselves in the way they are behaving?

Miss Doherty—Certainly. In fact, the act currently allows a lot of it to go undisclosed. Then if you add to that market rumours, there are things going on which the regulators cannot have sight of because they simply do not have the disclosure.

Mr KEENAN—Is it the practice of short selling that the association is worried about or is it the practice of disclosure around short selling?

Miss Doherty—It is undisclosed, unregulated short selling that we concerned about.

Mr KEENAN—You are not concerned, per se, about the practice of short selling?

Miss Doherty—Not per se. Per se, short selling is not a problem, but it depends upon what basis it is done and what other activities are going on around it. If you short sell because you genuinely believe that a company is overvalued, and it is, and the price drops then that is an effective way of correcting overvaluation. If you short sell because you have insider information or you have spread a market rumour, which is untrue, and then you trade off of that then obviously that is to the disadvantage of all other shareholders.

CHAIR—Which is why I am driving down that path. I think, in part, you have answered that question. Is it a failure of the act? If it is insider trading, there is already legislation that covers insider trading. If it is unscrupulous behaviour that breaches law then there are already acts to cover that.

Miss Doherty—I probably answered your question too narrowly. It is an amalgam of things which have all come at the same time. One of the Allco directors said that he had been hit by a perfect storm. Perhaps it is that sort of issue—that all of these things have happened at the right time, to sort of feed off one another. But, clearly, the issue is difficult for the regulators to deal with if they do not have the information. There is sufficient regulation of insider trading and market rumours for them to act, but if they are not aware of where those problems are then it is impossible—

CHAIR—It is more an issue surrounding disclosure than the practice itself being inherently—

Miss Doherty—Yes. But the issue is also around the price the shares have sold at. If you regulate it in the same way the naked short sales are sold, it can only take place in a rising market anyway, which makes a considerable difference.

Mr ROBERT—You speak about a loophole in the Corporations Act. What sections of the act comprise the loophole and what is your recommendation?

Miss Doherty—The difficulty is that the definition in section 1020B depends upon the issue of ownership of the shares. The act then goes on to make exclusions to the prohibitions contained in 1020B. There is an exclusion for arbitrage, which is not really that important. There is another exclusion in section 1020B(4)(d) which refers to sales where you have made arrangements to deliver. Then there is another exclusion in 1020B(4)(e), which refers to approved short sale products, which ASX has a list of. I imagine that section 1020B(4)(d) provisions should have taken in anywhere where you had agreed to borrow a share to cover. However, people have been using these securities lending agreements, which are not a loan; they are a sale and an agreement to repurchase. Effectively, the section says that they are not short selling, so they are not within the prohibition of 1020B and therefore they can carry it out. So I am not entirely sure how you go about closing up that gap, when you have a specific definition which brings those instruments in. But that seems to be the gap that exists.

Mr ROBERT—Going back to your statement about disclosure, we heard evidence yesterday in Canberra of a number of companies whose share price was X. They had a conference call with their institutional investors only, and during that conference call the company’s value dropped by half. I think it is reasonable to conclude that something within that conference call sparked the

share price's drop; otherwise it is a remarkable coincidence. Considering that retail investors were denied the opportunity to be involved in the conference call, they were not invited, do you believe that is adequate disclosure for a company?

Miss Doherty—No, it is not. If there was something that they disclosed in that conference call which then had a material effect on the price of the stock, it is something that should have been disclosed through their obligation for continuous disclosure under the market rules. It is something on which they should have put out a statement to all investors.

Mr ROBERT—Do you have any recommendation of how companies can better disclose whilst keeping institutional investors informed but providing the same timely information to retail investors?

Miss Doherty—It seems quite simple. They could have put their notice on the ASX before that meeting. Obviously, many retail investors are not sitting at home all day watching the ASX, but there is probably not a more perfect way of delivering that information. It would seem quite simple to put the notice up or even put the presentation up on the ASX website as part of their continuous disclosure obligations that day before the meeting.

Mr ROBERT—What is your view on direct voting?

Miss Doherty—The ASA supports direct voting.

Mr ROBERT—What is your view on the current 100-member rule within the Corporations Act?

Miss Doherty—It is not something that we have a specific view on.

Mr ROBERT—The current tracing provisions in the Corporations Act also apply to voting instructions. Does the ASA have a view in that respect?

Miss Doherty—No.

Mr ROBERT—Thank you.

Senator MURRAY—I want to return to the share lending issue. Do you think the law needs to be clearer as to what is or is not permitted with respect to share lending? Let me give you these propositions. Should the law specify that share lending can only occur with the informed consent of the lender? Do you think that share lending should be prohibited if the loan is for voting purposes? You appreciate the difference between market activity and making a profit, as opposed to someone who borrows them so that they can influence a company vote. Do you think share lending should be prohibited for directors, public officers and management of a company if it results in the transfer of ownership? The question is whether the ability to lend should be better prescribed. If you do not have answers to those specific questions, if you would like to think about it and come back to us, I would be very happy.

Miss Doherty—As far as securities lending is concerned, the ASA's position is largely that it is an issue where the owners of the shares, the lenders, need to consider the relationship between

the risk they take and the return they gain. At this time it would seem, at least from the reports we have seen, that the returns do not necessarily justify the risk. Frequently it appears that it is not transparent to lenders what actually happens with the securities they lend; the end purpose does not seem to be known to the actual lender. It is of enormous concern to the ASA that effectively they are not able to assess the risk of lending their stock. To answer to your first question, the ASA would say that institutional shareholders should have a clear policy about securities lending, which can be accessed, and they should also be clearly considering the relationship between risk and return when lending those securities and only take that decision if it fits with their policy in terms of their appetite for risk.

Senator MURRAY—The concept of informed consent has precedence in law and practice. For instance, the disclosure requirements surrounding financial products in the financial services act require the person selling the service or product to ensure that the buyer is informed and consents to the proposition before them. The proposition of informed consent means the borrower would be obliged to ensure that the person or the body lending understands the basis on which the shares are to be lent and the consequences of that in the broader sense. That is what is meant by informed consent, and I think there are precedents elsewhere. Do you react favourably to that?

Miss Doherty—I think we are approaching it around the other way and saying the lenders, as trustees, have a duty to know effectively what is happening to the securities that they have lent. I think we are just coming at it from two different directions.

Senator MURRAY—Let us explore this. There are two classes of lenders. There are lenders who lend other people's property—

Miss Doherty—Yes. I mean the lenders as in the beneficial owners of the shares.

Senator MURRAY—But there are also lenders who own the shares in their own right. Obviously I am thinking in particular of executives, directors and so on, whose very practice of lending their shares has caused great consternation in some market sectors. So there are those two areas. I understand that you are addressing only one area, but I suggest the other area needs attention as well.

Miss Doherty—That is something we certainly need to think about. I can come back to you about that if you would like.

Senator MURRAY—Yes, and could you let the committee know the outcome of the paper you have said you are producing in a week's time? You could send it through to the secretary.

Miss Doherty—Certainly.

Senator MURRAY—What about the other questions I asked you?

Miss Doherty—The second question you asked was about share lending being prohibited for the purpose of vote renting.

Senator MURRAY—Yes.

Miss Doherty—The ASA's position is quite clear: we do not believe securities should be rented for voting purposes. So we would support restrictions on that.

Senator MURRAY—You would support a legislative prohibition of that? There is no other way to do it; it is either lawful or it is unlawful.

Miss Doherty—I think we probably would support that. It is not something we have a policy on, but we certainly do not believe that votes should be rented for the purpose of meetings.

Senator MURRAY—Without me verballing you—which, as a politician, I would never do!—if you want to go firmer on that and consult with your colleagues and come back to us with a recommendation that lending for voting purposes should be prohibited, that would be of use.

Miss Doherty—I can do that.

Senator MURRAY—Thank you. And the third question?

Miss Doherty—I have written down that your third question was about the prohibition on directors, public officers and managers lending securities. This really comes back to—

Senator MURRAY—Lending their shares where ownership is transferred?

Miss Doherty—Yes.

Senator MURRAY—I think it would be utterly wrong to prohibit people using them for collateral, for instance. The issue is where ownership is transferred.

Miss Doherty—This comes back to the first question. I think it is something that we do not have a firm policy on at the moment and I would need to clarify with our executive how they feel about that.

Senator MURRAY—You can see why I focus on that class—because somebody in the marketplace is just in the marketplace, but a director or an executive has a material effect on how a company is viewed.

Miss Doherty—Yes.

Senator MURRAY—You will come back to us on that?

Miss Doherty—Yes, I can certainly come back to you.

Senator MURRAY—If the chair will allow me, I just want to cover the voting. If I were to draw conclusions from all the submissions we have received, I think the one area in which witnesses are telling us that corporate democracy is much, much weaker than political democracy is the area of voting. Direct voting is not facilitated, electronic voting is not facilitated and proxy votes are inadequately governed, administered and utilised. Proxy votes are not kept and can be destroyed. There is no ability for recounts and there is no adequate dispute resolution mechanism et cetera. Your own submission seems to add to that perspective. My view

is that corporations can learn from the mechanics, practices and processes which apply in a political democracy to ensure that every vote counts and is able to be counted so it can have an impact and so on.

From the same witnesses, though, there is also a resistance to more regulation. They essentially say that legislation permits many of these things to occur, but companies just are not doing them. I say that some of the companies are not doing them because the board and the management do not want more shareholder engagement and interaction because it will lessen their own power and their own discretion. So one of the mechanisms I have been interested in is whether we should encourage the regulators, particularly the ASX and ASIC, to activate the ‘if not, why not’ question. They could ask companies: ‘If you’re not doing electronic voting, why not? If you’re not allowing for direct voting, why not? If you’re not keeping proxy votes for a certain period, why not?’ That does not require a law change, but it does require people to own up and to have some market scrutiny from the regulators. How do you react to that proposition?

Miss Doherty—The ASA would support that type of movement to try and make voting clearer. Obviously we try not to look to regulation as the answer to everything, and your proposal seems like it is a good way to at least try and get an idea of why companies are not attempting to have a better practice around the issue of voting. If the answers that they are giving are not good, then obviously the question could be revisited. So it would seem as if it is a sensible suggestion.

Senator MURRAY—The submissions for this inquiry are on the committee’s website. Have you had an opportunity to look across them?

Miss Doherty—I have read many of them, over a period of time. If you ask me something specific, I may not remember.

Senator MURRAY—My specific question is this. We have had a number of suggestions with respect to voting and shareholder engagement, and your organisation has a particular reputation as an independent group without a vested interest, frankly, in a number of areas. If any of the suggestions or approaches particularly attract your organisation’s interest or approval, perhaps you could let the committee know and give those your support. That would be useful.

Miss Doherty—Yes, certainly. I started a list last night, but it is not exhaustive. If you do not mind that, I will send it in and it could be helpful.

Senator MURRAY—Thank you, Miss Doherty.

Mr KEENAN—I want to pick up a point that Senator Murray was making about stock lending. Has the association had any concerns up until the time in the last few months when this gained some public notoriety? Has the association ever had concerns in the past about this practice? I ask that because I understand that practice has occurred for a number of decades in Australia without incident.

Miss Doherty—I am relatively new to the association. As far as I am aware, it is not something that we have raised before, but I say that having only been with the association for just over two months. My understanding is that it has become a recent issue. I think for many

people it is something that has been going on but has never really broken through the surface. I think that maybe we are some of those people.

Mr KEENAN—You are talking about the risk-versus-the-return premise. Do you know what sort of return people do get from lending?

Miss Doherty—They are getting three or four basis points, aren't they?

Mr KEENAN—It is that high?

Miss Doherty—Sorry?

Mr KEENAN—Is the level of return that high? You were talking about the risk versus the return.

Miss Doherty—I cannot remember. You have put me on the spot as I have not written it down. It is significantly lower than you would imagine given the risk. If you want me to clarify that for you I can do that in writing.

Mr KEENAN—No, that is all right. I was just curious about what the return was versus the risk.

Miss Doherty—Unfortunately I do not have that here.

Mr KEENAN—I have actually heard it put, particularly by institutional investors, that they would be derelict in their duty if they were not getting this extra return by engaging in the practice.

Miss Doherty—The information that I have comes simply from a report that Alan Kohler did. Part of the problem with securities lending is that it is murky. There is no public disclosure. It is not clear what the size of the market is. It is not clear how many securities are actually on loan. That is something that the ASA sees as being an issue. There is not sufficient clarity around it.

Mr KEENAN—Let's move on from that issue. I am wondering whether there are any jurisdictions around the world that you would see as being particular models that Australia could emulate as to shareholder engagement. Otherwise, is Australia right up there with best practice?

Miss Doherty—I do not really have a comment on that.

Mr KEENAN—That is all right. I was just curious as to whether there was somewhere that we could look at. Do you find that among the members of the association there is a large groundswell of support for greater engagement? How would your members weigh the risks associated with greater shareholder engagement versus the compliance costs of doing that, the costs of which might affect their returns, for instance?

Miss Doherty—The members who are vocal and talk to us—not all members do—think that shareholder engagement is extremely important. They do meet their part of the bargain: they go to the AGMs, they read the documents and many of them write letters to the companies and

generally they eventually get replies to them. I think it really does come down to the diversity of opinions around this issue. I cannot say that there is a clear ASA membership opinion which says that shareholder engagement is worth the money that it might cost a company. But from the ASA's point of view, we think it certainly is. We believe that things such as AGMs, which are perhaps put up as involving a considerable cost to a company, are extremely important in terms of directors seeing their shareholders and hearing what their shareholders have to say. That is really the only opportunity for ordinary shareholders to communicate. So some of those things that may be slightly more expensive and cumbersome are really the only opportunities for visible engagement.

Mr KEENAN—I was not pushing the opposite case—I want to be clear on that. I was just playing devil's advocate as I was curious.

Miss Doherty—I am just having a go at pushing one of our barrows.

Mr KEENAN—I appreciate your answers.

Mr ROBERT—Going back to the issue of disclosure, with the situation I raised before, which was previously given in evidence, of a company that had a discussion with institutional investors and their share price halved, you indicated that, under continuous disclosure, that company should have lodged the same information at the same time with the ASX. Having said that, I would contend that that still would not give retail investors any time to do anything, because how would they know that the information was there on the ASX to allow them to sell down like the institutional investors would have? I would have perhaps thought that it might have been more prudent for a company to let as many retail and institutional investors know, perhaps by email since they have that database—although it is not complete; many still do not connect with the electronic world—by simply saying, 'In a weeks time there will be a discussion with institutional investors. The content of that information will be made available on this site at that time.' That would actually give retail investors the opportunity, and indeed the timeliness, to get the information at the same time as its institutional investors. Do you concur with that line of thinking?

Miss Doherty—It seems sensible.

Mr ROBERT—Good. The previous evidentiary provider spoke about the concise report and how over time the concise report has become anything but concise—and, indeed, should be renamed the 'substantial report'—to the point where they believe that the concise report is actually the full documentation minus explanatory notes. Is that also your contention?

Miss Doherty—It is not something that we have a firm position on, and I think that you will find that it varies from company to company. We encourage members, if they are interested in the report, to get the full annual report, and our members who are active and interested would normally look at the full annual report.

Mr ROBERT—Do you believe that the concise report has any value, considering that the annual reports are now mostly available online?

Miss Doherty—Again, that is not something I can answer on behalf of the association.

Mr ROBERT—Previous providers of evidence also spoke about the various mandatory reports enshrined in the Corporations Act and they believe that over the last amount of time the amount of mandatory reporting has increased. Do you believe that there are any elements of that mandatory reporting that are now superfluous, that could now be gotten rid of?

Miss Doherty—Again, I cannot give you an association answer for that. It is not something that we have a policy on.

CHAIR—As there are no further questions, I thank you very much for your evidence and for your presentation here today.

[12.28 pm]

NOBLE, Mr Gordon, Principal, Responsible Investment Consulting

CHAIR—Thanks very much for appearing before the committee and for the provision of your submission and evidence today. If you would like to make a short opening statement in relation to your submission, that would be welcome.

Mr Noble—Firstly, thanks for the opportunity to address the committee. I would be happy to take any questions as we go along. As our name suggests, Responsible Investment Consulting is a specialist consulting business around responsible investment issues. In particular, these are what we would term environmental, social and governance issues in investment processes. On a personal note, my background is that over the course of 2007 I was privileged to be able to work for the United Nations Principles for Responsible Investment, so I have some knowledge of the framework that was established and I would like to talk about the UN principles in my opening comments.

Firstly, I would like to provide some historical background on the United Nations Principles for Responsible Investment as they relate to this inquiry. Before the UN Principles for Responsible Investment were established, the United Nations had, over the course of a decade, started to develop a process of engaging with business communities and civil organisations. One of the initiatives established was the United Nations Global Compact. This was quite successful. There are now around 5,000 participants globally in this set of 10 principles. As a result, over the last decade we have seen a range of information coming from the corporate sector on corporate responsibility issues. Over the last few years one of the concerns at a United Nations level was that, despite the range of information that was coming through in what we would now term ‘sustainability reporting’, the investment community was lagging; broadly speaking, it was failing to incorporate a lot of this information into its investment processes. So a couple of years ago the United Nations Environment Program Finance Initiative and the United Nations Global Compact established the United Nations Principles for Responsible Investment. The principal reason for establishing this framework was to provide institutional investors with a framework to incorporate environmental, social and governance issues into investment processes.

Active ownership is a core part of what the UN principles are about, and therefore engagement is a core part of that. I will not go into more detail about the actual principles because they are publicly available, but this is obviously how they relate to the committee’s inquiry. At the time that these principles were established, two organisations from Australia were among the founding signatories. Two years later we have almost 60 signatories in Australia. If you count the international fund managers who are present in our market, we probably have another 10 or so signatories. What that means is that Australia, in terms of the United Nations Principles for Responsible Investment, has around one signatory in every six, and that provides us with global leadership potential in this area. In contrast, our signatories and participants in the United Nations Global Compact represent fewer than one signatory in 100 in the global community. So there is a stark difference in terms of how many we have for the United Nations principles.

There is an importance about this in terms of climate change and a range of environmental and social factors, in that our market has, broadly speaking, endorsed the UN principles. A lot of the major fund managers are signatories to these principles and a lot of the major superannuation funds are signatories, too. It means we have the potential to create a hub of expertise in our market. In the context of the current reviews of Australia's funds management industry—in particular, the taxation arrangements—and the potential to create greater export opportunities for our funds management industry, we should consider that responsible investment expertise and capacity is going to become a very marketable commodity, particularly across South-East Asia, as we go forward. So this issue is directly related to potential benefits for our funds management industry.

Having said that, we have some issues that I think we need to address for Australia to take up its leadership position in responsible investment. As I said at the start, engagement and active ownership is core to the signatories' commitment in signing up to the United Nations Principles for Responsible Investment. When it comes to engagement, the question is: how can you engage in the most cost-efficient manner? One of the issues we have in respect of engagement is that it is costly; it requires directors to devote resources to ensure that they have the research and understanding—and then of course they have to go and engage with the companies. Just because you sign up to a set of principles and say that you are committed to engagement does not mean to say that the companies with which you wish to engage are going to engage with you. So there is a two-way street in this process.

We would argue that we have to establish a mechanism that facilitates engagement in the most cost-effective ways. We are guided by some of the work that is happening internationally. In particular, the US Securities and Exchange Commission has established a debate on the proposals around establishing electronic shareholder forums. The mechanisms of the US Securities and Exchange Commission and where the debate goes is a very difficult thing to understand at any one time. It is a highly complex process, but they are having that debate. I think it is important that we have that debate in Australia too. At a company level, there are companies that are leading in terms of providing electronic shareholder forums and one particular company is Dell.

This is a process where you allow the engagement to happen as part of a very efficient process where people can submit questions and answers can be placed on the website. If you look at it in terms of how quickly the market can be aware of information, if the information is placed on the website, it can be available to all investors at the same time. In our submission we have suggested that we need to have a look at parliamentary democracy around questions on notice and how that applies to how information can be disclosed at a governmental level. We need a better way of having a range of information provided to the market.

The issues that we are concerned with are environmental, social and governance issues. These tend to be long-term issues that can have an impact on investment returns. One of the problems therefore is that for disclosure obligations around materiality, it is very difficult for an investor to be able to argue that it will influence the share price on a day-to-day basis. Climate change for instance will have an impact; we all know that. How a company responds to climate change will have an impact, but will that impact happen in a day, a month, two months or two years? We are arguing that we need a broader debate about disclosure. There are some mechanisms and some examples internationally as to how we can do that. We would not suggest that we have the

complete answers as to how it should happen, but we would encourage the committee to really look at this issue in a great deal of detail.

Mr ROBERT—You recommend a broader debate about disclosure—with what ultimate intent?

Mr Noble—The materiality of an issue that is provided to the market will depend on an individual investor. So the debate is to provide individual investors with information that they need which is material to their investment decisions.

Mr ROBERT—What problem will that be looking to solve?

Mr Noble—On a long-term basis we must consider environmental, social and governance issues in our investment decision-making processes. This is the argument that led to the establishment of the UN Principles of Responsible Investment. For instance, in the longer term a $10 billion or $20 billion superannuation fund has investment managers who trade in and out of companies, but the broader long-term environmental, social and governance issues are the issues that we need to pay greater attention to because it is the long-term investment returns of the superannuation fund member that will be affected.

Mr ROBERT—We are talking about disclosure. Are you suggesting that the super fund should be disclosing a lot of their long-term environmental and social agendas?

Mr Noble—Superannuation funds who commit to the UN Principles of Responsible Investment will commit to communicating back to their shareholders as to how they are implementing these principles. That is the sort of thing that we would want to see. We think superannuation funds should be providing a lot more information as to how they consider these issues.

Mr ROBERT—One of the problems we have—and it has been raised by others in front of the committee—is an information overload problem. There is an enormous amount of information coming from companies to investors, be they institutional or retail, to the point where many retail investors simply cannot digest it. Wouldn't it exacerbate the situation to suggest that more information come to them, in the form of exactly how a corporation is responding to, in your case, the PRIs but, in a wider sense how they are responding to social and environmental issues?

Mr Noble—I do not share the view that individual investors do not have a capacity to take on information. I have confidence that a lot of individual investors have quite a degree of capacity and quite a degree of interest in these issues. I do not think it is the individual investors who are coming and saying they are concerned about issues. It is more the corporates, the accountants and the lawyers who might be concerned about it. I think that, from an investor's perspective, more information is not a bad thing. It is the mechanism that we need to find to make that efficient. I think that is where we are at.

Mr ROBERT—Looking at your submission, your key recommendation is for questions on notice to be part of an AGM—or indeed you propose a technology solution to make it wider. So an investor with $100,000 worth of stock—although you note that that could move—could ask a question on notice within a technology framework and the company could provide an answer,

and it is available for all shareholders to view. What other recommendations do you have to increase shareholder participation?

Mr Noble—In our market a lot of this requires our shareholders, our investors, to become active too. I am not here to say that there is a regulatory answer to everything. We need, from an investor perspective, to be a lot more engaged around these issues. Investors need to call for a lot more in the form of sustainability reporting and a lot more information. I think there is actually an element where the investors need to be active rather than there needing to be a regulatory answer to all this. I do not think that providing a regulatory answer which requires more reporting is what is required. I think we need to enable those who wish to go to best practice—and there are already a number of Australian companies doing this in terms of providing enhanced sustainability information—to go to the next step. So it is really to look at the regulatory mechanisms that enable those who wish to go to the next step to do that. Investors also have to lift their game and be a lot more active around this. But the more efficient the process is, the more likely that we are not going to waste valuable resources in inefficient engagement. That is really the issue that I am concerned with.

Mr KEENAN—Could I pick up on that point? Are you actually saying that we should require them, through regulation, to do this, or are you saying that we need to use regulation to provide some standardised format for them to do that, or both?

Mr Noble—I think that what would be valuable would be some guidance notes from ASIC and the ASX around how companies who wish to go down this path could do so.

Mr KEENAN—If there is an interest, why can't the companies get together and just do that for themselves?

Mr Noble—One of the issues that came from the US in terms of their inquiries around this is liability—some liability issues about where it leads to any liabilities for them if questions are posted on the website. It is the same issue in this market. If there were some guidance around this from the regulatory side of it, I think it would help facilitate companies to be a bit more prepared to go down that path. Remember we have got listed on our markets some leading international companies whose shareholder bases are very much international, so they are no doubt focused not just on the domestic market in terms of their shareholders but on the international clients.

Mr KEENAN—So you are arguing that we should facilitate this, not that we should require it.

Mr Noble—That is right.

Mr ROBERT—What is your view on the 100-member rule from the Corporations Act that 100 shareholders—even if they hold only one share each—can force an AGM?

Mr Noble—I think in practical terms it means that that does not happen. If you look at the United States in comparison, they have an investor-company dialogue that results in activist investors putting shareholder resolutions as a form of being able to have a discussion with companies. That is a conflict based approach in the United States. It means that, whether it is on,

say, pay or climate risk, in the whole AGM process organisations expend a lot of energy building up campaigns in order to have an engagement. I do not think that is particularly beneficial in terms of the overall process.

Do I think the 100-member rule works in our market? I don't. It means in practical terms that it is difficult for institutional investors who have genuine concerns—for instance, about climate risk—to be able to have a dialogue with a company if the company does not want to have that dialogue. But I do not want to go over to the US system, which is about conflict based resolution. I think this is where you come back to having a forum that enables debate to happen without it being a conflict based system, as it is in the US.

Mr ROBERT—What do you think is the biggest impediment currently in the marketplace to further improving shareholder participation?

Mr Noble—Cost is the big issue. Everyone is focused on their investment returns, and in a down market that becomes more so. The problem is that, whilst we all know that environmental and social issues are here to stay—in particular that climate change is here to stay—the short-term temptation is to focus on our investment returns today and not invest in the research, because the research may cost us a few basis points. That is the biggest issue. That is a cultural issue. This is not something for which I am calling for regulation. This is something that the investment industry needs to get its head around and debate. It is happening at an international level, and that is what the UN principles are about. It is happening too in the Australian market. There are some good signs in this market.

Senator MURRAY—Mr Noble, your eight owners are responsible for A$350 billion of invested funds, according to your submission. That is a lot of market muscle. Do your views reflect theirs or are what you put the views of your organisation on its own?

Mr Noble—The views I am speaking are those of Responsible Investment Consulting. I am not speaking here for the United Nations and the United Nations Principles for Responsible Investment. I apologise if I have not made that clear at the start.

Senator MURRAY—No, it just gives it much more weight if I see you sitting there with A$350 billion above your head, but that does not mean that I will not be paying attention to what you are saying.

Mr Noble—I would like to have that over my head too.

Senator MURRAY—I get the impression from some witnesses and their submissions that pretty well everything is right and not that much needs to be changed. The impression I get from others is that shareholder engagement has actually not been a focus of or the subject of emphasis by regulators, policymakers and so on. Which category do you fall into?

Mr Noble—In terms of investor engagement, I would say that generally speaking there has been a lack of activity in this market; that is the case. But, as I have said, there are some very positive signs here. I know you have had the Australian Council of Super Investors Inc. submitting to you. Given their support for the UN principles, a number of signatories have come on board as a result. There have been some very good signs. I see that in the end the companies

that do incorporate environmental and social governance issues into their investment processes are going to generate better long-term returns. I think we have to have a debate about that and prove the value of that. That is where we are at at the moment. We are in this middle game.

Senator MURRAY—As you probably know from my participation in this committee's report on those matters, I agree with that general observation. But I have a more prosaic interest—that is, whether the basics of shareholder engagement have properly been the focus. My instinct is that many boards, many directors, like to have as little active shareholder engagement as possible because it maximises their power, their discretion and so on. The law allows electronic voting. It does not prohibit direct voting. It does not say that you cannot keep your proxy votes or that a company cannot have a process for recounting votes. But those are practices that go on. Is there a mechanism outside the law to encourage these areas? I have always been particularly attracted by the way in which the corporate governance principles were developed as a result of the interaction of the ASX, ASIC, some of the institutions and some of the major corporations. Do you think that process needs to be re-energised but with a specific request that better shareholder engagement be examined?

Mr Noble—If you look back over the last six or seven years, the debate on corporate governance has come an incredible distance. The nature of this issue is that it is constantly evolving, and therefore I think that the regulatory response, the industry response, needs to constantly evolve, too. I do not think we will ever be in a situation where we can say: 'We have the right structures. It's all under control right now. Let's sit back and relax.' Because then a new form of market manipulation, a new form of hedge fund activity, will start to challenge the market. So there is a need for constant evolution. I think the corporate governance principles within the ASX have demonstrated a capacity to keep evolving. That sort of consultative model needs to keep going. However, I note that, in the recent debate, there were two broad positions as to which way it should go. It is captured in the comments of the committee: 'Do we have too much disclosure and, therefore, is it an imposition on the corporation? Which way should we go?' At that point, when the industry is unable to provide a direction, that is obviously where we turn to the political process to make a judgement as to the way to go. I can only comment on the way I see it, and the broad principle is that I do not want to see a regulatory environment that constrains innovation but I do want to see greater disclosure in the marketplace. I think the issue is how we achieve that.

Senator MURRAY—You were probably somewhat bemused by my question on the $350 billion. I flicked the page as I was talking to you, and I suddenly spotted that figure. Of course, that figure was from another submission, not yours. My colleagues were awake enough to say to me, 'Don't flick the page and talk about somebody else's stuff!'

Mr Noble—Just for the record, between $13 trillion and $14 trillion of investment globally is signed up to the UN principles. In terms of this market, I would suggest that between one-third and one-half of our market have signed up.

Senator MURRAY—So my figures are right but it was just the wrong context. Thank you to my colleagues for realising what I had done. Your basic proposition is that responsible investment makes companies money, essentially, and that greater shareholder engagement, because they are concerned with these issues, will encourage companies to get more active in this area. Is that a good summary?

Mr Noble—Yes, I think so. If you can minimise the long-term risks that a company faces—and remember that the principal group we are talking about here are superannuation fund members that invest for, say, 30, 40 or 50 years—then over that period of time these issues ultimately embed themselves in the value of a company. So not considering them in the short term costs in the long term.

Senator MURRAY—Thank you.

Mr KEENAN—I want to follow up your response to Senator Murray's point. If it is the case that private companies will make better returns by adhering to these principles, then surely the last thing you would want is government involvement, because the private sector is best equipped to go out for a dollar, if that is the case, and they will certainly develop it themselves.

Mr Noble—Outside of the corporate regulatory environment, we are seeing increased regulation around a whole range of things in any case, so a company needs to take into account these sorts of things, whether it is climate change, waste management, biofuels—all those issues that are going to have an impact. To do its job a company has to do that. You have this debate. The companies that can establish the best form of engagement with their owners over the long term are going to get a premium in terms of their shareholder value because there will be a perception, and quite rightly so, that they represent lower risk. The companies that do not—those that have poor disclosure—will struggle in the end, I think. There will be a cost premium that they will pay for the fact that they are not perceived to be handling issues that are not going to go away.

Mr KEENAN—It is just that there is a linkage between returns and I hope every face of the corporate sector will follow that path and chase those returns, and that they will do it without government assistance, if that is the case. I think that they are best equipped to do that and they have shown every indication that they will chase a return if it is there. I want to turn to the United Nations Principles for Responsible Investment. They are called PRI, aren't they? I am just wondering how they came into being. What process was used to develop these principles?

Mr Noble—To make the point, the principles are owned by the investment industry. They were developed by the industry. The United Nations agencies—that is, the United Nations Global Compact and the United Nations Environment Program Finance Initiative—basically created a collaborative mechanism to bring together institutions across the globe. The process involved a series of quite lengthy workshops where they debated the framework with the industry. It really was the industry's initiative and it owns it. Without it endorsing it—

Mr KEENAN—Which industry and from where? I was in the private sector and I was not asked to contribute. I am just wondering where—

Mr ROBERT—Neither was I.

Mr Noble—Regarding democracy in the institutional sector, we do not have the same transparent processes as parliamentary democracy, clearly. A range of large institutional investors—obviously not mums and dads—were involved in that process. The founding signatories—there were around 26 or 27—are some of the largest household names.

Mr KEENAN—So they are mainly US companies?

Mr Noble—I think six continents were represented in that. You had the US and the Europeans, and two Australian signatories were amongst that group as well. In that sense, there was never a global vote on every institutional investor, but I think the success can be seen by the fact that 320-odd signatories have since joined and signed up to these principles. Remember, it is voluntary and it is aspirational—there is no requirement—but it has certainly become something that the industry has taken up.

Mr KEENAN—So there was a workshop between large companies—a broad geographic spread or whatever—and they got together in New York and nutted it out over a couple of days?

Mr Noble—Yes. I understand there were a couple of those kinds of workshops in different locations and a lot of communication in the meantime to do that, so it was a very facilitative process.

Mr KEENAN—So the people came together, they had this process and then it was put to the General Assembly?

Mr Noble—No. Let me make it clear that I am not speaking for the UN principles. I really need to make that clear. There is the United Nations and there are a whole lot of agencies. The United Nations environment program is effectively an agency of the UN, so it is very much different to the UN General Assembly, where you have those countries' votes. This is a collaborative partnership approach that the UN adopted about a decade ago, and that was the format that it has developed. In that sense, the UN has created a collaborative partnership by bringing together the investment industry, and it is the investment industry that owns these principles.

Mr KEENAN—I am just wondering, when you say 'industry', how would you define that? For instance, who within the industry was there? What are examples of names of some companies or managers?

Mr Noble—Institutional investors, pension funds, CalPERS—the Californian pension fund. There was a range. I can obviously provide you with the founding signatories which would give you an indication of—

Mr KEENAN—No—it is just that we were talking about large, multinational companies. I assume that only very large industries or businesses would have been involved in this.

Mr Noble—Although the two signatories in the Australian market—Christian Super and Catholic Superannuation—are by no means huge institutional organisations. I guess there was a call for those who wished to be involved in that collaborative discussion, and a range of institutions said, 'Yes, we're interested.'

Mr KEENAN—I have not read the principles. I should have bought a copy, if I had been quicker off the mark. I wonder what sorts of responsibilities, particularly social responsibilities, does this impose, if you like?

Mr Noble—This is an important point. The UN Principles for Responsible Investment are framed around investment risk. As opposed to the concept of, say, ethical investment or socially responsible investment, which take a moral point of view on an issue—for instance, 'We don't like alcohol, gambling, mining stocks or the like'—the UN principles are around the basis that you actually assess the environmental and social impact of an issue on your investment rather than ruling it out, per se, by saying, 'We don't like that.' It is not based on an ethical investment model; it is based on a risk model, an investment management model. There are six principles around active ownership and engagement. That is essentially it.

Mr KEENAN—What sorts of specific social things are contained within the principles?

Mr Noble—The principles are aspirational and voluntary. Environmental and social governance issues will effectively be defined by the investors who will look at them and determine what those are. This is not a set of principles which is telling the investors what those issues may be; it is a set of principles whereby investors basically commit to considering environmental, social and governance issues in their investment processes. It does not tell them which ones, how to do it et cetera.

Mr KEENAN—So it is a relatively small document. It is virtually a brief document, is it?

Mr Noble—There are six principles and they run to a handful of lines. The way in which the UN principles work is that the signatories are asked to provide a yearly report or answer a set of questions as to what they are doing and that is collated in terms of a group report that is released to say, 'This is what the community of signatories are doing.' But I repeat: they are aspirational and voluntary and they do not require any particular action.

Mr KEENAN—I understand. They are not very strictly defined. They are essentially saying, 'We need to look at environmental and social things and we are taking into account the way we do our reporting.' It does not even list subpoints: you need to take into account this, this and this.

Mr Noble—That is right—it does not do that.

Mr KEENAN—Finally—and I have asked this question to some other people who came to give evidence today—which country would you recommend we look at in terms of shareholder engagement? Who does it best?

Mr Noble—I would recommend that the committee looks at the debate around the Securities and Exchange Commission—their electronic shareholder forums. As I have mentioned earlier, I would not advocate the US model in terms of investor engagement, where investor groups are forced to effectively put resolutions onto company AGMs in order to have that debate. I do not think that—

Mr KEENAN—I am just wondering whether there is another country that we would look at where we would say, 'Yes, that's an excellent model. They do it better than Australia'.

Mr Noble—As I said in my comments, I think we are positioned to take leadership.

Mr KEENAN—So that means we already have—

Mr Noble—We have a good market and a good structure. We have probably the largest group worldwide that has committed to these UN principles. We have a market that is starting to look towards Asia in terms of a funds management export industry. We are very, very well positioned, and there is going to be increasing demand, particularly across South-East Asia. If we want to be a hub for the finance sector, this is one way we can differentiate ourselves. I would not say that anyone is doing it better than us, but I would say that we can move towards world's best practice.

Mr KEENAN—We already are world's best practice.

Mr Noble—It is a complex thing. There is no market that is best. They are better in some areas and not in others. That is what I am saying.

Mr KEENAN—Again, could you define that for us? I would be interested to know if there are examples of where things are done better. We could go and look at them and see whether they are appropriate for Australia.

Mr Noble—I would suggest looking at the US Securities and Exchange Commission debate on electronic shareholder forums as the key one. That has got some real potential, so I would really recommend you have a look at it.

CHAIR—Firstly, I will ask you a broad question and then I have a couple of specific questions. In the area of providing incentives for companies to engage further with your own shareholders, what mechanisms can you see being provided that are not being provided now? What is out there now, or could be done, that could provide an incentive to companies?

Mr Noble—As I have indicated, some regulatory certainty or some guidance around shareholder engagement either from ASIC or the ASX would assist companies to know, if they do engage—

CHAIR—Do you mean more regulation or do you just mean clearer regulation?

Mr Noble—I do not think we are talking legislation here. I think we are talking guidance notes. I do not come here as a corporate lawyer and, therefore, I am not looking at individual sections of the Corporations Act, but clearly that is an area where, if there are impediments, they need to be addressed. A review process that looked at Corporations Law would hopefully pick that up, but, as I said it, is not within my expertise to comment on that.

CHAIR—There has been a lot of discussion, and particularly a lot of media, recently about short selling and vote lending and a range of issues around those. What is your organisation's view on that? What impact is it having—or has it had; it has been around for a long time but is more in the media now—on the market more broadly, not on individual investors?

Mr Noble—Take a large superannuation fund that is engaged in the practice of lending its stock. The issue is that, if they have signed up to the United Nations Principles for Responsible Investment and they are seeking to engage with companies, does the company come back and say to them, 'We're not really sure that you actually own this stock today because you are engaged in this practice'? They are still the long-term owners of that stock, so they still have the

beneficial control over it. But the problem in terms of engagement is that it is a two-way street. Whilst you can have over your head that $350 billion, or even a trillion dollars, and say, 'I represent all this,' if a company says, 'I am actually not sure whether you have that money today because you are engaged in this practice,' it is one of those long-term issues that can be an impediment.

CHAIR—On that same question, what is the impact for individual retail investors? Is there some concern for your organisation in terms of responsible investing and consulting and of responsible issues around corporate governance? Is this a general problem for the market for individual investors?

Mr Noble—Individual investors have a strong interest in this. Look at the research, for instance, on climate change. The Climate Institute report that is out this week suggests, I think, that 90 per cent of people believe this is an issue. They are the investors at the same time, so I think individually investors are interested in and engaged with. They probably do not have all the information or the answers as to how to deal with this issue. Things like an electronic shareholder forum can actually provide this group of investors with the information that they are looking for, and I do not doubt that they would be one of the largest users of this kind of facility.

CHAIR—Can I just finish up on the issue of disclosure. We have heard a lot of evidence and we have all asked questions around the disclosure of information. An issue arises when there is disclosure in two different forms, one being by invitation to, say, a teleconference where information is disclosed. At the same time, it may be disclosed according to law to the Australian Stock Exchange, but obviously the issue there is not the disclosure but the timing and the method of disclosure. Do you have any view or opinion on how that works—whether there are advantages or disadvantages, whether or not it is responsible?

Mr Noble—As we move into this greater technology age I think we do start to have more issues around this. The privileged position that institutional investors are in, which is justified in the sense of their holdings in a company, can potentially represent some issues. I think the answer is to provide a platform—and again we have to use the technology that is available—that enables information to be provided to the market at the same time.

If an institutional investor is asking a question, they are asking it for a reason and for them it is material. This gets down to that issue of what materiality is from an investor perspective. A company may not think the particular issue is material in the short term, but we are entering a zone where investors have a range of ways they invest. Some might create a climate change fund and they are interested in particular things and therefore particular pieces of information are going to be material for those investors. So I think we do have to embrace technology if we want to be world's best practice. Technology is going to be the answer here, and I do not think we should be differentiating between a small investor and a large institutional investor as to who gets information first.

CHAIR—There being no further questions, I thank you for your evidence today and your submission.

Proceedings suspended from 1.12 pm to 2.15 pm

FABIAN, Mr Nathan Alexander, Head of ESG Research, Regnan Governance Research and Engagement

MATHER, Mr Erik, Managing Director, Regnan Governance Research and Engagement

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

Mr Mather—We are a specialist engagement service and therefore we are very interested in the terms of the inquiry and what we can contribute to it. We have been doing engagement for nearly eight years, on behalf of institutional investors, focusing on the top 200 companies. What does engagement actually mean? It means researching and being informed of the risks we think might impact on current and future investments and having a conversation with those investee companies, in the top 200, about our findings in relation to their exposure to risk. Those companies will then either improve or correct our understanding and agree that there is an opportunity for them to improve their own practices, or some combination of both. We have been doing that for the last eight years and over that period we have engaged with all the top 200 companies on at least one and usually multiple heads of environmental, social and corporate governance risk. We do that because it is a risk management, wealth preservation and potentially wealth enhancement service.

We ask the committee to look at engagement as one of possibly three tools available to institutional investors in terms of engagement. We think of institutional investment as a pipeline. At the end of the pipeline, after a risk has manifested itself, we have litigation, class action. It is an after the event approach. In the pipeline itself, inside the company, we have a proxy voting service, which conveys, through voting practices, concerns to directors and companies. We look at proactive constructive engagement as being the third tool in engagement and long-term wealth creation by conveying concerns and expectations to companies in advance of that risk necessarily being manifested because it has hit the headlines of the newspapers or there is already a fall in the share price.

Justice Neville Owen, in section 6.3 of the HIH royal commission report, actually stated there was a fiduciary duty to engage. We would say that, apart from the fact that people who manage money on behalf of others have a fiduciary duty, it makes good economic sense. To use a landlord and tenant example, it is much smarter from an economic outcome viewpoint to engage the tenant and make them a better tenant as opposed to waiting for the tenant to transgress any particular expectations and boot the tenant out and go through all the costs of seeking a new tenant. We think one of the issues for this committee is whether or not the role of that fiduciary duty is sufficiently well understood in practice.

The other point we would like to emphasise from our submission is that a lot of the focus on engagement and shareholder participation tends to be very much in the area of corporate governance. Whilst we support corporate governance very strongly, we think that that is a very narrow interpretation, and the lack of environmental and social risk engagement comes at a

significant cost to financial markets because, for example, social as well as environmental issues—the natural environment and the interface between a company and the environment—also impact the licence to operate. If we think of the celebrated examples of the last five years, shareholders have lost significant amounts of capital where those licences to operate have been breached. In practice very little social and environmental engagement occurs. Companies frequently say to us, 'You're the only groups that are conveying those issues to us.'

In terms of the role of Regnan, we are an industry-owned initiative and, at the time of our original submission to you, we were engaged by $52 billion of investee funds. Today that has grown and, whilst the markets have declined, we account for seven per cent of the entire ASX 200 index and, because institutions own 40 per cent of that index, that translates to about one in six institutional dollars. So there are some significant institutions who are taking this proactive constructive approach to engagement. However, the industry as a whole has not embraced this in its majority in terms of institutional investment. When we talk about institutional investment we are really talking about 90 per cent of that being superannuation, based on APRA figures, the balance being typically life insurance funds. So institutional investment is code for, in our view, superannuation moneys, and the sole purpose test which governs those moneys should be clarified to ensure that engagement and engaging on environmental, social, as well as corporate governance issues, where they are relevant to financial return, is part and parcel of good fiduciary exercise. And the reason that that is valid is explained in our submission. We talk about the terms 'permanent' and 'universal' share ownership, and they make the case that institutions—that is, particularly superannuation funds—are very much exposed to that.

My concluding comments are that the United Nations Principles for Responsible Investment, the UNPRI, are a very effective and, increasingly, the globally recognised platform in which these practices can occur. We are very supportive, as an organisation, of those practices because they are principles and they do not in any way, shape or form dictate or hamstring the way in which institutional investment can occur. So we believe that it would be an advance if, as a matter of policy, all government moneys were invested within the platform of the UNPRI because that does not dictate any particular course of conduct but it does make very clear, as a signal, that it is appropriate to take into account engagement with investments, as well as across all three pillars of governance.

Finally, there remains uncertainty about the role of engagement, and we believe that the government has the opportunity to initiate an industry-led piece of work that would explain what shareholder engagement practices are in theory, as well as give practical examples. A precedent for that is the Mays report, which was a Commonwealth government initiate that presented institutional investors' perspectives on corporate sustainability. Also, the ASX Corporate Governance Council implementation review group, of which I was a member in a personal capacity, had the same challenge in that the principles were relatively clear and were embodied in law—and we are not saying that there is a legal issue here—but the practices were of some confusion. In fact, in the case of the implementation review group, what occurred there was that we, the members of the committee, in frustration of the market's understanding of what governance really was, actually wrote out in longhand what we thought were effective disclosures in order to provide an example, some leadership, to companies to show that you can provide disclosure about corporate governance principles in a way that preserves your financial value but also deals with valid financial market expectations. That is the summary of what we wanted to speak to as key points from our submission. We are happy for your questions.

CHAIR—Thank you. You have extensive experience in the engagement area—eight years. Through your research, experience and contact with the top 200 companies, what are the barriers? What is preventing that proper engagement or full engagement process taking place?

Mr Mather—A major barrier is culture. With all of these sorts of issues there is and has been a siege mentality. It is less so today, but it still is a significant siege mentality. There is a significant practice of running interference—that is, that the last person who should know about any of these things, who should be talking to the market, should be the directors. We have multiple layers of bureaucracy that prevent that communication. In my experience, once a company director is sitting at the table and you explain the research that you have undertaken that has led you to a conversation, there is almost invariably a fruitful dialogue. There may not be agreement. But in terms of engagement by directors about the issues that might relate to environment, social or corporate governance, typically they are interested to get that communication, but their practice is not a wide one. As I have said, there are significant barriers in between, just getting in contact with company directors because of all the various bureaucracy you have to go through.

Another thing is that for some period there has been a significant misconception that active engagement, having communication about environmental, social, as well as corporate governance risks, is some form of micromanagement or interference. It can be, but properly executed it is the complete reverse. It is actually a sensible dialogue about where the long-term strategy of the business is headed. Many company directors have given us feedback that it is helpful to get insight into the market, including where they have told us: ‘No, you’re not understanding these issues.’ And we are happy to say: ‘That’s because you don’t disclose it to the market.’ Usually, there is an ‘Aha!’ moment: the directors all understand what the issues are and they talk about it all the time but, because they do not communicate with the rest of the market in an effective way, they do not have insight to the fact that the market is not understanding these issues.

In corporate governance speak, a good example of that is executive remuneration. I am not aware of any company director who does not complain about the onerous burden of disclosing corporate remuneration. A number of company directors have scenario tested: if we execute the plan that we have and the pay-off to executives is this, in an upward trajectory—that is, bonuses are paid in the maximum amount or thereabouts—is there a risk that our share price could have halved and, because of the way we have structured our share plan and our reward scheme, there could be significant bonus payments made while shareholders are not receiving their rewards? I am not aware of any company where that has ever been scenario tested. To give you a very pointed example, under conventional disclosures by companies of options packages, calculated under the Black-Scholes method, which is taking into account liquidity, risk and a whole heap of other mathematical factors, there is the potential to calculate—that is, best estimate—what the future value of a particular option might be.

In one case, we went to a company and asked them why it was appropriate that the reward an executive was likely to receive would be in the order of $10 million, when the share price was in a negative trajectory. The company said, ‘That’s what we are required to disclose statutorily.’ But that is rubbish, because the current share price is $2 and, for that to be triggered, the share price would have to go to $4 and shareholders would have received 100 per cent return on what their shares are worth today. Our response was: ‘That’s a very sensible argument that you put forward

and it makes all the sense in the world. Can you show us anywhere in the document where that explanation occurs—to take the statutory disclosure and make it relevant to the shareholders?' There had been no exercise of grey matter in converting the technical rules and making them relevant to shareholders. I give you that as an example of where a lot of the challenge in shareholding engagement is simply about cultures and about addressing what the issue is that shareholders should be aware of. That one was a very clear one. Subsequently, that company has addressed that issue of their communication. I hope that gives you a flavour for some—

CHAIR—It does. I might counterbalance that answer by asking, percentage wise, how much of the engagement is on the cultural side and how much has to do with, let's say, gaps in the legislation or regulatory capacity?

Mr Fabian—My view is—and as Erik has stated—there has been a lack of confidence in the ability to engage, under the sole purpose test, on issues that were not directly financially related, in the traditional financial sense, being short-term earnings, price-earnings ratios—these kinds of issues. So the broader discussion on governance has not really gone on.

I think we are starting to see a change in that and more clarity—I would emphasise Mr Mather's point. More clarity or guidance on the sole purpose test and the obligation to engage on ESG issues of materiality would encourage trustees to do a couple of things. The first one is to push the market providers, their funds managers and asset managers further on the extent to which they carry out their oversight obligations on behalf of trustees, on behalf of institutions. The UNPRI is starting to bring this change about, but it is slow at the moment. I think it is worth watching what happens over the next year or two with this change that is taking place in the market.

The consequence has been this agency separation, and a lack of confidence on the part of the end asset owners is to drive the change through the market. We do not advocate a strong regulatory response to force the market to do this. We are starting to see the market change of its own volition. Asset managers and the asset owners they represent are starting to have these conversations with companies, which is drawing more reporting out of them, which is setting a higher bar of expectation for performance on ESG.

I will finish by picking up the issue that Erik mentioned—encouraging companies to disclose some of the thinking that they would previously have assumed nobody was interested in, using the remuneration example.

CHAIR—You mentioned this change. You said it is beginning to change. There have been references by other people that there is some change now—more disclosure, some better mechanisms being applied for shareholder engagement. What was the catalyst for that change? Was it the UNPRI?

Mr Fabian—I think that gave a lot of confidence. We cite it as the biggest change—the biggest catalyst, if you like, for that change. But there are some other pretty serious catalysts as well. Some of these issues are materialising as serious risk for business—strategic, medium- and long-term risk. Climate change is the obvious example. There are other ones. On the social side there are the changing population demographics. Businesses that are responsible strategically need to start considering these things, and I think that is a strong pressure as well.

Mr Mather—I would add that the greatest level of support and why this is moving forward comes down to individuals. Typically company chairs as individuals are leaders and embrace these issues, look forward, are willing to sit down and have dialogue with the market and recognise the important role. That is the leadership.

The other thing is that typically it is like the 'reformed addict' approach. Those organisations that have been on the receiving end of the consequences of poor corporate engagement are typically those who today are very effective at that, because they have learned the hard way. It is a bit like this: if we were to go down to Canberra now and ask householders about how interested they are in fire insurance around their houses, they would be very interested, and you would probably find that 99 per cent of all householders were insured. We know for a fact that some years ago only about three-quarters were. It is the same thing with a lot of companies. So there is the positive—it is the culture of the corporation, and hopefully not because they have been on the receiving end of poor shareholder engagement.

The biggest barrier is the lawyers who sit there and say, 'No, you mustn't talk to the market about those sorts of issues or disclose those factors because you will experience some sort of liability.' I think it would help if directors were provided with some sort of clarification in relation to safe harbour. That is, a company director who has a bona fide good reason for engaging with shareholders and communicating things that they understand to be facts should be protected from liability, provided that they have not selectively disclosed a market sensitive issue, in which case the normal law should apply.

CHAIR—It almost seems counter to what should be taking place in terms of the Corporations Act and regulation. That legislation is there to support disclosure, to support information to the market—and there are specific rules about that—rather than put up a barrier in itself to more information going out.

Mr Mather—We would agree, and the other thing we would offer anecdotally is that the legislation is used as a business tool to selectively disclose. In other words, if we have something really positive talk about, we are happy to talk to anybody; but if in fact it is contentious or something of that nature then it is like a wall of silence that goes up. Some institutions, not all, will deliberately hide behind the issue of selective disclosure in the Corporations Act or whatever it might be, when clearly the issue might be in relation to, for example, reporting lines: 'Do you have an officer whose key performance indicators are responsibility for management of exposure to greenhouse gases in the organisation?' Now, that is simply a matter of a reporting line and, in our view, a reasonable inquiry to make, but sometimes, if a company is particularly sensitive about that, they will fabricate the fact that answering is potentially a breach of continuous disclosure or it is market sensitive: 'What's in our annual report's what's in our annual report, and if you want to know anything else turn up to our annual general meeting.' That is not in all cases, but of course it is in the cases where shareholder engagement can actually be productive to driving economic value, which is exactly where these issues need to be addressed.

CHAIR—You raise a very complex and difficult issue, though, because no law in essence is going to stop those that will always hide behind it—the letter of the law type approach—and use it to their advantage to not disclose, although the law is actually about disclosure. Are you saying it is not so much a problem with the Corporations Act itself in terms of engagement but strictly a

problem with the culture in some companies, which then makes it much more difficult, obviously, to try to remedy?

Mr Mather—In the balance between culture and the Corporations Act, the weight is on the side of culture. What would be helpful is some sort of safe-harbour amendment to the Corporations Act that would clarify that, if you conduct engagements in a particular way, that engagement in and of itself is not going to expose you.

CHAIR—I know what you are saying to me, Mr Mather, but I just do not know how in law you might approach something close to that—how you would give safe harbour. If there is an act for which there is liability, then that is the case. What you are saying just does not seem to fit in terms of the legal and fiduciary responsibilities and other obligations that directors, boards and companies have to the market and their shareholders. If somebody were withholding information because they thought they might be liable for some act, in the end would that not be the case? Look at some of the problems we have today in terms of the collapse of certain companies and unscrupulous or illegal practices. I do not know that any change in the law would help; the law already prevents people from doing this.

Mr Mather—We agree with what you are saying, and our submission also makes clear that you cannot legislate for good practices, including good shareholder engagement. So the balance of our submission to you is about what could be done in terms of the signalling proposal, which is that, where government funds, or public moneys, are invested, they will take these things into account and they will encourage and engage with investor companies as a matter of good practice. That is leadership by example. Our other proposal was for some sort of a government initiated but industry led discussion paper about what are good practices in theory and how do they work in practice in the real world. So, life case studies would be very helpful to leading organisations in relation to moving forward on their shareholder engagement. As I said earlier and as you have heard in other evidence, we would say that a number of organisations are moving forward with this, but it is really about the laggards that drag down or potentially drag down the value of the market because they do not engage in those practices sufficiently proactively.

CHAIR—Sure. Thanks. I will come back with further questions, but I might hand over to Senator Murray for the moment.

Senator MURRAY—I am interested in the fiduciary points you made. Essentially, I have the view that any superannuation fund or investment fund operates in a position of trust either directly or indirectly for those who provide the funds which they invest. That as you know in both law and morality adds an extra dimension to your responsibility. The question is: do you exercise that, as used to be the case, in loco parentis—in other words, as the parent—and take all the decisions or do you get informed consent? It seems to me that there is a patchy response so far. There is a very, very good attitude to investment portfolios. As a superannuant you are asked what investment portfolio type option you would choose. If you do not choose that, you choose the default option—and I think that is informed consent. Mostly they are very easy to read and very easy to decide on and you get an annual report as to the performance against either the default or the particular situation you have ticked.

But that same principle does not apply to other critical areas of institutional interaction with the companies in which they invest. That is particularly the case in voting matters—there is no informed consent—and in authority matters. For instance, there was the recent furore over share lending. Perhaps they exist, I do not know, but I have never seen anyone be asked, 'Do you consent to shares being lent by our institution?' I think that is a fundamental issue because you are giving away ownership of something which you would otherwise have ownership in. The question arising from that lead-in—so that you understand the thinking I am employing—is whether it is desirable for institutional investors to ascertain the voting preferences of those on whose behalf they invest. If so, how should that be done? Should it be a general authority or should it be a specific requirement? For instance, whether you are entitled to lend shares would be a specific requirement but whether you want your institution to vote as they see fit would be a general requirement.

Mr Mather—We are not a dedicated proxy voting agency but, in terms of our experience, we would counsel great caution before the beneficiaries of moneys held on trust each exercised a view and conveyed a view in relation to voting because I think that would be unworkable in practice. The other thing is that we feel the issue should be resolved on the basis of risk and the derivation of long-term value. A manager, whether operating on their own account or as an agent, should be maximising the returns in line with the Superannuation Industry (Supervision) Act rules and therefore should be exercising votes as to whether or not it is in the interests of the company to exercise a vote in a particular way. In that regard I would counter the question by saying currency management is a perplexing issue in relation to the derivation of long-term value. I have not yet heard debate on whether the members of a pension fund or elsewhere should have a say on whether or not currency ought to be hedged or unhedged as the case may be. It is answered in relation to how we would drive long-term value for the particular superannuation portfolio, and there are various decisions made—some to hedge, some not to hedge or some hybrids of a fifty-fifty hedge in terms of currency exposures. In relation to voting, we believe that the institution should exercise the vote as fiduciary, and for retail funds there is a requirement for disclosure of voting practices. I am familiar with an IFSA guidance note that actually specifies that and their members have adopted it.

Senator MURRAY—Let us talk about risk. By the way, you are correct—yes, I do recommend active participation, because risk is enhanced, in my view, if significant investors do not participate in key and material votes that companies put up. But I would also suggest to you that risk is there if share lending goes on. Let us deal with your risk parameters. Surely in the lending of shares, which typically goes from a superannuation fund via a third-party sister custodian and then out into the marketplace, a material exercise of authority of that sort—the scale of which, until the recent exposure of these issues, was not widely understood—is the sort of area where deliberate informed consent should be asked for and secured. There are a range of areas in which it is assumed the fiduciary principle allows an exercise of power without reference to the members or the superannuants or whoever it is that forms your base client. That may be true for normal understood market participation, but I would suggest to you that risking money through hedging activities is not expected activity from a superannuant. It might be from a gold producer—in the minds of the superannuants; I am not talking about the minds of informed people like you. I suggest to you that lending shares might be regarded as an appropriate activity for a speculator but not for your super fund. I am asking you a specific question: are there any other categories where the opportunity should be provided to superannuants or unit holders for giving informed consent with respect to their investment other

than: 'Here are the investment or default options you can choose'? If you want time to go away and think about that and come back to us on it, by all means do so.

Mr Mather—I think we would prefer to take that on notice, if we may. I understand the question, but we would prefer to take that on notice and maybe follow up with a response.

Senator MURRAY—Thank you. The culture questions raised in the interchange you had with the chair were very productive. There are two examples I have given during these hearings which I think have been effective devices in overcoming institutional apathy or resistance or cultural issues. The first is the 'if not, why not' approach. This is where the law facilitates a certain activity but it is not happening in the marketplace, and the regulators combine to encourage it through the 'if not, why not' approach. That is one mechanism, and I would like your response on that. The second mechanism I can give you an example of is the development of governance principles. A decade or more back, governance principles were regarded as environmental issues for crazy bleeding hearts. Then people got to understand that this was central to management, and the device was created of the ASX, ASIC, major institutions, major organisations and major corporations getting together and working out a practical set of governance principles, which have now got widespread support and adoption in our marketplace, to the good of the market in creating wealth. Do you think that the use of those two types of devices to advance shareholder engagement issues would assist in overcoming the cultural issues that you were discussing with the chair earlier?

Mr Mather—We have submitted on this matter previously. Our view is that including 'if not, why not' type disclosure in relation to what is collectively referred to as non-financial risks—that is, risks other than the validity or otherwise of the financial accounts—ought to be incorporated in the same principles based regime of an 'if not, why not'. We support the work of the parliamentary joint committee inquiry into corporate responsibility in relation to that.

Senator MURRAY—Let me give you a specific way in which I am suggesting it could be used. Electronic voting is permissible, but it is not widely practised. The 'if not, why not' approach, I think, would encourage a faster take-up. That is an example I give you.

Mr Mather—You mean that if a—

Senator MURRAY—Electronic voting, at present, is not prohibited by the Corporations Law, and yet it is not widely adopted in corporations. If the regulators were to take the 'if not, why not' approach and asked companies why they have not adopted electronic voting for their corporate resolutions, I think it would have the effect of starting to change the culture.

Mr Mather—We would not disagree with the idea of asking that question, provided that there is an understanding that there are three mechanisms that are available in terms of shareholder engagement, which I mentioned earlier: the end-of-pipe litigation, the proxy voting in the pipe and, in advance of the pipe, proactive and constructive engagement—which we believe can add enormous value by conveying concerns and expectations to companies in relation to the opportunity to address misunderstanding or to amend practices before they become the subject of a proxy voting process, because it has to be cheaper to resolve the issue through conversation than through either electronic or paper based voting on a particular issue where it is contentious.

Senator MURRAY—The last part of the question is whether the approach taken for development of corporate governance, which includes elements of shareholder engagement, could be adopted to advance the issues of shareholder engagement further.

Mr Mather—Do you mean through the Australian Securities Exchange corporate governance principles?

Senator MURRAY—Let me recap for you. The Australian Securities Exchange, ASIC, individual organisations that matter in that aspect—such as IFSA and all those sorts of people—and major corporations got together and worked out the corporate governance principles, which then were used to overcome corporate inertia and resistance and to change the culture. Can you use that same approach to advance shareholder engagement issues?

Mr Mather—You can. I would like to take that question on notice as to how that might work. What you seem to be proposing would is an 'if not, why not' statement, where a company must disclose whether it has an engagement practice.

Senator MURRAY—No, you obviously do not understand.

Mr Mather—No, I do not think I do.

Senator MURRAY—'If not, why not' arose after the corporate governance principles had been developed. If you are going to try to increase shareholder engagement, the question is: 'How do you do that?' If you do not want to do it by law—because it is difficult to change culture by law—what mechanism do you employ? To get corporate governance established in corporations they first had to devise the principles, so that is what they did.

Mr Fabian—I think it has worked to a point and has been a good model; however, the driver for change now has to be very strong investor demand and institutional demand. That will probably lead to requests from companies and investors for a regulatory regime to give force to what they agree in the market on engagement.

Mr KEENAN—You talked earlier about an appropriate regulatory response from government. You do not support a strong regulatory response, but do you support any regulatory response at all? Are you asking government to regulate in favour of these areas or just to encourage the private sector to get involved?

Mr Fabian—Which areas are you talking about regulating?

Mr KEENAN—Enhancing the ESG framework. Your answer was in response to a question about whether there should be a regulatory response from government to encourage the private sector to involve themselves in this. You said you did not think we required a strong response. Do you think we require any response?

Mr Fabian—I think the market response at the moment is making for change. As we have said, guidance on the sole purpose test and trustee obligations would help those individuals to understand the scope of risk and opportunity as part of the fiduciary obligation. I think reporting on ESG issues by companies is still inadequate across the board. We have many leading

companies in Australia on a global scale whose reporting is thorough and detailed and a foundation for very good engagement.

Mr KEENAN—They would be the larger companies.

Mr Fabian—Yes, they are.

Mr KEENAN—Do you think it is difficult for smaller companies to do this in the same way as large companies? Do you think the government should invest only in companies that are capable of doing this? I assume you are talking about doing this through the Future Fund or something like that. Would that disadvantage companies that do not have the resources to necessarily do this in the same way?

Mr Mather—In our experience, it is the converse. Large companies are so large that they are exposed on a variety of fronts—health and safety, natural environmental interface, social licence to operate et cetera. In mining, for example, the consequences of a health and safety breach are much more material for a small company than for a large company. For a large company, they will be absorbed from a financial perspective. If BHP Billiton have a breakdown in one part of their business, they are unlikely to have a trading halt if production has dropped as a result of that particular incident, because they are a diversified entity. Smaller businesses are far more exposed to more narrow elements of ESG. Whilst there continues to be a view in some circles that these issues are overly complex, in our experience, many company directors that we sit down and talk to are very lucid on the fact that these key issues are pertinent to the derivation of income for the business. But typically they are not asked about those questions. The typical CEO or chair will be asked: 'What is the margin on services over the next three months? How many widgets are you going to produce? Is the US Federal Reserve going to increase interest rates and do you think Chinese growth is going to continue?' It is almost a standard questionnaire these companies get, and all of these issues the company can anticipate but cannot actually manage per se. Health and safety and the environmental footprint are things a business can manage 100 per cent. In many cases this is being disclosed to the board and in a number of cases it is being disclosed to the market—but not sufficiently broadly, our work tends to find.

We think the key issues we have asked about in our submission are areas where the government can be supportive. Also, it would be very helpful as a non-regulatory response to improve the culture and move towards a more positive shareholder engagement regime if APRA were to include in its review of superannuation funds the question: 'In the execution of your duty on behalf of beneficiaries do you engage with your investor companies, and what sorts of issues do you engage upon?'

Mr KEENAN—I appreciate that. You are looking for leadership from the federal government and you have mentioned APRA. Are you saying we should only invest in companies that conform to these ESG guidelines?

Mr Mather—No. We do not propose that government funds be invested only in companies that conform to any particular strictures. We do not advocate screening. What we do advocate is that the funds, as part of their mandate, be told—and it should be made very clear—that in executing this mandate—on which we want to get a return of five per cent above the inflation rate or whatever the investment objective might be—we expect them to engage with and

potentially report back to key stakeholders on the nature of the engagement and why they have done that in the interests of the business. That would be in the same way as they would report whether or not they have hedged a currency or whether or not they have changed their asset allocation. It is simply a business decision and they would engage, based on economically rational principles, not because they want to pursue any particular ideology. It would be only in relation to driving financial outcome. That is a risk based process.

Mr KEENAN—I understand that. I understand what you are saying: you pursue these things for economically rational reasons. My concern is that would mean that the government could not invest in large sections of the market and, in particular, in smaller publicly listed companies as opposed to larger companies, which I think have the resources to be able to engage at this level of reporting.

Mr Mather—It is often a view that investment should not occur in the mining sector because it is a dangerous sector. We say the reverse. The mining sector is, in fact, the sector in which the larger companies are better at disclosing and better at engaging than many other aspects of the market. Typically, they do that because many of them had bad experiences a couple of decades ago and they have learnt from them—hence the reformed addict comment that I made in my opening statement.

In fact there is a particular role for government to say, ‘We’ve invested in this particular stock. We’re monitoring the company’s behaviour in terms of health and safety. We’ve identified the fact that health and safety is declining and we have engaged with the company to understand why and to inform ourselves better and, as a responsible owner, to encourage improvement’—and we do that because it is financially advantageous rather than simply saying that we’ll sell out of the company. If you do that (1) you miss out on the opportunity to invest in that company and (2) you miss out on the opportunity to encourage that behaviour and send a leading signal to other market participants: ‘Oh, yes, it’s all right to do that; in fact it makes sense.’ Therefore not only doing the practice but also reporting on engagement is a useful protocol. There is a precedent for that, because the UNPRI, the United Nations Principles for Responsible Investment, under principle 6, encourage signatories to report on an annual basis on how they exercise those principles.

Mr KEENAN—You were talking about an industry led grouping to have a look at these things at a function convened by the government. Why can’t industry convene it if they are going to lead it?

Mr Mather—I cannot answer your question in any way other than by stating I agree with your implied comment that there should perhaps be more industry led initiatives. The fact of the matter is that they are not there. That is perhaps a market failure. That presents the exact opportunity for government to step in and say, ‘We will support a legitimate and industry wide review of these issues for the purposes of documenting what are practical examples of engagement and to lead by example on them.’ There would be a how-to and why-to publication that could be promoted and sold to the industry. Investors’ perspective on corporate sustainability is a precedent as to how that can work—and work successfully.

Mr KEENAN—I note yours is an industry focus group. I am just not sure why everyone is waiting around for the government to do it. If there is money in it and it works well, why can’t industry just go ahead and create these guidelines itself?

Mr Mather—Quite frankly, I think part of the reason is short-termism. We could have a longer conversation about some of the sorts of things to do with short-term measurement. Companies are put under pressure by that. Superannuants expect and measure performance over three months and six months, which in superannuation terms is completely ridiculous in terms of measurement and the weight that investment performance outcomes are given. Economic outcomes take longer than three to six months to materialise, particularly for a superannuation portfolio—but that is for another conversation. The failure is there and it is recognised to varying degrees, so therefore there is an opportunity to initiate some leadership for what would be a very positive outcome for continued economic performance.

CHAIR—Thank you very much for your evidence.

[3.05 pm]

CONLON, Ms Kathleen, NSW Division Councillor, Australian Institute of Company Directors

McCANN, Mr H Kevin, AM, Corporate Governance Committee Member and NSW Division Councillor, Australian Institute of Company Directors

STORY, Mr John Douglas, Chairman, Australian Institute of Company Directors

CHAIR—I welcome the Australian Institute of Company Directors to the committee hearing. Thank you for appearing. I invite you to make a brief opening statement.

Mr Story—Thanks very much, Chair. The AICD is the peak organisation representing the interests of company directors in Australia. Current membership consists of more than 22,000 individuals spread across Australia, drawn from large and small organisations across all industries and from the private, public and not-for-profit sectors. The AICD is committed to supporting and promoting high standards of directorship and corporate governance through its education programs, events, communications and membership activities. We recognise that the occurrence of corporate failure in any one instance will have the inevitable consequence of undermining public confidence in directors generally. We seek to resist that perception. Directors as a body are keen to maintain the trust and confidence of their shareholders and they see shareholder engagement as an essential element of that process. Shareholders are entitled to assurance that the stewardship of their investments is professional, legitimate and ethical and that directors are meeting their fiduciary duties.

In any system there is a need for continuous improvement, and corporate governance is no different. In this process of evolutionary improvement, it must be remembered that one size does not necessarily fit all. Technological changes provide us with exciting new opportunities to communicate and interact with our shareholders. They allow companies to revisit traditional forms of engagements, such as the AGM, and to consider new ways to exchange information, to register votes and to enable participation from remote locations—to name but a few—but the effectiveness and durability of these initiatives will be determined over time.

None of these comments, however, implies that our current model for board structure and corporate governance has failed or that fundamental changes are needed. Indeed, an international study, released today by Professor Kakabadse of Cranfield University in the United Kingdom, establishes that Australia's chairmen of boards are far ahead of their counterparts in the USA and the UK in driving the performance of the business and monitoring the progress of their companies. This research covered more than 12,000 organisations in 17 countries, including 400 board members. It concludes that chairmen and directors in Australia are vitally involved in the businesses they lead.

It is a fundamental principle of good corporate governance that boards should be fully engaged and accountable to their shareholders, but the process of decision making must be left to the board. Why is this principle so important? It recognises that shareholder participation in business decisions would dilute board accountability and make it impossible for companies with large numbers of shareholders to operate effectively in a modern economy.

Directors of a company are required by law to act in the best interests of the company and its shareholders as a whole. The practical reality is that, if they are to achieve this objective, they must of necessity take into account the interests of the company's employees, suppliers, customers and the communities in which it operates, all within the context of both short- and long-term considerations.

CHAIR—Mr Story, if I could just pull you up there for a moment. I am more than happy to incorporate your speech. It will save you the effort of going through it.

Mr Story—Sure.

CHAIR—Is it the wish of the committee that the remainder of Mr Story's opening statement be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The remainder of the statement read as follows—

Shareholders are a diverse group with short and long-term interests. They range from Australian individual investors, managed funds and superannuation funds to globally managed funds and hedge funds. The investment profiles range from passive long term holdings to aggressive short term opportunism. Our governance model of delegated authority from shareholders to boards deals effectively with the inherent conflicts arising from shareholder diversity and turnover. The notion that ordinary people, or "mums & dads", are the sole focus for a company's shareholder engagement does not match the shareholder profile of large listed companies in Australia.

Directors aim to lift company performance and deliver value for shareholders today and in the future. But directors today feel more exposed than ever before to the perils of 20/20 hindsight and the need for statutory safeguards where they have acted in good faith, informed themselves about the subject matter to the extent they reasonably believe is appropriate and rationally believe that the decision is in the best interests of the corporation.

It is important to understand the balance between the respective roles of board and management. Many shareholders have unrealistic expectations about what boards should be doing in areas that are the responsibility of management. The board's role is about stewardship, monitoring the performance of management and being involved in the broad, strategic direction of the company in the future. We have brought along a table of key responsibilities to highlight to the Committee the roles of board and management and to indicate the opportunities that are currently available to shareholders to engage and participate in the governance of their companies. We believe that this allocation of roles and responsibilities, which has been tried and tested over a long period, represents an appropriate balance.

Enterprises support the economic fabric of the nation and the prosperity of its citizens. It is in everyone's interest that the goal of improving company performance is achieved and that boards are not unreasonably constrained by regulation from undertaking prudent risks to earn rewards for their shareholders. The burden of regulation falls unequally and is especially detrimental for smaller companies. We believe that an extension of the business judgement rule across all of the duties and obligations would be a sensible and logical initiative.

Many of our comments here today and in our submission address the perspective of the larger, listed companies. Our membership is much wider than this. While the larger companies provide corporate governance leadership to the smaller ones, it must be recognised that not all companies have the resources or access to directors with the required experience and independence to satisfy all governance expectations. The widely-respected ASX Principles of Corporate Governance recognise these challenges and provide for reasonably–explained variations.

From the earliest days of the limited liability company, shareholders have appointed directors to manage companies on their behalf and directors have been fully accountable to their shareholders for this delegated authority. The modern world has changed the scale and complexities, but the fundamentals remain as relevant today as then.

Our stable system of corporate and political governance has attracted considerable foreign investment to Australia, representing well over one-third of the Australian financial market. This has contributed to Australia's prosperity over the past ten years and we all have an interest in maintaining that stability so that the confidence of foreign investors continues.

Australia today is confronted by unprecedented challenges driven by the turmoil within the global financial markets. These have revealed inadequacies within the operations and regulation of our own markets, and evidence of the excesses that are inevitably associated with periods of sustained prosperity and growth. We would submit, however, that there is no evidence of systemic failure within our rules and practices of corporate governance. That is not to say that there is no opportunity for incremented improvement, but our systems have served us well, and we are confident that they will continue to do so.

CHAIR—Thank you very much for that. Given that, with all the other witnesses we have heard, we have used the full time, we might just get into some questions, if that is okay.

Mr Story—Yes, without delay.

CHAIR—Thank you very much. Mr Story, your submission is probably slightly different to many of the others we have heard in that, if I divine it correctly, you are not necessarily saying that engagement with shareholders is in itself a problem or that it is not a problem of the companies or directors but perhaps more of a cultural, systematic failure. Perhaps you could describe that to us.

Mr Story—I think all boards are conscious of the need to engage with their bodies of shareholders and they recognise that the bodies of shareholders are made up of diverse groups. They involve the retail shareholders and the institutional shareholders. Tracking through the identity of your institutional shareholders in practice is a challenge. We recognise that need and companies spend an enormous amount of time and effort to promote that engagement. We accept

there is always the opportunity for incremental improvement, but we do not by any means believe that the system is inherently wrong or that there is any systemic problem with it.

Mr McCann —To take up John Story's point, our shareholder base today is extremely diverse. I am sure John is like me—as a chairman of public listed companies I seek to go and see my major shareholders at least once or twice a year. There are some shareholders such as quant funds that tell me not to bother; they do not want to talk to me. So in a couple of registers I have 12 per cent of the shareholders who say: 'I don't want to talk to you. There is nothing you can tell me.' This is because these people invest on a model based theory and they do not want me interfering with that model. I have hedge fund investors who also do not want to talk to me because they are either long-short or special opportunity investors, or something else.

As we point out in our submission, many shareholders do not want to talk to us. A lot of shareholders do want to talk to us and they are the people we want to engage with. In terms of the broader issue, we spend a lot of time in our companies trying to make sure we are communicating effectively. That means writing to shareholders, lodging material on the ASX and putting material on our website. Today, on one of the boards, we have just mailed out a sustainability statement. So we communicate a lot. When Mr Tweed decides to try and rip off my shareholders, I write to the shareholders and say, 'Don't touch him.' In the course of a 12-month cycle there will be a lot of interface with shareholders. I do want to meet them, I want to know what they are thinking and I want their feedback. So that is a continuous process.

Mr Story—Companies as a matter of practice will work with the analysts and give regular briefings to the analysts. We live in a world of continuous disclosure and I think every company takes those obligations pretty seriously. Whatever is to be discussed with the analysts is released on the company's website prior to that discussion. If shareholders are interested and wish to be engaged, there is a huge amount of material available on the websites of the companies which sets out exactly the information that is made available to the analysts and is made available at exactly the same time or shortly prior.

CHAIR—I will take you up on that point but, before I go there, I want to give you some context in terms of my previous question. What has been raised with us in terms of shareholder engagement and participation is the voluminous nature of annual reports. There is too much information or information that is too difficult to read, to interpret or to understand. There are issues around proxy voting system and how that works, vote lending or vote renting and AGM participation, for example. In reality very few people attend AGMs or have a capacity to attend, depending on how the company structures that AGM, where it holds it, how it holds it and so forth, even though it has met all its legal obligations. There is still a fair bit of interpretation or leeway in what the company can do. There are a whole range of issues around that. The context of my question was shareholder engagement and participation. From your perspective, do you see from the membership in your organisation that, yes, they accept that there is a problem with that or that, no, there is no engagement issue and the system, the Corporations Act and so forth, work amply enough to provide all the mechanisms to make sure we have a robust, sound market?

Mr Story—We would acknowledge that it is an important issue and there is always the opportunity for incremental improvement, but within the body of our membership, with 22,000 members spread across the country, is this raised as an issue of serious concern? No, I cannot

honestly say that it is. The directors of listed companies who are involved in our committees, on our councils and on our boards are not coming to us with feedback to say, 'We are getting pressured by shareholders who say they are not sufficiently engaged.'

We honestly do not see it as an issue out there. We are not getting pressure or any expressions of concern on the part of the shareholders or on the part of our members. It is something of concern to the companies because we believe that our shareholders should be engaged. We want to keep them engaged and we want to keep them involved. But is there anything to our knowledge that is suggesting a weakness in the system? No, there is not.

CHAIR—I am sure the rest of the committee will have other questions on that, so I will leave that, but I will go to the disclosure issue that you raised, particularly with analysts and any information. I agree with you that companies meeting their obligations would release that information to the market in a timely, proper manner, but I pose to you the issue of preferential treatment of some information. For example, there might be an invitation-only teleconference to a select group of either institutional investors or other retail investors, depending on the shareholding, where that information is released in a particular forum and perhaps released at the same time through the Australian Stock Exchange to meet all obligations. But, of course, not everyone is going to have access to that immediately. They are not going to know about that information being there. The others have had the preferential treatment in the sense that they have been invited to view the information. So it is not so much about the disclosure—the disclosure is there—but about the timing of the disclosure and the method of disclosure, which then has an impact on engagement. Do you have any views or comments on those sorts of situations?

Mr Story—At the same time as any information is released on the website by the company, it is released to the ASX. On the ASX's website any new release is being flashed up. The brokers are obviously monitoring that. I acknowledge that a retail shareholder could be trading without the benefit of the input of talking to his broker and without taking the trouble to look at the website before he trades online, but really, if he is prudent, before he trades he will be taking the trouble to check what is out there.

CHAIR—Absolutely. That is probably not where my question was going, but I understand that is the case. It is more about trying to understand a bit better the engagement whereby every participant, every shareholder, has equal access and equal engagement. Obviously, if there are two shareholders and one has an invitation to information and there is an almost immediate impact following the release of that information, that shareholder has an advantage, whereas if it is just put up on the website, yes, sure, everyone has access to it—if they know it is there. Many investors may not know it is there. It has been raised with us as an issue and it is certainly something that we are interested in, and it applies not just to the situation I have described but also to other matters within company disclosure law.

Mr Story—All I can say is a shareholder has the means to find that information. It would seem to be prudent, before a shareholder trades, to check the ASX website to see whether there has been a recent release.

CHAIR—I suppose the whole point of this is keeping up with modernity and the way things are being done. While perhaps there is no legal requirement for companies to do certain things, it

might be prudent for them, and also good for their shareholders and the market, to start using technology. For example, if you do have a teleconference, you could broadcast that more widely—in fact, you make it available to all shareholders. You make an announcement through the Stock Exchange that in the following days there will be a teleconference and it will not be limited to invitation-only shareholders. It will actually be open to anybody through a webcast, an MP3 or some other method to have the full engagement.

So really my question is about whether these sorts of issues are coming back through your membership and, if they are not, perhaps that is something they ought to be looking at in terms of full engagement. We have the technology. It is not a complicated matter today to make that information available to everyone at the same time in different formats. I put that to you.

Mr McCann—Mr Chairman, I have two things by way of response: firstly, if you are having a teleconference, it is usual to provide a webcast facility for people who are not participants to listen into the proceedings. You will not be able to interact with questions and answers, but you can certainly be present. Secondly, in my experience, it would be very unusual for a company to be disclosing something that was price sensitive in a teleconference of that kind; if you were about to announce a downgrade or an upgrade or some bad thing that had happened to your company, you would not do it in a teleconference. You would make a—

CHAIR—I was not referring to very sensitive information but perhaps customer relations type teleconferences, information sharing or updates on company performance—things that might not normally be seen as market-moving sensitive information, just general information.

Mr Story—I think it is becoming more and more the general practice that, where an analysts' briefing has gone out on the web to selected locations, that will go up on the website. It will not be immediate. There are a few technological issues here because normally, where they do go to remote locations, you are offering the opportunity for questions. If it goes out as a general webcast then the opportunities result in questions and it becomes technological and more difficult. I think we are heading down that path. I think the principle of it is well accepted—that, whatever information is going out either to the analysts or to the institutions, it should be made available to the broad body of shareholders at the earliest opportunity. That is a fundamental principle and we absolutely accept that principle.

Mr ROBERT—I refer you to your submission. On page 15 of your recommendations, at the third bullet point, you state: 'Companies would like to be offered opportunities by intermediaries to discuss a range of conclusions'—that is, before the intermediary, be they a proxy service or investment banker, decides to dump on you on the market and you would like to be able to correct any anomalies. How do you envisage that occurring? Is that a regulatory issue?

Mr Story—No, I think it is an evolutionary process we are going through. We are seeing the role of the corporate advisory firms increasing and the institutional shareholders are seeking their assistance more. Currently, they are often underresourced. They have a lot more on their plate. Now they have the challenge we all have. They are trying to assess the results of numerous companies in a very short period. Sometimes they are pretty desperate in trying to get these reports out. I do not think they have the physical resources to sit down with each of the companies and review the reports that they are putting out. One of the roles of the AICD is to talk to them, talk to the institution or institutional investors, and work this through. I do not think

the problem is so dire that we need legislation, but I certainly think we need a lot more dialogue and a lot more understanding of our respective positions.

Mr ROBERT—On page 16 of your submission, at the fifth bullet point of your recommendations, you recommend using professional search firms to expand the pool of potential recruits. You then refer to your directors' register and so on. I am led to believe that about 70 per cent of director appointments in the last year or two within the top 300 companies were of directors who are existing members of the top 300 companies, which may indicate that the gene pool is a little small and is being shared with only 30 per cent of new entrants coming through. Is that of concern, considering your recommendation?

Mr Story—The fact that we are getting 30 per cent coming in from outside is what I would regard as a good sign. You want a board that has diversity, you want a majority of people on that board who have had hard directorial experience. It is a job, in a sense, that you really do learn on the job. If you had a board composed of certain people who had never sat on a board of a publicly listed company in their life, I think you would be in a lot of difficulty. I think most companies are conscious of the need to improve the gene pool—but they will do it methodically—to bring new people, new blood and new perspective to a board and are conscious of the need to improve the gene pool by bringing new people in.

Mr ROBERT—So you believe that something like Pareto's law of 80-20 and, in this case, 70-30, is sound?

Ms Conlon—As somebody who has joined fairly recently from the 30 per cent, as opposed to the 70 per cent, of top boards I can say that in my experience one of the things that are really important is the degree and breadth of knowledge that you need, particularly in the top 100 companies. So I think having a group that is highly experienced in operating at both the public company level and the governance level is actually critical to governance. So it would be quite difficult for a board to operate within the whole governance framework without experience. As you add from one board to another board, you bring that experience to the other board. I think the 70-30 split is actually a reasonable split given the need for continuity and experience.

Mr ROBERT—Mr Story, your institute says on page 17, at the second bullet point down, that you support the proposal for electronic voting of proxies. Do you support direct voting—the ability for investors, be they institutional or retail, to directly vote on issues regardless of the medium?

Mr Story—The biggest challenge with proxy voting is getting the proxies in. The people on your register are the custodians. The people on your register are not the people who are actually the owners of the shares. So you have got the custodians, who are the people lodging the votes. The person who votes is the registered shareholder, that being the custodian. The custodian has to go to the fund manager, in turn the fund manager has to go to the institutional shareholder—and he may have a dozen institutional shareholders. The manager has to work out which institutional shareholders he is holding what shares for, and the institutional shareholders might be in, say, Australia or the US. Direct voting would be useful. It is not going to change the world. It probably facilitates the lodging of the vote a little more easily, but the real challenge is the custodian chasing up the fund manager and the fund manager chasing up the institutional shareholder.

Mr ROBERT—You say at the bottom of page 25:

One difficulty for directors seeking to communicate directly with their shareholders is identifying who their major shareholders might be.

You offer a recommendation, saying:

Changes to section 672 of the *Corporations Act 2001* are required to provide more transparency …

What do you recommend those changes actually being? I admire the bold statement that we should make changes. A little more guidance would be helpful.

Mr Story—We were hoping you weren't going to ask that!

Mr ROBERT—I am happy for you to take it away and have a good hard think.

Mr Story—Yes, we will take it away. I think it was a bold statement and I think that is going to be a very difficult issue to grapple with, to be honest.

Mr ROBERT—That would be fabulous, because I always try to get in with an answer myself. In respect of financial reporting—indeed, all reporting for companies under what is currently enshrined in Corporations Law—is there any mandatory statutory reporting currently within the law that you think should not be mandatory? Is there an opportunity here for us to take a burden away from companies?

Mr Story—One of the vexed areas is the remuneration report.

Mr ROBERT—Yes, as everyone keeps telling us.

Mr Story—On the one hand there are people asking for more information but, frankly, on the other hand the more information we provide the more obscure it becomes. Some companies are putting in 25 or 30 pages of remuneration report, and they are not shedding any more light on the issue. I think it would be a good opportunity to start over again with the remuneration report and try to identify exactly what people are seeking.

Mr ROBERT—Does the AICD have a template to which ASIC could give its imprimatur to help with that simplification?

Mr Story—Not at this stage. It is something that we are looking at, because it continues to be a burning issue. It is not right where it is and it is something into which we have an obligation to put more work. Where I would like to see us coming from is identifying what the principles are and not getting o burdened down with the technical detail. The technical detail is being provided because that responds to what the legislation is requiring. In a sense there is a template in the regulation at the present time, and what companies are putting in is following the template of the regulation. But that regulation is not focused on what I think our shareholders are seeking to learn.

Mr ROBERT—I am more than happy to take anything further you might write as to what other areas of mandatory statutory reporting you think should not be mandatory.

Mr McCann—I will add a footnote to John's comments. One of the problems with the remuneration report is that previously remuneration information was distributed between the financial accounts and the body of the remuneration report. We have the right to opt out of putting it in the financial information if we put it in the report, so the result is that you have got pages of information on options, which are historically interesting, I suppose, but really do not help the shareholder understand much about the remuneration policy of the company. I agree with the chair. I think if we had a principles based requirement rather than a black-letter one we would get much more intelligent reporting to the shareholders and to the financial community.

Mr Story—I will expand. One of the big issues—I think the chair raised it earlier—is the actual financial report, the annual report itself, which again is about regulatory compliance with the international financial reporting requirements. Those are dense and obscure at the very best, and we would strongly argue that the picture of a company that is painted as a consequence is not a true reflection of the financial situation of the company. We have set out what we have referred to as a shareholder-friendly report, and that is really a variation to the concise report. It is an evolution of the concise report which is designed to set out the information that we believe company shareholders are looking for, and our reporting committee has spent a lot of time developing a template for the shareholder-friendly report. We could certainly make that available to you.

Mr ROBERT—That would be tremendous.

Mr Story—It is a sort of substitution for the financial report, because that is a statutory requirement, and we are going to have to continue to do it. But what we are looking for is reporting of the underlying sustainability of the company.

Mr ROBERT—I refer to page 18 and the final bullet point in your recommendations, which is to amend the 100-member rule to at least five per cent of the total voting shares to requisition an EGM. One other organisation giving evidence went so far as to say that the 100-member rule could perhaps stay to get a resolution item on an AGM and move to what you are recommending, 5 per cent, to call an EGM. What is your view of that approach?

Mr Story—Our primary concern is in relation to the calling of an EGM, because that is where the expense is. It is a substantial expense, and there are also the time and trouble for shareholders and people lodging proxies. The logistical demands of that are enormous, so that is our primary concern. We would be less concerned with a resolution being included on the notice paper of an AGM. The only caveat I put on that is that of course it has to be a resolution that is in accordance with the business of the meeting. We would be concerned if there were a multitude of frivolous resolutions, which would serve to disrupt the conduct of the business of the meeting.

Mr KEENAN—Your organisation argues, I think very strongly, that Australia has a very sound system of corporate governance. I am just wondering whether you think that any of the more high-profile issues that we have seen reported in the last few months around short selling, margin lending and stock lending have highlighted any regulatory holes within Australia's corporate governance?

Mr Story—I think that what we have seen over the last six months has evidenced issues in relation to the operation of our markets and the supervision of the markets. I think you are seeing some of the excesses that have arisen at the end of a long period of sustained prosperity and growth, but I do not think any of those suggest a systemic weakness in our systems of corporate governance. I do not think what we have seen to date has evidenced failure of corporate governance.

Mr KEENAN—I understand what you are saying about it being very sound, but do you think it makes absolutely no case for any changes at all, even maybe in terms of increased disclosure?

Mr Story—We are moving away from what we regard as corporate governance. But, to get onto short selling, I think the case has been made for disclosure. Where there is stock borrowing and short selling involved, I think disclosure is the appropriate course.

Mr KEENAN—Some people who appeared before the committee earlier suggested that we should be enhancing environmental and social reporting frameworks. I would be interested in any comments you have on that.

Ms Conlon—I think it is important to encourage reporting on sustainability, as we have talked about, but I think it is very difficult at this point to decide exactly what should be reported and how it should be reported. As the whole issue around sustainability and environmental impact is changing and evolving, I think it would be very difficult to regulate. Sustainability reporting is a guideline and a suggested thing to do, but we think it would be very difficult to regulate at this point.

Senator MURRAY—This committee did not recommend in its last report on this matter that such matters be legislated. The committee, in fact, left it to the business community to develop. So that is the position of this committee as at last year.

Ms Conlon—We would argue that we would agree with that position, and that is something that is evolving and being developed by the business community.

Mr McCann—To follow on from that point, the ASX Corporate Governance Council had a very lively debate on whether they should intervene and have an 'if not, why not' regime. The view was eventually taken that this it is evolving and that we should give it another couple of years to see how sustainability reports evolve and how the corporate social responsibility reports evolve. There is certainly no doubt that companies in the resource fields or that have a large environmental footprint are issuing reports. I think that for other companies, which have a lighter involvement in the environment, to have a mandatory requirement at this stage would be unhelpful. Let us have a look in two years time. But I think this is a case where the corporate community, where it has got a heavy footprint, believes that it should be reporting to its shareholders and to the community at large. So I think we are all in agreement that, at this point in time, mandatory requirements would not be helpful. I think it is better to let the market develop.

Mr KEENAN—Everyone is in furious agreement about that. I do not think anyone advocated that it be mandatory. I was interested in the viewpoint you would have.

Mr Story—I would suggest that you are seeing good reporting coming forth. There are companies which are regarded as leaders in this, and I think that their colleagues are reading those reports and are learning from them. I think you will see an incremental improvement, but every company has a different profile and they are all grappling with this in different ways.

Mr KEENAN—Do you think it would be useful for the government to step in and try and establish some standardised reporting? Do you think that would actually be helpful to the private sector or not?

Mr Story—I do not think it would at this stage. If, in a couple of years, the corporate community has not risen to the challenge then a heavier hand may be required.

Mr KEENAN—I did not mean that the government should mandate it but just that it might suggest that this might be a sensible way of doing it. It has been suggested to us that that would actually be useful to the private sector.

Mr Story—I think you have seen the guidance emerging from those companies who are doing it well. Some are doing it as an opportunity for PR spin or 'greenwash', as the term is used, but there are other companies which are reporting on a substantive basis, and I think those companies are recognised in the marketplace. I think people will aspire to follow the path they are taking.

Mr Story—We would really prefer that, if there were going to be some guidelines, they come from the ASX Corporate Governance Council. That council felt it would be premature to recommend that every company have a CSR report or a sustainability report, but they are going to revisit the issue in two years time, after we have got a body of experience.

Mr KEENAN—Thank you for that. Thank you for your very comprehensive submission too.

Senator MURRAY—I will start by endorsing the last remark by Mr Keenan. This is the 12th year I have sat on this committee, and the AICD have consistently provided very thoughtful, detailed and well-considered submissions, which have been of great assistance. Of course, I have not agreed with them all, but that is my job! This is another such submission, so thank you very much.

Mr Story—Jennifer Stafford, who is sitting at the back, is primarily responsible for drawing together our diverse views.

Senator MURRAY—Thank you. I want to talk about this issue of the non-binding vote on remuneration. Frankly, I think there are two separate issues. There are remuneration packages for executives—and they might also happen to be directors—and there are remuneration packages for directors. My own opinion is that director remuneration packages, as opposed to executive remuneration packages, require more shareholder determination and executive remuneration packages are properly the province of the board. However, there is an issue as to whether the non-binding vote is ignored or discarded by the company—and there have been a couple of instances of that. What view do you think policymakers such as us, legislators, should take of circumstances where large companies such as Telstra think it is in order to disregard a non-

binding remuneration vote which is contrary to the resolution put forward by shareholders? Mr Story, you know why I am asking that question, don't you!

Mr Story—Are you coming to Telstra? I have personal experience of this.

Senator MURRAY—Exactly—and I was aware of that. But it does throw up an issue. The assumption of legislators would be that a strong indication of opposition from a substantial number of shareholders—I do not mean a 50.1 per cent to 49.9 per cent indication—would cause boards to pause as to their view on the resolution they put forward. But the fact is that we have now seen a couple of circumstances where boards have not taken heed of the shareholders' view. What lesson should we draw from that, if any?

Mr Story—Telstra is a relatively isolated instance. Telstra have taken the very strong view that the remuneration policy they have set forth is the right policy for this company in these circumstances. They have heard the outcome of the vote but they have said, 'We maintain the position that we hold.' At that stage it is really a question for those shareholders who have voted against the remuneration report to ask: 'Are we still prepared to rely upon that board or do we treat this issue so seriously that we should remove the board?' It is open to shareholders to take that step to remove the board. The Telstra board is quite properly saying: 'We've heard all your views and we've taken all those considerations into account but we are the people who are responsible for running the company and, having thought it through conscientiously, we believe it is the right policy. As long as we are the board, this is the policy we will follow, and therefore you the shareholders should make a decision as to whether you want us and that policy or want to remove us.' That, I think, is a robust system.

Senator MURRAY—You then move to a situation where the shareholders concerned might want to look at the possibility of removing part or all of the board. For instance, they might want to remove the chair of the remuneration committee because he or she was responsible for putting up the proposition. Is that easy enough to do, or possible, under the company constitution rules? For instance, if there is a no-vacancy declaration, is it made harder if there are difficulties in getting nominations put up? In some companies, as you know, that is more difficult than in others. Is that an issue?

If your line of thinking is right—and I am attracted to it, because as long as you have a non-binding vote; that is the logic, isn't it?—then the question is: is it feasible for shareholders who are opposed to an issue to do that? I for one think that getting rid of an entire board is an extremely dangerous thing to do. You can pick off the odd director, but to knock off a whole board is, I think—

Mr Story—But it would certainly be open at the next annual general meeting to seek the removal of the chairman of the remuneration committee or the chairman of the board, or whatever you thought was appropriate. There are ways to send a fairly firm message, if you are so minded. Having said that, I think that the Telstra case is a fairly rare example, and I do have a personal experience of it. In that instance, we acknowledged to the market that we had taken a decision in particular circumstances that, in hindsight, we thought we probably should not have taken. The criticism we had was not in relation to the quantum or the outcome but in relation to the action we had taken to achieve a particular objective. It was taken in the context of a major acquisition and we were seeking to bring about an orderly merger. But the market considered

that the steps we had taken were inappropriate, and we had a 40 per cent vote against the remuneration report. We certainly acknowledged to the market and to our AGM that we had heard that message loud and clear, and to my mind it was probably a pretty effective instance of the non-binding vote serving its purpose.

Senator MURRAY—Thank you for the frankness and straightforwardness of your response. Moving on to page 42 of your submission, I will just read out some of what is there for the audience and the *Hansard*:

- AICD supports the use of polls and direct voting …
- Chairmen should be required to vote in accordance with the wishes of the shareholder who gives them a proxy …
- Shareholders are entitled to have confidence in the processing of their proxy voting recommendations …
- AICD supports the use of technology-enabled processes …

My brief summation of many of the submissions to us and witnesses' evidence is that the voting process—as a generalisation, not with respect to every company—is not quite what it could be and that they wish there were better processes for direct voting and electronic voting, for the retention of proxy votes and the proper direction of proxy votes; and an ability to recount votes and some system of dispute resolution if the proxy votes or any other votes are deemed to have been lost, not properly recorded or whatever. That is my summation of a number of propositions, and propositions have been put to us as ways to rectify this.

Could I ask your executive, the person who wrote this, if you would not mind going away and having a look at what people have said both on the *Hansard* record and in their submissions and perhaps come back to us with a view—because these are principles—as to precise mechanisms to address those sorts of issues, if you think they are valid. Obviously, if you do not think they are valid, do not do so.

Mr Story—I appreciate that what we have suggested there is in general terms, and we will endeavour to refine those to come up with something more specific. Having said that, I still believe that where our difficulties in relation to voting often arise is in their passage between the institutional shareholders, the proxy shareholders, and—

Senator MURRAY—Yes, I heard that.

Mr Story—That is where things are getting lost.

Senator MURRAY—I am looking at whether there are some mechanisms which could smooth that, either through ASIC practice notes or through minor tweaks in the regulations, or whatever.

Mr Story—We will see what we can come back with.

CHAIR—Thank you very much Mr Story, Mr McCann and Ms Conlon. I thank you for your submission and your opening statement, which, I can assure you, will be fully incorporated into the *Hansard*. Given that we went slightly over, I am sure that, if we had more time, we could have kept discussing some issues. But thank you very much for your time today.

[3.51 pm]

MATHESON, Mr Ian, Chief Executive Officer, Australasian Investor Relations Association

CHAIR—Mr Matheson, thank you for appearing before the committee. I invite you to make any opening remarks that you wish to make before we move to questions.

Mr Matheson—Yes, if I may make a few introductory comments. Firstly, for those of you who may not be aware of who the Australasian Investor Relations Association are, we have been around since 2001. We are a national not-for-profit organisation, representing listed companies and advisers to listed companies, and we advocate best practice in investor relations by listed entities to thereby improve the relationship between listed entities and the investment community. We have about 110 corporate members representing, at last count, about two-thirds of the total market capitalisation on ASX. It is important to recognise that our members range from the largest companies in the top 10 right down to very small companies by market capitalisation as well.

Key points in our submission are: firstly, we believe it is important to consider the impediments to companies' ability to engage with shareholders, as well as shareholders' ability to engage with companies. Secondly, we believe in equity, and part of that is the lack of transparency around some holders of securities which the company is not in a position to actually discover, and that is brought out in our submission. One overview comment we would also like to make is that we think there is no such thing as corporate democracy. Corporations are not democracies—they are plutocracies—and, while some of the principles that apply in the political domain apply to corporations, they are two fundamentally different precepts.

I will make a couple of additional points. In more recent issues as well we believe it would be useful for there to be a disclosure policy by superannuation funds and unit trusts on stock lending. Secondly, it would be useful to have disclosure of short selling and for the Corporations Act to be amended to include covered short selling as part of that definition. Thirdly, we believe it would be useful for there to be disclosure of stock lending by the Stock Exchange itself through the clearing and settlement mechanism CHESS, which is the case, we understand, in the UK through the CREST clearing and settlement system.

I have a few points on AGMs and general disclosure of information which have come up in the last few days. That is the advantage of being last at the hearing. Over the last two days I have had the advantage of also hearing the areas of interest of the committee. AIRA is working on some guidelines on electronic communications between listed entities and shareholders, which we think actually address a number of issues that have been brought up during the course of the last two days as they relate to simultaneous communication with investors, large and small, whether invited to presentations or not.

It is our understanding from some of our service provider members that there are approximately 350 companies that employ webcasting services, for example, for their results presentations and annual general meetings. I think it should also be borne in mind that there are only about 50 listed companies in Australia with greater than 50,000 shareholders. So the need

for mass marketing, if you like, is really clustered around the top 200 to 300 companies, and arguably even then they would be talking to some fairly small shareholder bases.

I would certainly reject the assertion made yesterday that there is selective disclosure of information going on at briefings held by companies. As the committee would be well aware, listed entities are required under the continuous disclosure rules to disclose any new material information to the market ahead of that being disclosed at a briefing. I can assure you from a member's point of view that that is complied with and everyone is very aware of directors' and officers' responsibilities and the penalties that apply.

In relation to annual general meetings, we certainly support the IFSA proposals for the greater use of electronic lodgement of proxies. I think it is important to also acknowledge that the infrastructure is already there. If there are any shortcomings in the system at the moment, in our view direct voting is not the silver bullet in this equation. Electronic voting, if it were offered by all or a majority of listed companies—certainly those larger companies that have large shareholder bases and institutional investors—would certainly be helpful. I think some of the recommendations that have been made in the IFSA submission, including requesting ASIC to issue some sort of no-action letter, would be very helpful.

Finally, I will make one comment about engagement by companies with shareholders. As the representatives from the AICD alluded to, there are different layers or levels of company owners, but as far as superannuation funds are concerned—they are, if you like, the largest beneficial holders of shares in this country—the reality is that individual large superannuation funds do not want to engage with companies directly. Companies find it very difficult to actually engage directly with their major beneficial shareholders in the case of superannuation funds. To be fair, the reason given for why they do not want to engage directly with companies is purely a resourcing issue. I think that is something that needs to be borne in mind if you are going through a health check of shareholder engagement and participation. There are many superannuation funds in this country, but most are not terribly large, and even the largest industry superannuation funds, for example, are not set up themselves to engage directly with companies. Hence they go through bodies like ACSI, the Australian Council of Super Investors.

CHAIR—Thank you very much. I note with interest you said that there were only about 50 companies that had more than 50,000 unique shareholders. To put that into terms that we understand, as lower house members we each have a constituency of about 90,000 individual electors. That puts it in some sort of context, something that we understand. It is not a foreign figure to us.

I am very much interested in the effect of the non-binding remuneration vote and the impact it has had on companies—on their willingness to engage or to use that non-binding vote as some sort of a measure or tool for engaging with their shareholders. I am wondering if you have any particular view of or information in relation to that.

Mr Matheson—In keeping with the general growth in the investor relations function in Australia, which is a phenomenon that as occurred around the world, as institutional ownership has grown, the demands for access to management of listed companies by institutional investors has grown both here and abroad, and companies have had to tool up and allocate more resources internally to how they go about engaging with different types of shareholders. I am sure you will

appreciate that, within the institutional investor community globally, as Mr Story from the AICD alluded to previously, there is every shade and complexion investor under the sun now within the global funds management industry. I could not tell you how big it is today, but there would be approximately $20 trillion of funds under management—a good deal of which is actually invested in Australia. It has often been said to me in the past that Australia has one of the highest levels of foreign portfolio investment in our companies than any other OECD economy. That has historically been a function of the size of the resources industry in Australia. So when a portfolio fund manager wants to get exposure to Australia historically, they would buy BHP or Rio Tinto.

CHAIR—In your view, is there a problem with shareholder engagement—the way they engage with companies? If there is, is it more an issue of culture and history than of the Corporations Act or law or regulation?

Mr Matheson—I noted one of the previous witness's comments about culture, and I would suggest that it is a function of the ownership structure of the company. I am sure you would all appreciate that, of the listed spectrum of companies listed on the ASX—of which there are approximately 2,200—probably 300 have some level of institutional ownership and some level of stockbroker research coverage. Beyond that, there is very little, if any, institutional ownership and there is no broker research. The demands and the disciplines imposed on a lot of those smaller micro-cap companies are much less. Typically, in a lot of those smaller companies, you might have a founding shareholder who is the managing director who still might retain a substantial shareholding in the company. Sadly, from my observations, as those companies grow—as they all want to grow—it takes some form of crisis as a listed company to make that sort of transition from treating themselves essentially as a family company or a private company to being a listed public company with all the disciplines that go with that. It often takes some sort of crisis—be it a profit warning or some other exogenous factor beyond the company's control—that inevitably leads to their share price taking a significant downturn, for them to realise that their relationship with the investors is something that they need to devote more resources to.

CHAIR—Is this a problem that we can examine more closely in terms of Corporations Law, or is this more an evolutionary problem, as you have just described, and—again, to use the same word—more cultural?

Mr Matheson—I think it is an evolutionary thing. It is cultural to the extent that it is cultural in those companies where you might have a dominant founding shareholder who is still the managing director and who thinks that minority shareholders have a lesser role to play than he or she. At that sort of level you are really talking about very small companies with very small shareholder bases, and those shareholders might be friends and family of that same founding managing director.

CHAIR—Just to move away from that topic, I would draw your attention to dot point 2 in your submission regarding section 672 of the Corporations Act about the derivative instruments such as equity swaps, contracts for difference and so on not being captured by the beneficial ownership tracing provisions. Could you provide us with a bit more insight into (a) how that works and (b) the impact and effect that it has on shareholders, on the market and on decision making?

Mr Matheson—First of all can I say that we were delighted to hear the Prime Minister in London, Friday week ago I think, saying that the government intends to take a leadership role in this area and progress the disclosure of equity derivatives, because it is something that we have been talking to regulators and Treasury about for about 18 months. I know it is an issue from talking to our sister organisations in other jurisdictions which have smaller disclosure regimes than we do. It is a massive problem as the derivatives market has grown globally. Just to explain the section 672 beneficial ownership tracing process, if I could take the liberty of going back about 14 years to a previous life—

CHAIR—As long as you do not give us the full history year-by-year account!

Mr Matheson—I will be quick! Following the inception of the compulsory superannuation system, as superannuation grew, one of the unintended consequences of compulsory superannuation is that super funds are required to use a custodian for safekeeping and registration purposes. So the custodian, be it JP Morgan nominees or NAB Custodian Services, becomes the registered shareholder and therefore the legal owner of shares. Companies were starting to see, in the early or mid-nineties, superannuation funds starting to grow and that was being manifested through larger shareholdings of the bank nominees appearing on their share register. There was this complete disconnect between nominee holders and the actual institutional investors, fund managers, who would come into see them. They would have a business card for some funds management company and then they would try to reconcile that with their share register and there was no marry-up. Then it became clear that there was this provision, which I and a few others discovered, available in many Commonwealth countries, modelled on the UK Companies Act, that enabled listed entities issuers to trace beneficial ownership of their shares by lodging a tracing notice to the registered holder, who was in turn required to disclose anyone that had a relevant interest in shares.

To cut a very long story short, a process was established whereby, in my understanding, probably 400 listed companies employed an agent to conduct on a regular or periodic basis those types of beneficial ownership tracing purposes. The advantage of having that information is that the company knows who is actually buying and selling shares on a daily basis. The shortcoming of section 672 and the definition of relevant interest is that it only extends to ordinary shares; it does not extend to derivatives or debt. Hence, given the growth of the derivatives market and the growth of corporate debt programs, we think it is part of good communication and good engagement with shareholders at all levels to be able to have a line of sight, if you like, of who holds these shares or other instruments and who is trading in them as well.

Mr ROBERT—What are the major types of derivative instruments that are actually being used? Is it mostly options?

Mr Matheson—It is a combination. As we said in the submission, it is options, futures, contracts for difference and equity swaps. Contracts for difference are a larger part of the UK market than they are here. As you may be aware, the ASX introduced exchange traded CFDs toward the end of last year, but CFDs are largely an over-the-counter product. The most popular derivative products are futures, options, instalments, CFDs and equity swaps.

Mr ROBERT—Currently, on the beneficial ownership tracing provisions, is the tracing provision only for if a substantial amount of share is held or can it be any number?

Mr Matheson—Any number.

Mr ROBERT—What do fund managers normally track? For example, if there were—and there are—a lot of hopeful investors using a range of derivative products to make money on a rising or falling market, generally what size holding would tracing provisions be used against?

Mr Matheson—In a typical analysis of a company's share register it varies from company to company. Typically, we used to take the approach of once you started to see individuals' names starting to appear on the share register, again recognising that those are the registered shareholders, who may be interposed entities—be they trustee companies or, normally, bank custodians—as opposed to individuals. Companies are not terribly interested in individuals, except if it is a large shareholding, and they certainly would not serve a notice on an individual, because they are apparent.

Mr ROBERT—But if it is one per cent?

Mr Matheson—That is probably a reasonable rule of thumb.

Mr ROBERT—Is the only change you are looking for in 672 to capture the non-ordinary shares? I note that the Australian Institute of Company Directors are saying that one difficulty is identifying shareholders and that there needs to be changes to section 672. They were a little coy about recommending what changes. You have stated you want to see derivative instruments, or all other non-ordinary shares, caught up in that tracing provision ownership. Is that the only change you are looking for under that section?

Mr Matheson—With the clarification that it is all equity derivative instruments but also debt instruments as well.

Senator MURRAY—On the same topic of tracing, is a tracing notice able to pick up when shares have been lent?

Mr Matheson—It is a very good question. The answer is: invariably no, it does not. It depends on the bank custodian that has responded to a tracing request. Some custodians identify the fact that a particular chunk of shares have been lent out to a particular client by having a little negative symbol alongside the holding, but it is my understanding that typically most custodians do not lend. They have a sort of pooled account that they lend into and out of, as opposed to particular client holdings. To answer your question: there is no visibility arising out of this beneficial ownership tracing process as to who has lent their stock out and, conversely, who has borrowed it.

Senator MURRAY—I do not know if either this committee or the government itself might recommend changes to the practice of lending shares. Do you think this committee should consider your recommendation for beneficial ownership tracing provisions to also apply in some way to shares that are lent?

Mr Matheson—I certainly think consideration should be given to that, but at the very least, as I have said in my remarks today, we think that every fund manager of every superannuation fund

should have on their website, and disclose in their materials and PDSs et cetera, the policy on lending stock. At least then an investor knows what the position is.

Senator MURRAY—As you would know from the interaction that has been going on over the last two days, providing there is informed consent plus disclosure I am less concerned about share lending for profit-making purposes in the market—although I appreciate the share price consequences of that—than I am about share lending for voting purposes, which, particularly in circumstances which result in ownership votes—mergers, acquisitions and those sorts of things—could be tricky. Does your association have a view as to whether lending shares for voting purposes should be prohibited?

Mr Matheson—We are certainly opposed to the lending of shares for vote-renting purposes. Again, keeping with the comments by Mr Story from AICD, it is increasingly difficult for companies to get a handle on who has voting authority. I have said, in addressing questions earlier about beneficial ownership tracing, that just gives you an angle on who has a relevant interest. That does not necessarily mean that that tells you who has voting authority. There are many permutations of all of that as well. Some fund managers may have voting authority on some of the shares that they hold in a company. With other shares, the client—in the case of my example, a superannuation fund client—may actually retain voting rights. So it is difficult enough to get a clear enough picture of who actually holds voting rights, retains them and exercises them without any added complication of some of those shares being lent out to a third party who is not even disclosed through this beneficial ownership tracing process.

Senator MURRAY—I am unashamedly opposed to the practice of lending shares for voting. I personally would support its prohibition, and I intend to argue that case. However, to argue that case I need support. You have indicated that you do not like the practice, but you have not gone so far as to confirm that it should be prohibited in law. I would like to ask you not to answer that question straightaway—because you probably need to consult with colleagues—but, if you have the view that it should be prohibited as a result of discussions with your organisation, I would be grateful if you could convey that to the committee.

Mr Matheson—Sure.

Senator MURRAY—I want to deal with another aspect which has been covered in the last two days of hearings. That is this general proposition: the committee—rightly, I gather from the questions and the witnesses who have come forward—are of the view that the Corporations Law does not prohibit—indeed, it intends to facilitate—better voting practices and that it does not prevent direct voting, electronic voting, the retention of proxy votes, better counting mechanisms, dispute resolution mechanisms et cetera. And yet there is corporate inertia, if you like, in this area. Do you think there are any mechanisms, outside law change or regulation change, which could enhance quicker take-up of more modern and facilitative voting practices?

Mr Matheson—I would only draw your attention to the IFSA submission working party recommendations, which include the recommendation that ASIC issue a no-action letter which would then give corporations and companies certainty that, if they were to offer electronic lodgement even if their constitution did not provide for it, neither ASIC nor anyone else would take any action. I think that would go a long way towards relieving issuers of any concern that

they might have that they were breaching their own constitutions and might suffer some consequence.

Senator MURRAY—That is a practical suggestion and I would support it. What about an 'if not, why not' approach once that is done?

Mr Matheson—I think using technology is a fundamental shareholder right. I am not necessarily convinced it lends itself to an 'if not, why not' approach. The technology is available now to facilitate it, but there are a couple of minor issues in the overall scheme of things and, if they were fixed, I think there would be a much higher adoption rate. If a member brought this up as an issue, a lot of companies would say: 'Thanks for telling us. We didn't realise you actually wanted us to offer this.' It is a bit like asking: should you have 'if not, why not' if the company does not offer lodgement by fax or does not offer lodgement by mail? This is not a behavioural type thing whereby it is appropriate for some companies but not for others; it is a mechanism for lodgement which is not expensive. The registrars charge a fee to offer and process electronic instructions. But once these issues have been dealt with—that is, the no-action letter from ASIC—and the registrars are able to accept split votes from custodians and there is a general awareness among the larger companies that institutions actually want to be able to vote like this, it will become another straight through processing scenario, which should make sense for everyone.

CHAIR—Thank you very much. We appreciate the time you have taken to give your opening remarks and evidence to the committee. I thank Hansard, the committee members and all the witnesses today.

Senator MURRAY—Particularly the travelling Western Australians.

CHAIR—Yes, as always.

Committee adjourned at 4.22 pm