Parliamentary Joint Committee on Corporations and Financial Services

Better shareholders – Better company

Shareholder engagement and participation in Australia

June 2008

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

Terms of Reference

The Committee is to inquire 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.

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Chapter One - Introduction

Background

1.1 On 30 June 2006 the committee resolved to inquire into the engagement and participation of shareholders in the corporate governance of the companies in which they are part-owners. The committee agreed to examine the following terms of reference:

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.

Conduct of the inquiry

1.2 The inquiry was advertised in the *Australian* newspaper on 11 July, 27 July, 8 August, 22 August and 5 September 2007. The government also invited written submissions from a range of industry stakeholders, academics and government departments and agencies. Details of the inquiry were placed on the committee's website.

1.3 A total of 45 submissions were received and a list of them is included in Appendix 1.

1.4 The committee held two public hearings; in Canberra on 15 April 2008 and Sydney on 16 April 2008. A list of the witnesses who appeared at the hearings is included in Appendix 2 and copies of the Hansard transcripts are available on the internet at: www.aph.gov.au/senate/committee/corporations_ctte/sharehold/index.htm.
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Report structure

1.5 Chapter Two outlines Australia's current regulatory framework for corporate governance, the role of shareholders in ensuring good corporate governance, the importance of effective communication between company boards and shareholders and the voting mechanisms through which shareholders enforce the accountability of company boards. The final section of the chapter canvasses the opinion of contributors to the inquiry on the most appropriate way to approach shareholder engagement reform.

1.6 Chapter Three examines possible improvements to the flow of information and dialogue between companies and shareholders, with attention also given to the disclosure of stock lending and margin lending activities; as well as examining issues specific to the separate institutional and retail investor groups.

1.7 Chapter Four assesses issues raised with the committee pertaining to the efficacy and integrity of different absentee voting mechanisms and the ability of shareholders to express their views effectively through the voting process.

Chapter Two – Background on corporate governance

2.1 This chapter outlines Australia's corporate governance framework and its relevance to shareholder engagement, based on the delegated authority model in which company directors make decisions in the company's interest, subject to shareholder oversight. As background for the following two chapters, the committee describes the importance of effective channels of communication between companies and their shareholders, as well as efficient and transparent voting mechanisms to enable shareholders to enforce board accountability. Finally, the committee notes inquiry participants' preference for a non-regulatory approach to improving shareholder engagement in Australia.

Corporate governance model

2.2 The participation and engagement of shareholders in the companies in which they invest occurs within the parameters of the delegated authority model of corporate governance. This operates on the basis that company directors are responsible for overseeing the direction and management of the company, which they have a fiduciary duty to undertake in the best interests of the company in accordance with section 181 of the Corporations Act 2001 (Corporations Act). Although the Corporations Act provides for shareholders to engage in direct decision-making in limited circumstances, such as amending the company constitution (section 136) or reducing share capital (section 256C), this control over setting the direction and overseeing management of the company rests with the Chairman and the board and implemented by company management under the guidance of the Chief Executive.

2.3 In discharging their duties, directors are held accountable for their decisions by shareholders with the legal entitlement to remove and appoint directors under section 203D of the Corporations Act. This governance model recognises that management by shareholders would be impractical, but ensures that those responsible for the company's performance and direction are accountable to the owners of the company for the decisions they make on their behalf.

2.4 The Institute of Chartered Accountants described the accountability of the board as the mechanism for offsetting the concentration of decision-making control they possess.[1] Similarly, the Australian Institute of Company Directors (AICD) told the committee that this corporate governance model struck an appropriate balance between control and accountability:

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1 Institute of Chartered Accountants, *Submission 7*, p. 2.

> …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.[2]

2.5 They also advised that it best manages the conflicts associated with a diverse mix of shareholders with both long- and short-term imperatives.[3]

2.6 ASX Limited commented that this framework provides good value to companies and shareholders via improved corporate governance:

> Shareholder involvement in corporate governance primarily consists of monitoring the performance of the board of directors and the company as a whole. The agency costs associated with this model, such as continuous disclosure compliance and other forms of shareholder monitoring and company communication, are outweighed by the efficiencies which flow from this model.[4]

Shareholder engagement and effective governance

2.7 The critical nexus between these decision-making and accountability functions is engagement between shareholders and the company board that is informed, meaningful and effective. Evidence received by the committee suggested that participation and engagement with company boards is an important means by which shareholders are able to improve the value of their share ownership and minimise risk.[5] Treasury submitted that ineffectual shareholder engagement brought increased investment risk:

> Shareholders must retain effective mechanisms to examine the affairs of the company and voice concerns to the company and its managers. Shareholder participation is vital in ensuring accountability of the company's board and management. Without effective monitoring of directors and management by shareholders, there is an increased risk of directors and managers underperforming.[6]

2.8 To provide an example of its benefits, Australasian Investor Relations Association cited a recent US survey of fund managers claiming that a potential ten per cent share price premium could be attached to companies with 'superb' investor relations.[7]

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2 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 56.

3 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 56.

4 ASX Limited, *Submission 14*, p. 2.

5 ASFA, *Submission 2*, p. 2; Regnan Governance Research, *Submission 22*, p. 2; Chartered Secretaries Australia, *Submission 8*, p. 3.

6 Treasury, *Submission 17*, p. 4.

7 Australasian Investor Relations Association, *Submission 12*, p. 1.

2.9 Shareholder engagement and participation that contributes to good corporate governance has two main features:

1. Shareholders being well informed about the companies in which they invest through effective communication; that is, transparent reporting of company information and meaningful dialogue between shareholders and company boards; and

2. Shareholders being able to perform their accountability role by exercising their voting entitlements effectively.

2.10 These elements of shareholder engagement are summarised below and the issues raised during the inquiry that relate to them are examined in further detail in chapters three and four respectively.

Communication between shareholders and company boards

2.11 Access to relevant information and the opportunity to engage directly with the board on matters of corporate governance are critical to enabling shareholders to exercise their accountability in a way that benefits the company. The various methods, both mandatory and voluntary, that companies use for communicating information to shareholders include:

- Mandatory company reporting as stipulated by the provisions contained in Chapter 2M of the Corporations Act;
- Regular disclosure of information that might have a material effect on the share price as mandated by ASX Listing Rule 3.1;
- Reporting performance at company meetings, which must be conducted in accordance with the provisions contained in Chapter 2G of the Corporations Act;
- Informal briefings to investors, usually major institutional shareholders.

2.12 In its submission, Treasury outlined the importance of shareholders being able to make an informed assessment of the companies they invest in:

> A key objective of Australia's financial reporting framework is to provide existing and potential shareholders, as well as a range of other stakeholders, with full and reliable information about a company. These disclosures enable users to make informed investment decisions, actively participate at AGMs, influence management and hold it accountable for the company's operations. The financial reporting framework therefore provides an important platform to enable shareholders to participate and engage with a company.[8]

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8 Treasury, *Submission 17*, p. 8.

2.13 An important consideration during the inquiry was the need for companies to tailor, and shareholders demand, methods of communication that best suited the requirements of diverse classes of investors. In particular, there is a clear distinction between the type of communication with company boards that is suitable to large, well resourced institutional investors, and the most appropriate way for companies to engage with individual retail investors. The next chapter, Chapter Three, addresses the problems associated with communication between companies and shareholders in the context of these two separate investor classes.

2.14 What ought to be noted here, though, is the increasing significance of institutional investors that has occurred in recent times. According to the ASX, institutional shareholders comprise a growing segment of the equities market, largely due to the increasing value of superannuation funds under management. Their submission stated that, from June 1988 to March 2007, institutional investment rose from 23.1 per cent to 40.4 per cent of total investments. They added that 'a significant proportion' of the 32.5 per cent of securities held by investors outside Australia (in March 2007) would be institutional investment. During the same period household (retail) investment declined from 36.1 per cent to 23.7 per cent as a proportion of total investment in the Australian stock market.[9]

2.15 Treasury also commented on the 'de-retailisation' trend, emphasising the need for the corporate governance framework to be flexible enough to adapt to the 'differing requirements of different types of shareholders and their relative prominence in the market at any one time'.[10]

Accountability through shareholder voting

2.16 The voting rights attached to share ownership provide investors with an important mechanism by which to maintain the accountability of a company board. The principal regulatory provisions that apply to voting on company resolutions, including the election of directors, are contained in Part 2G.2 and part 2D.3 of the Corporations Act. The ASX Listing Rules, which are enforceable under sections 793C and 1101B of the Corporations Act, also regulate company voting procedures. ASX Listing Rule 14.2 sets out the requirement for companies to provide for proxy voting. The Listing Rules also establish the process for electing company directors. The relevant provisions are as follows:

- Listing Rule 14.3 stipulates the time frames within which director nominations must be accepted (35 business days, subject to the company constitution);
- Listing Rule 14.4 limits tenure of directors to three years (after which time they must be re-elected); and

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9 ASX Limited, *Submission 14*, p. 4.

10 Mr Matthew Brine, Treasury, *Committee Hansard*, Canberra, 15 April 2008, pp. 70-71.

- Listing Rule 14.5 requires director elections to be held annually.[11]

2.17 Chapter Four reviews evidence to the committee on problems associated with the mechanisms used to lodge and record votes and the capacity of shareholders to exercise their vote effectively.

Preferred approach to reform

2.18 As described by the committee intermittently in the following chapters, the basis for any deficiencies in the participation and engagement of shareholders on corporate governance matters is frequently company or shareholder inertia or apathy, or companies' cultural resistance to acknowledging the views of investors. In other words, investors and companies are not always choosing best practice currently permitted by the current regulatory framework, rather than being hampered by it, or being permitted to abuse an overly relaxed system to the detriment of shareholders. Consequently, the majority of contributors suggested that additional regulation may not be effective or warranted in facilitating engagement.

2.19 Although the committee received a number of recommendations on regulatory means to improve shareholder engagement, contributors did not mostly express the opinion that the current regulatory framework for corporate governance was fundamentally responsible for obstructing engagement between shareholders and companies. For example, AICD said: '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'.[12] They added that, from their experience, shareholders are not expressing concern that they are insufficiently engaged.[13] The Law Council of Australia submitted that the current system allowed sufficient shareholder participation and did not require legislative or regulatory change.[14]

2.20 Chartered Secretaries Australia (CSA) noted the importance of maintaining a balance between engagement with shareholders and the efficient management of companies. They asserted that there are:

> …areas where further discussion and communication by relevant parties could engender improvements, but we stress that any additional regulation at this point is more likely to create regulatory and administrative burdens on companies than facilitate the effective engagement of shareholders.[15]

11 ASX Limited, *Submission 14*, p. 5.

12 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 58.

13 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, pp. 58-59.

14 Law Council of Australia, *Submission 21*, p. 1.

15 Chartered Secretaries Australia, *Submission 8*, p. 3.

2.21 The Institute of Chartered Accountants concurred, stating that shortcomings in company governance 'are best overcome by proactive voluntary corporate governance action rather than prescriptive regulation'.[16] CSA contended that black-letter-law approaches tended to produce 'the wrong outcomes'.[17] The Business Council of Australia maintained that 'flexibility' within the regulatory framework best facilitated engagement.[18] Regnan commented that regulatory change must be preceded by investor demand:

> …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.[19]

2.22 ASX Limited stated that any further regulatory diversion from the delegated authority model would be unwarranted:

> Starting … from the basis that the current governance framework works well, and contributes to market efficiency, any exception to the default position that shareholders appoint directors as their agents to act on their behalf needs to be supported by an identifiable and justifiable principle. An example of such a principle is regulation providing for a direct shareholder vote in circumstances where a conflict of interest between shareholders and directors cannot be managed by any other means. In our view, current regulations give adequate effect to this principle.[20]

Committee view

2.23 Shareholders own their companies, so engagement with company boards is their right, but there is a benefit beyond the exercising of that right. Shareholder engagement through dialogue, disclosure and voting ensures the accountability of company boards and management, providing an important check on their power that serves to improve corporate governance standards. This works in much the same way as the central tenets of democracy improve the standards of political governance via the accountability of elected representatives. In the political sphere this occurs through best practice elections, checks and balances on institutional power, selection on merit and transparency. Maintaining political accountability includes equally vital institutional and participatory elements; the right structures need to be in place to enable democratic participation to be as effective as possible. Similarly, the willingness and capacity of shareholders to engage, question, form opinions and vote

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16 Institute of Chartered Accountants, *Submission 7*, p. 5.

17 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 4.

18 Business Council of Australia, *Submission 29*, p. 2.

19 Mr Nathan Fabian, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p. 51.

20 ASX Limited, *Submission 14*, p. 2.

on company matters is essential to bringing these democratic principles to bear in the corporate realm.

2.24 However, the notion that those granted responsibility for running publicly listed companies should be accountable in this way is sometimes met with resistance from elements within the corporate sector. Some company boards prefer instead to use the delegated authority model of corporate governance as an opportunity to operate autonomously, with minimal shareholder-based accountability. This attitude is clearly detrimental to the objective of best practice corporate governance.

2.25 The committee recognises that Australia's standards of corporate governance are relatively high. But there is certainly room for improvement; Australia's companies and boards are not perfect. Companies that have failed to adequately facilitate shareholder engagement and participation need to be pressed harder to do so. Regulators such as the Australian Securities and Investments Commission and the ASX, as well as industry bodies such as the Investment and Financial Services Association, have developed very effective best practice methodology and principles. These organisations should be encouraged to continually adapt their corporate governance guidance to account for shareholder engagement objectives and to explore ways of ensuring they are adopted by companies not giving them sufficient credence. Rather than imposing minimum standards of engagement on companies, legislative reform is best suited to removing impediments currently preventing companies from engaging with shareholders in line with best practice guidance.

2.26 It is in this context that the committee discusses the more contentious shareholder participation and engagement issues and makes its recommendations.

Chapter Three – Improving information flows

3.1 This chapter examines the communication and information side of shareholder engagement, while those issues related to shareholder decision-making and accountability mechanisms are discussed later in Chapter Four. In particular, this chapter examines issues relating to the communication channels between companies and their shareholders, including the following:

- Facilitating communication and information flows between companies and institutional investors, particularly in the context of complex share ownership arrangements;
- Addressing the difficulties for retail investors in accessing company information and communicating with company boards; and
- Potential improvements to disclosure on short selling and margin lending activities.

Institutional investor issues

3.2 Institutional investors are generally large investment vehicles with the ability to buy and sell securities in large quantities. In Australia, they are typically superannuation funds and other managed funds investing on behalf of their members. The committee was informed that while these entities increasingly want to engage with companies, complex share ownership arrangements and uncertainty over certain legal obligations was hindering communication between companies and their institutional shareholders.

Willingness and capacity to engage

3.3 Institutional investors determine the extent of their engagement as shareholders on the basis that its cost will be outweighed by the benefits that accrue from engaging, namely improved investment returns.

3.4 Evidence to the committee suggested that the level of shareholder engagement by institutional investors is increasing. For instance, Riskmetrics held the view that institutional investors 'are increasingly involved in the governance of the companies in which they invest'.[1] This had been assisted by companies, in turn, becoming increasingly willing to discuss with, and listen to, concerns and queries from shareholders on corporate governance issues.[2]

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1 Riskmetrics, *Submission 13*, p. 3.

2 Riskmetrics, *Submission 13*, p. 3.

3.5 They suggested that institutional investor participation may be extrapolated, albeit imperfectly, from voting levels and the outcomes of votes at company meetings:

> Since 1999, when a study found only 35% of all available shares were voted on director re-election resolutions at top 100 ASX-listed companies, turnout on all resolutions at top 100 companies has increased to 58.2% of all available shares in 2006. It is also worth noting that institutional shareholders are also increasingly willing to vote against management – in 2006, the average level of dissent by shareholders from the board recommendation on controversial resolutions was 21.2% for top 200 companies, up from 8.2% in 2005. Equally importantly, however, the increased level of constructive dialogue between company directors and managers, and shareowners, is evidenced in the decline in the number of controversial resolutions put to shareholders, from 20% of all resolutions put to top 200 company shareholders in 2004 to 8.9% in 2006.[3]

3.6 The Business Council of Australia (BCA) indicated that institutional investors preferred to influence corporate governance outcomes through discussion with the board, rather than expressing their views by casting negative proxy votes.[4] The committee notes that this description of preference is probably accurate, but is difficult to quantify.

3.7 Nowak and McCabe submitted that institutional investors are well placed to engage with the companies in which they invest. They outlined the following relevant factors:

- the availability of dedicated resources to monitor and analyse individual company and industry performance;
- the services of corporate investor relations specialists; and
- access to company management through formal communications and informal meetings.[5]

3.8 Despite their capacity to do so, Nowak and McCabe argued that institutional investors would determine their level of engagement on the basis of costs and benefits:

> …the calculation for the institutional investor remains one of balancing the information and transaction costs of active engagement against the benefits of doing so. The benefits are more likely to outweigh the costs of engagement where their holding of shares in a particular corporation is

3 Riskmetrics, *Submission 13*, p. 3. Statistics come from Riskmetrics annual Voting Outcome reports. Controversial resolutions are deemed to be those where one or more features deviate from accepted standards of good governance, eg ASX Corporate Governance Council.

4 Business Council of Australia, *Submission 29*, p. 8.

5 Nowak and McCabe, *Submission 5*, pp 2 – 3.

> significant in the context of their portfolio and/or overall market trading volumes in that corporation. Nevertheless our research finding was that a number of institutional investors adopted a policy of non-engagement and the proponents of this approach argued that engagement would be a distraction from their primary focus.[6]

3.9 The Association of Superannuation Funds of Australia Ltd (ASFA) indicated that anecdotal evidence suggested 'growing engagement and more active involvement of superannuation funds in voting'.[7] However they commented that superannuation funds are limited in their capacity to engage with the companies in which they invest:

> ...on some issues funds may seek to engage whereas at other times their involvement may not be as active. Given that superannuation funds in total have engagement with just about every company listed in Australia, it is difficult for individual trustee boards to engage on every issue with every fund. The trustees of each fund have responsibilities with regard to a number of matters, and just one part of it is the engagement with companies and participation in the voting processes.[8]

3.10 Australasian Investor Relations Association also held the view that superannuation funds do not want to engage directly with companies:

> 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.[9]

3.11 The role of the intermediaries used to undertake this task is discussed in the following section.

3.12 In the following chapter, the committee discusses the importance of institutional shareholders engaging on corporate governance matters by exercising an informed vote on important company resolutions.

The intervening role of custodians

3.13 Although institutional investors are increasingly involved with governance issues, the capacity issues mentioned above usually makes their engagement with

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6 Nowak and McCabe, *Submission 5*, p. 3.

7 Mr Ross Clare, ASFA, *Committee Hansard*, Canberra, 15 April 2008, p. 25.

8 Mr Ross Clare, ASFA, *Committee Hansard*, Canberra, 15 April 2008, p. 23.

9 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 69.

companies indirect. In their submission to the inquiry, ASFA indicated that it is reasonable for funds to delegate responsibility for shareholder engagement to their fund managers, as long as this policy is adequately disclosed.[10]

3.14 The ownership arrangements institutional investors enter into affect their engagement with the companies they have an interest in. Superannuation funds for example, which comprise the majority of institutional investors, often delegate responsibility for managing their investment portfolio to an external fund manager. The funds are the beneficial owners of the shares, but their investments are often managed externally, particularly with smaller funds, and the securities are invariably registered in the name of a custodian. Fund managers are not necessarily the registered owners of the shares either, though; this responsibility usually rests with entities that specialise in providing custodian services, typically investment banks.

3.15 The interactions between funds, investment managers and custodians varies, which is reflected in the myriad ways and extent to which beneficial share owners either directly or indirectly engage with the companies in which they invest, if at all. Funds' policies on corporate governance engagement outline the fund managers' role in monitoring corporate governance and the circumstances in which managers are required to exercise their own discretion on voting, or consult with the fund on a voting position. IFSA told the committee that it encourages fund managers to establish direct contact with company boards and senior management.[11]

3.16 The role of intermediaries on voting, including advice from proxy advisory services, is discussed in the following chapter.

3.17 The committee was advised that the main difficulty with these complex arrangements is with companies struggling to identify, and thus engage with, the beneficial owners of shares. According to Australasian Investor Relations Association, listed companies are increasingly seeking to identify and establish direct contact with beneficial share owners, usually fund managers, so they can engage with their institutional shareholders.[12] Despite sound intentions though, evidence suggested that the task of identifying beneficial share owners behind custodial arrangements remained problematic. ACSI told the committee that:

> …the companies say to us that we are not really aware of which superannuation funds own how much of what because you are all in there as custodially owned. We are in favour of them having as much transparency as possible without having to spend money to find out exactly who their institutional shareholders are and who the ultimate beneficiaries are. [We are] in favour of unpacking the institutional side.[13]

10 ASFA, *Submission 2*, p. 2.

11 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 3.

12 Australasian Investor Relations Association, *Submission 12*, p. 3.

13 Mr Michael O'Sullivan, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 61.

3.18 It added that companies having a clearer understanding of their shareholder base would improve superannuation funds' capacity for engagement.[14]

3.19 Some organisations contended that the tracing provisions in section 672 of the Corporations Act, which enable companies to direct the registered owners of shares to disclose information about those with relevant interests in the shares, do not work as effectively as they could. AICD suggested that the tracing provisions needed to be bolstered and recommended that section 672 of the Corporations Act be amended to provide for the following:

> - Imposing an administrative obligation on the registered holder of shares or scheme interests to create, maintain and update a register of relevant interests where that interest exceeds, say, 1% of all shareholdings in the company.
> - Requiring that a copy of that Register be provided on written request to the company, scheme or ASIC.
> - Should third parties desire to have access to such information for bona fide reasons, they may make application via ASIC in the same manner that they can now in the terms of S.672A(2) of the Corporations Act.[15]

3.20 They proposed that this would align the tracing provisions with the substantial holding provisions in s671B of the Corporations Act.[16]

3.21 ASX Limited also highlighted the role of custodial ownership in constraining 'genuine intentions on the part of [companies] to engage with their investors'. They wrote:

> A practical impediment to effective shareholder engagement is the difficulty sometimes encountered by companies in seeking to identify their shareholders. A lack of transparency as to ultimate shareholder identity may result from the understandably widespread use by shareholders of custodians through which to hold their investments. The use of trading techniques involving equity derivatives and short selling may also make ultimate economic ownership of securities difficult to establish.[17]

3.22 Australasian Investor Relations Association suggested that section 672 was deficient because it applies to ordinary shares only, without extending to interests held via derivatives instruments such as equity swaps and contracts for difference. Their submission provided the following example:

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14 Mr Michael O'Sullivan, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 62.

15 AICD, *Submission 35*, Attachment 1, p. 2.

16 AICD, *Submission 35*, Attachment 1, p. 2.

17 ASX Limited, *Submission 14*, p. 3.

> One of our members recently informed us that they became aware that a foreign based hedge fund had acquired an economic interest in their company to the value of AUD700 million via a contract for difference. This was not able to be discovered through the operation of the beneficial ownership tracing process as provided for in s.672.[18]

3.23 They recommended that section 672 of the Corporations Act be amended to capture derivative instruments.[19]

Committee view

3.24 The committee recognises that institutional shareholders' inevitable use of intermediaries is making it difficult for companies to know the identity of beneficial share owners of companies. To alleviate this problem the committee joins IFSA in urging institutional investors to make direct contact with company boards to assist them in having this information. The committee, however, does not support AICD's suggestion for custodial share owners to be required to hold a register of interests, as it does not think the benefits would justify the administrative burden created.

3.25 The use of derivative instruments presents a more significant problem, given the evidence the committee received in regard to the application of the Corporations Act tracing provisions. The committee recognises the complexity of these arrangements and the practical difficulty of tailoring the legislative framework to ensure companies can obtain accurate information regarding ownership at any given time. However, the committee is of the view that the government should at least investigate the implications of extending section 672 of the Corporations Act to include derivative instruments.

Recommendation 1

3.26 The government should examine the implications of amending the tracing provisions in section 672 of the Corporations Act to include derivative instruments.

The increasing significance of responsible investment

3.27 Responsible investment for institutional investors refers to taking an active approach to share ownership to engage with companies on environmental, social and governance (ESG) issues. The basis for this investment approach is the recognition of the importance of ESG issues to ensuring long term sustainability and thus minimising long term investment risks.

3.28 Responsible Investment Consulting told the committee that long term issues are highly relevant to superannuation fund members who may be investing over a 50

18 Australasian Investor Relations Association, *Submission 12*, p. 3.

19 Australasian Investor Relations Association, *Submission 12*, p. 4.

year period. Those companies that invest responsibly will be seen to represent a lower risk, thus attracting 'a premium in terms of their shareholder value'.[20]

3.29 Responsible Investment Consulting stated:

> [Environmental, social and governance issues] 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.[21]

3.30 Regnan emphasised the importance of ESG issues to institutional investors that spread their risk across the entire investment spectrum:

> Because universal owners own cross-sections of the economy, they inevitably find that some of their holdings are forced to bear the cost of other sectors' or firms' externalities. This creates an incentive for universal owners to minimize negative externalities and maximize positive ones across portfolio holdings.[22]

3.31 Responsible Investment Consulting suggested that investors need to be more demanding of companies for sustainability reporting, rather than having additional reporting being mandated. It indicated that the greatest barrier to engagement on ESG issues is cost:

> 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.[23]

3.32 Interestingly, Regnan suggested that small companies have greater exposure to ESG issues than large ones and were therefore not disadvantaged in bearing the cost of engaging with shareholders about them. The reason, they suggested, is that large companies are more diversified and better able to absorb the consequences of an ESG risk coming to fruition:

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20 Mr Gordon Noble, Responsible Investment Consulting, *Committee Hansard*, Sydney, 16 April 2008, p. 38.

21 Mr Gordon Noble, Responsible Investment Consulting, *Committee Hansard*, Sydney, 16 April 2008, p. 33.

22 Regnan Governance Research, *Submission 22*, p. 7.

23 Mr Gordon Noble, Responsible Investment Consulting, *Committee Hansard*, Sydney, 16 April 2008, p. 36.

> 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.

3.33 Both Responsible Investment Consulting and Regnan told the committee that companies may be concerned about potential liability issues relating to selective market disclosure. They requested that regulatory guidance be provided to remove lingering concern about the potential liability that may accompany communicating ESG information to shareholders.[24] Regnan proposed an amendment to the Corporations Act giving 'safe harbour' to companies undertaking this kind of engagement in good faith.[25]

3.34 Regnan also suggested that governments, when investing, do so 'within the platform of the UNPRI'.[26]

3.35 The Australian Institute of Company Directors (AICD) suggested that, given the evolving nature of sustainability reporting, it would be preferable to allow practices to develop for another two years before contemplating mandatory requirements or an 'if not, why not' regime.[27]

Committee view

3.36 The committee strongly supports and encourages companies adopting ESG reporting on a voluntary basis. The committee recognises that ESG reporting is in its early stages and companies should continue to be given the opportunity to determine the best way to approach the task free of government regulations. However, investors are increasingly pressing for ESG reporting and companies should respond to this demand accordingly. If companies cannot, by the end of the current decade, show that they have done this in a manner acceptable to shareholders then it is the view of the committee that the government should consider regulating in this area.

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24 Mr Gordon Noble, Responsible Investment Consulting, *Committee Hansard*, Sydney, 16 April 2008, p. 35; Mr Erik Mather, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p. 47.

25 Mr Erik Mather, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p. 48.

26 United Nations Principles of Responsible Investment. Mr Erik Mather, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p. 44.

27 Mr Kevin McCrann, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 64.

3.37 Companies should be encouraged to adopt ESG reporting and engage on ESG issues without being concerned that it may contravene their continuous disclosure obligations. Accordingly, the ASX should clarify the scope of Listing Rule 3.1 as it applies to engagement on ESG matters.

Recommendation 2

3.38 The ASX should clarify the scope of continuous disclosure requirements as they apply to engagement on ESG issues.

Legal uncertainty over engagement

3.39 The committee also received evidence outlining potential legislative disincentives for institutional investors to engage with companies. In particular there remains some doubt as to whether trustees may, in the course of undertaking normal shareholder engagement practices, be contravening aspects of the Corporations Act.

3.40 Regnan raised specific concerns relating to the responsibilities of superannuation fund trustees under the sole purpose test contained in section 62 of the *Superannuation Industry (Supervision) Act 1993*. In general terms, the provision stipulates that regulated superannuation funds must be maintained for the purpose of providing retirement benefits to members.[28] Regnan told the committee that the sole purpose test needed to be clarified to ensure that trustees engaging on ESG issues, where relevant to financial returns, fell within its scope.[29]

3.41 The committee discussed the sole purpose test in this context in its 2006 report on corporate responsibility. It did not accept a narrow interpretation of the provision that would constrain trustees from researching and considering environmental and social performance, but did recommend that the Australian Prudential Regulation Authority (APRA) clarify the matter.[30] At the time of writing, a government response to the committee's report had not been provided.

3.42 The potential 'dampening effect on institutional investors acting collectively' with the Corporations Act takeover provisions was also raised. ACSI submitted that:

> …there are certain sections of the Corporations Act (namely section 606 and Part 6C.1) which when combined with the very broad definitions of "relevant interest" and "associate" have a dampening effect on institutional investors acting collectively. Institutional investors could unintentionally

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28 Australian Prudential Regulation Authority, 'The sole purpose test', *Superannuation Circular No.III.A.4*, February 2001, accessed on 22 May 2008 at http://www.apra.gov.au/Superannuation/upload/III-A-4-The-Sole-Purpose-Test.pdf

29 Mr Erik Mather, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p. 44.

30 Parliamentary Committee on Corporations and Financial Services, *Corporate responsibility: Managing risk and creating value*, June 2006, p. 74.

> breach these sections if they seek to act collectively, especially if they act outside the context of an upcoming company meeting.

3.43 They warned that the Australian Securities and Investment Commission's (ASIC) attempt to remove this potential impediment to engagement was too narrow, as the relevant Class Order only applies to circumstances where institutional investors enter into an agreement on matters relating to a general meeting. ACSI contended that collective engagement often occurred outside the context of company meetings, and recommended that ASIC revise its guidance accordingly.[31]

Committee view

3.44 The committee is of the view that where institutional investors are concerned that shareholder engagement may contravene their regulatory obligations, ASIC should take the appropriate measures to clarify the scope of the Corporations Act as it applies to collective actions under the takeover provisions.

Recommendation 3

3.45 ASIC should clarify the position of institutional investors engaging collectively with companies outside company meetings in terms of the Corporations Act.

Retail investor issues

3.46 Retail investors are essentially those shareholders who are not institutions. As a category, they range from a person holding a handful of shares in a single company to private investors with substantial, diverse shareholdings.

Willingness and capacity to engage

3.47 Retail shareholders are faced with essentially the same question as institutional investors on the question of whether to actively engage with the companies in which they invest: is engagement worth it and do I have the ability to do it?

3.48 AICD told the committee that many shareholders have no interest in engaging with the companies they invest in.[32] Professor Margaret Nowak and Dr Margaret McCabe from the Curtin University of Technology suggested that the costs of engagement to small retail investors are often not worth the benefits:

> Cost (especially in time) relative to the benefits from accessing and analysing comparative industry and market information to make judgments on relative firm performance, is a major factor. ASX research shows that direct investors spread their portfolio across industry sectors and that 40%

31 ACSI, *Submission 11*, pp 4-5.

32 Mr Kevin McCann, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 58.

> have a spread across three or more sectors. This compounds the cost of acquiring and analysing the information to facilitate active engagement.[33]

3.49 They added that the powerlessness felt by individual investors over company decision-making and board composition compounded the disincentive to engage.[34]

3.50 Nowak and McCabe questioned the reasonableness of any expectation for retail shareholders to be engaged with companies, proposing instead that 'rational apathy … is often optimal'. When dissatisfied with company performance or direction, retail investors selling their shareholding remains the most effective option.[35]

3.51 Treasury framed the issue of retail investor apathy as a 'free rider' problem:

> The free rider problem … encourages shareholders to refrain from undertaking acts of management oversight because it is in their interest for someone else to undertake these acts (allowing them to reap the benefits without bearing the costs).[36]

3.52 Dr Shann Turnbull of the International Institute for Self-governance proposed that companies need to better harness the efforts of shareholders who are willing to engage to overcome the free rider problem. He suggested that company constitutions allocate governance powers to a 'shareholder watchdog committee' to facilitate a self-regulatory approach from companies. This would in turn enable government to reduce its own regulatory burden on companies. [37]

Simplifying company information for retail investors

3.53 The relationship between the information available to shareholders about companies and their ability to engage and make informed assessments on the basis of that knowledge was briefly outlined in Chapter Two. The most important primary source of this information is contained in the annual reports companies provide investors in accordance with their obligations under section 314 of the Corporations Act. However a common complaint amongst contributors to the inquiry was that the overwhelming and inaccessible nature of corporate reporting information has become a major hindrance to shareholders' capacity or willingness to engage with companies.

3.54 The CLERP 9 reforms helped to alleviate the problem, for both shareholders and companies, of the requirement to send shareholders hard copies of mandated company reports. These reforms to the Corporations Act have allowed shareholders to choose whether they are sent the inevitably bulky company annual report or be left

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33 Nowak and McCabe, *Submission 5*, p. 1.

34 Nowak and McCabe, *Submission 5*, p. 1.

35 Nowak and McCabe, *Submission 5*, pp 1-2.

36 Treasury, *Submission 17*, p. 5.

37 Dr Shann Turnbull, *Submission 23*, p. 2, p. 6.

with the option of accessing it via the internet.[38] Unfortunately, this measure has not necessarily addressed the reason why shareholders do not, or cannot, read annual reports.

3.55 Contributors to the inquiry maintained the view that mandated company information remains inaccessible to ordinary retail investors.[39] For instance, the Australian Shareholders' Association said 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.[40]

3.56 Chartered Secretaries Australia (CSA) stated that company reports have become inaccessible as a consequence of mandated disclosure 'bolt-ons' in the Corporations Act.[41] While supporting the continued availability of mandated information to those wishing to access it, CSA suggested that companies should have greater discretion when determining the most appropriate way to communicate with their shareholders.[42] They also encouraged companies to utilise interactive technology to make the online annual report more relevant.[43]

3.57 CSA recommended removing the Corporations Act requirement for companies to provide a 'concise report' to shareholders, due to its conciseness having been eroded by additional regulation:

> 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.[44]

3.58 AICD indicated that it would prefer to see a principles-based, rather than 'black-letter', approach to company reporting.[45] Their submission advocated greater emphasis on providing meaningful information by focussing on 'performance rather

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38 Sections 249J and 314 of the Corporations Act; see for example McConvill, J. *An introduction to CLERP 9*, LexisNexis Butterworths, 2004, pp 151-152.

39 See for example Chartered Secretaries Australia, *Submission 8*, p. 5; AICD, *Submission 25*, p. 49.

40 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 21.

41 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, pp 6-7.

42 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 9; CSA, *Submission 8*, p. 5.

43 Chartered Secretaries Australia, *Submission 8*, p. 15.

44 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 10. See section 314(2) of the Corporations Act.

45 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 63.

than conformance', encouraging companies to provide voluntary company reviews in a comprehensible form.[46] According to AICD, voluntary 'shareholder-friendly' reporting should be characterised by the following:

- a balanced view of company performance written in plain English; and
- clear explanations of the relevant financial results.[47]

3.59 The Institute of Chartered Accountants stated that 'reporting and communications are the mechanism through which a company drives effective engagement and participation'. They criticised the 'tool-kit' approach to reporting for not containing the sort of information that investors desire:

> In their current form, these reports do not address the company's strategy, its success or failure in implementing it, or insights into what future performance might look like if the strategy is well executed.
>
> …
>
> … there is little meaningful information available about how the objectives of the company are set, how risk is monitored and assessed, how performance is optimised and whether a company has the ability to create value through entrepreneurialism, innovation, development and exploration, providing accountability commensurate with the risks involved.[48]

3.60 The Institute of Chartered Accountants suggested a more 'holistic' approach to corporate performance reporting and recommended that the committee conduct a separate, detailed inquiry into the issue.[49] Australasian Investor Relations Association emphasised that investors increasingly preferred to access company information via electronic media and suggested that the opt-in for hard copies of the annual report should be extended to other forms of statutory communication, such as the notice of meeting.[50] ASA, however, opposed this proposal on the basis that shareholders may mistakenly opt out of notification of a meeting they have an interest in attending.[51]

Committee comment

3.61 The committee acknowledges that while the CLERP 9 reforms on the electronic provision of annual reports may have saved a considerable amount of paper,

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46 AICD, *Submission 25*, p. 49.

47 AICD, *Submission 25*, p. 50.

48 Institute of Chartered Accountants, *Submission 7*, pp 2-3. They also emphasised that the importance of effective reporting also applied to institutional shareholders.

49 Institute of Chartered Accountants, *Submission 7*, pp 4-5.

50 Australasian Investor Relations Association, *Submission 12*, p. 5. CSA also recommended that all statutory information should be allowed to be provided electronically. See CSA, *Submission 33*, p. 2.

51 ASA, *Submission 38*, p. 6.

the information that companies must legally provide shareholders is so dense as to be incomprehensible to most people. Evidence to the committee suggests that the concise report, which was intended to overcome some of these problems, has failed to serve its purpose. The absence of a report from companies outlining their performance and objectives in plain English represents a major barrier to retail investors engaging with companies.

3.62 The committee is of the view that the ability of shareholders to access company reports on the internet has made the concise report much less relevant than it once was. The electronic provision of company reports now allows shareholders to access specific aspects of company reports that are of interest to them, making the necessity to provide a concise report increasingly obsolete. Therefore, companies' obligation to provide it under section 314(2) of the Corporations Act should be removed. This would hopefully encourage companies to produce a plain, comprehensible statement of company performance and direction that is better suited to the requirements of shareholders.

Recommendation 4

3.63 The government should amend section 314 of the Corporations Act to remove the requirement to produce a concise financial year company report.

The usefulness or otherwise of AGMs

3.64 The requirement for publicly listed companies to hold an annual general meeting (AGM) is included at section 250N of the Corporations Act. These meetings provide an important opportunity for retail shareholders to engage directly with company boards and executive management. However, the committee heard a number of claims that the relevance of the forum is diminishing, an argument supported by falling AGM attendances. There was, however, support for reviving the AGM and the committee received a number of suggestions on how it might be made more relevant.

3.65 The voting process as it relates to AGM attendees is discussed in the following chapter; the focus of the following discussion is the AGM's deliberative function.

3.66 CSA suggested that the original purpose of the AGM had been overtaken by technological advances, making it less relevant to shareholders:

> …the AGM was created in an era of horse and coach; pen and ink; limited printing and a fledgling postal service, all of which dictated that members would physically meet with directors annually. It is now an era of advanced technology: mobile telephones; cameras and text messaging; the internet; webcasting; powerful portable computers and geographically dispersed shareholders.
>
> …

> …the information that is dealt with at an AGM is available many months before the AGM is held and that this affects attendance.[52]

3.67 They informed the committee that AGM attendances for the top 200 ASX-listed companies were falling steadily, continuing a long term trend. The results of their biannual survey of governance practices reported:

- the proportion of top 200 company AGMs attracting more than 300 shareholders falling from 35.7 per cent in 2001 to 11.1 per cent in 2007; and

- the proportion of top 200 company AGMs attracting fewer than 100 shareholders increasing from 23.2 per cent in 2001 to 41.3 per cent in 2007.[53]

3.68 CSA suggested that recent strong company results may partly explain falling attendances.[54] However, they also expressed the view that AGMs no longer appeal to shareholders due to the absence of a deliberative purpose, with votes determined by proxy before the start of the meeting. Further, continuous disclosure has removed the informative role AGMs once served.[55] AICD also emphasised the diminishing importance of physical meetings in a technologically advanced society, highlighting the constant information available to investors in the financial media.[56]

3.69 AICD further claimed that shareholder activism had 'diverted attention away from the traditional agenda of the annual meeting'.[57] This view was supported by the Business Council of Australia, who expressed the view that special interest groups were dominating company meetings.[58]

3.70 Despite falling attendances, both AICD and CSA maintained that retail shareholders still relied on company meetings as a forum for engagement.[59] AICD stated that:

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

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52 Chartered Secretaries Australia, *Submission 8*, p. 11. See also AICD, *Submission 25*, p. 44.

53 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 2.

54 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 5.

55 Mr Tim Sheehy and Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 5.

56 AICD, *Submission 25*, p. 44.

57 AICD, *Submission 25*, pp 44-45.

58 Business Council of Australia, *Submission 29*, p. 6.

59 Chartered Secretaries Australia, *Submission 8*, p. 12.

> The meeting provides a forum for personal appraisal of new candidates for election to the board and the way in which the meeting is conducted conveys to shareholders something of the culture of the board and the chairman's character.[60]

3.71 CSA proposed improving the relevance of the information gleaned at the AGM by separating its formal voting and informal information/dialogue functions.[61] This would be achieved by keeping voting open beyond the close of the meeting to enable shareholders to exercise their vote having had the benefit of discussion and questioning during the AGM.[62] This proposal is discussed further in the following chapter from paragraph 4.43.

3.72 CSA also questioned the requirement for small companies - those outside the ASX top 300 - to hold an AGM every year when direct voting can be used instead.[63] ASA disagreed that small companies should be exempted:

> The AGM is the only forum for shareholders to directly question the board with regard to the management of the company. It is the one opportunity for directors to hear directly the views of shareholders and is an important part of shareholder participation and engagement. In the experience of the ASA, companies within the ASX 200 are generally better at communicating with shareholders. It is those companies the CSA seek to exclude where shareholders most need this forum.[64]

3.73 In its discussion paper, 'Rethinking the AGM', CSA also posed other potential changes:

- mandating a minimum time for discussion and questions at AGMs;
- extend the statutory timeframe for holding AGMs by a month to ameliorate the crowded AGM season; and
- encourage chairs of board committees to answer shareholders' questions at the AGM.[65]

3.74 A potential option for improving the relevance and accessibility of AGMs is to utilise technology to enable participation from remote venues. Boardroomradio, for example, strongly advocated the benefits of companies having the option to host

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60 AICD, *Submission 25*, p. 47.

61 Chartered Secretaries Australia, *Submission 8*, p. 12.

62 CSA, 'Rethinking the AGM', *Discussion Paper*, 2008, p. 9. They suggested that this should not extend to unlisted public companies such as not-for-profit companies.

63 Chartered Secretaries Australia, *Submission 8*, p. 13.

64 ASA, *Submission 38*, p. 4.

65 CSA, 'Rethinking the AGM', *Discussion Paper*, 2008, pp 12-13.

'virtual' AGMs over the internet.[66] However CSA told the committee that a major concern with this idea was the reliability of current technology to transmit meetings in real time; querying whether such meetings would be deemed to be invalid if a technological failure restricted participation. They also raised the logistical issues that eventuate when trying to equitably manage a meeting with questioners in multiple locations.[67]

3.75 Mr Stephen Mayne also made a number of suggestions to improve AGMs. These included:

- maximising attendance by holding meetings at more convenient times for those with work responsibilities;
- allowing the press to ask questions at the meeting; and
- limiting the time available to individual shareholders speaking at AGMs to prevent them being hijacked.[68]

3.76 The Business Council of Australia noted that some companies found it useful to invite shareholders to submit questions prior to the AGM, though the limited resources of small companies may not permit this.[69]

Committee view

3.77 The committee is of the view that although technology has replaced the informative purpose company AGMs once served, they are still a useful engagement forum for retail investors. These are shareholders who are not generally invited to the private briefings accorded to institutional investors, and the AGM is their only chance for a face-to-face meeting with the company board. Companies should therefore endeavour to hold AGMs at convenient times and allow reasonable time for questions and discussion with shareholders. They should also broaden participation by allowing investors to submit questions to the board and by transmitting the meeting online. The committee agrees with CSA, though, that online participation is potentially unwieldy and unfair to those attending the meeting in person.

3.78 The committee does not support exempting small companies from holding AGMs.

3.79 The relevance of AGMs to modern shareholder requirements clearly needs to be addressed. The current legislative framework does not prevent the AGM from facilitating shareholder engagement, but the attitude and culture of some company

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66 Boardroomradio, *Submission 30*, p. 7.

67 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, pp 16-17.

68 Mr Stephen Mayne, *Submission 18*, pp 2-5.

69 Business Council of Australia, *Submission 29*, p. 9.

boards has meant that AGMs do not always represent a forum that best serves that purpose. The committee is therefore of the view that ASIC should carefully examine this area in preparation for establishing a comprehensive set of guidelines or principles for companies holding an AGM. These should include ways to improve the participatory aspect of meetings through discussion and questions, including questions on notice to the board, as well as maximising shareholder attendance. The guidelines should also outline best practice for managing conflicts of interest at company meetings, particularly with respect to the Chair maintaining control over procedural matters where a conflict exists, and the handling of discretion over voting undirected proxies.

3.80 Best practice guidelines have worked well to improve corporate governance generally and the committee is of the view that guidelines on AGMs would encourage companies to adopt a better approach to this important forum for shareholder engagement.

Recommendation 5

3.81 ASIC should establish best practice guidelines for company annual general meetings.

3.82 The committee is also of the view that companies should be encouraged to simplify their reporting to shareholders in this way.

Recommendation 6

3.83 ASIC should establish best practice guidelines for clear and concise company reporting.

The 100 member rule

3.84 Section 249D(1) of the Corporations Act stipulates that:

(1) The directors of a company must call and arrange to hold a general meeting on the request of:

  (a) members with at least 5% of the votes that may be cast at the general meeting; or

  (b) at least 100 members who are entitled to vote at the general meeting.

This is usually referred to as the '100 member rule'.

3.85 A significant history of opposition to the 100 member rule was reinforced during the inquiry, with the general tone of complaint continuing to be that the rule is open to abuse. For instance, Treasury stated that ability of relatively small groups of shareholders to impose the cost of an extraordinary general meeting (EGM) on companies gave them 'significant and undue leverage when negotiating with large companies'.[70]

3.86 The ACTU disagreed, suggesting that the 100 member threshold was large enough to prevent meetings being called 'on a vexatious basis'.[71]

3.87 The Exposure Draft of the Corporations Amendment (No. 2) Bill 2006 proposed to abolish the 100 member rule and leave the five percent requirement, which would have brought Australia's law into line with comparable jurisdictions.[72] The committee also notes its previous recommendation in support of abolishing the rule.[73] However, Treasury indicated that attempts to modify the rule had failed to garner the support of state attorneys-general. It told the committee that the new government was attempting to have the matter reconsidered:

> Recently, the minister, Senator Sherry, indicated at the last meeting of MINCO that he would like this issue reconsidered. He has asked Commonwealth officials, in consultation with our state counterparts, to put together a discussion paper that identifies all the options and the pros and cons of those options and that will, hopefully, move the debate forward.[74]

3.88 CSA gave their support for a five per cent threshold of voting entitlements, while retaining a 100 member rule for proposing resolutions at AGMs. They told the committee that the purpose for calling a special meeting should have substantial enough support to justify the expense borne by the company:

> …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.[75]

3.89 AICD offered conditional support for this proposal:

> …it [would have] 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.[76]

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70 Treasury, *Submission 17*, p. 7.

71 ACTU, Submission 24, p. 7.

72 Explanatory Memorandum, Exposure Draft Corporations Amendment Bill (No. 2) 2006, p. 5; Treasury, *Submission 17*, pp 6-7.

73 The committee made an exception in the case of mutuals. See for example, Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Exposure Draft of the Corporations Amendment (No. 2) Bill 2005*, June 2005, pp 3-9.

74 Mr Matthew Brine, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 73.

75 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 12.

76 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 63.

Committee view

3.90 Although no significant abuse of the 100 member rule has occurred, the committee is again of the opinion that it has the potential to be abused and should be replaced. The government should continue to negotiate with state attorneys-general to achieve this outcome.

Recommendation 7

3.91 The government should continue to negotiate with the states to have the 100 member rule abolished.

Disclosing material information equitably

3.92 The committee heard mixed reports about the equitable distribution of company information to different classes of shareholders. In particular, concerns were raised that the practice of companies offering private briefings to institutional shareholders disadvantaged retail investors and may breach their continuous disclosure requirements.

3.93 Chapter 6CA of the Corporations Act outlines companies' obligations to disclose in accordance with the ASX Listing Rules. ASX's principles on which the Listing Rules are based include the following:

> Timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest.[77]

3.94 ASX Listing Rule 3.1 states:

> Once an entity is or becomes aware of any information concerning it that a reasonable person would expect would have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.[78]

3.95 ASA told the committee that a disincentive for retail investors to engage is a perception of an uneven playing field with respect to disclosure.[79] Boardroomradio argued that there is a divergence of information available to different classes of investors. For instance, market information disclosed to professional investors in selective briefings may not be appropriately reflected in the company's disclosure to the market at large in accordance with the ASX Listing Rules. They claimed that retail investors are at a disadvantage by not having timely access to market information of a

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77 ASX, *ASX Listing Rules*, 'Introduction and objectives', accessed on 19 June 2008 at http://www.asx.com.au/ListingRules/chapters/Introduction.htm

78 ASX, *ASX Listing Rules*, Chapter 3 – Continuous disclosure, accessed on 19 June at http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf

79 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 20.

material nature.[80] Boardroomradio proposed that companies should be required to maintain up-to-date shareholder email lists to allow instant dissemination of important company information.[81]

3.96 Boardroomradio also suggested that audio transmissions of such briefings should be provided to all investors, via the internet, and should fall within the terms of the ASX's continuous disclosure requirements.[82] AICD also recommended that the information provided in these briefings should also be posted on company websites.[83]

3.97 Responsible Investment Consulting complained that the present ad hoc approach to companies' engagement with shareholders was inefficient for companies and inequitable for shareholders:

> From a company perspective the demand for engagement, whether it be to supply additional information, or to communicate views places pressure on a company's resources.
>
> Where a company does respond to an engagement request there is no mechanism for the response to be distributed to other market participants beyond making an announcement to the market. This is a highly inefficient practice and can result in a company entering multiple dialogues on similar issues, wasting valuable company resources. It is also counter to the principle that market participants should have equal and timely access to material information.[84]

3.98 They proposed a system of 'questions on notice' to companies, whereby both questions and responses would be available to registered market participants.[85]

3.99 Treasury told the committee that any company that selectively disclosed price sensitive information would be in breach of the listing rules and the Corporations Act.[86]

3.100 AICD defended the practice of offering private briefings:

> These briefings give institutional investors opportunities to question the board and management on more detailed matters, often financial, than might be raised at annual general meetings. Such briefings are not a means for giving some shareholders inside information and anything significant

80 Mr John Murray, Boardroomradio, *Committee Hansard*, Canberra, 15 April 2008, pp 14-15.

81 Boardroomradio, *Submission 30*, p. 9.

82 Mr Bill Gair, Boardroomradio, *Committee Hansard*, Canberra, 15 April 2008, p. 19.

83 AICD, *Submission 25*, p. 28.

84 Responsible Investment Consulting, *Submission 4*, p. 4.

85 Responsible Investment Consulting, *Submission 4*, p. 5.

86 Ms Marian Kljakovic, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 74.

> should be reported immediately to all investors. The company may not divulge any exclusive information or anything that is price sensitive.[87]

3.101 They rejected assertions that such briefings contravened ASX Listing Rule 3.1 and indicated that prudent retail investors would check the ASX website for new information releases.[88] Australasian Investor Relations Association also rejected claims that selective disclosure was occurring during private briefings to certain investors.[89]

Committee view

3.102 The committee supports companies holding private briefings with institutional investors conducted within the parameters established by ASX Listing Rule 3.1. ASIC should carefully monitor the effect of these briefings on share prices to ensure companies are not selectively disclosing material company information.

3.103 The committee also considers that companies should post the information contained in private briefings on their websites. If possible, this information should be available at the same time as the briefing itself and shareholders should be forewarned of its pending availability to provide the most equitable access.

Recommendation 8

3.104 ASIC should selectively or periodically monitor and enforce company information disclosure in private briefings to institutional shareholders to ensure compliance with their continuous disclosure obligations.

The public share register: concerns about privacy and predatory offers

3.105 Presently, section 173 of the Corporations Act allows anyone to inspect a register of shareholders kept pursuant to section 168 of the Act. The unrestricted nature of this provision and the associated lack of privacy it affords shareholders was the subject of strong criticism to the committee.

3.106 In their evidence to the inquiry, CSA strongly advocated legislative changes to protect the privacy of retail shareholders. They described the current legislative arrangements as an 'anachronism', mostly utilised nowadays for the nefarious purpose of making under-priced offers in an attempt to exploit uninformed shareholders. In their submission CSA wrote:

> Modern technology makes the disclosure of shareholders' particulars vulnerable to predatory behaviour, in a way that is not possible with other forms of wealth holdings such as bank accounts and superannuation.

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87 AICD, *Submission 25*, p. 28.

88 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 59.

89 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 69.

> CSA notes that Australians understand their right to privacy, as embodied in legislation, and increasingly query why they have no right to privacy as investors. With the growth of the numbers of shareholders in Australia, the question of providing privacy and protection to them has become more urgent.[90]

3.107 They suggested that companies releasing their share register details to predatory parties served to further disengage shareholders, some of whom assume the offers are supported by the company.[91]

3.108 Both ACSI and CSA recommended that a 'proper purpose' test be applied, enabling companies to test the bona fides of those seeking access to the personal details of their shareholders.[92] ACSI recommended that a proper purpose could include:

- shareholders wishing to contact other shareholders about issues relating to a general meeting resolution;
- shareholders checking their details have been correctly recorded;
- a request from an executor; and
- a request from a regulatory agency.[93]

3.109 In response to a question on notice from the committee, CSA offered its support for a proposal to amend the Corporations Act to allow companies to keep two separate registers. One would contain all shareholders, whose details would only be disclosed to other shareholders and those making offers as part of a takeover bid in accordance with Chapter 6 of the Corporations Act. The other register, available publicly, would only include the details of those with a substantial shareholding – over five per cent. This would align the public register with the substantial shareholding provisions in section 671B of the Corporations Act.[94]

3.110 ASA disagreed that access to share registers should be restricted:

> Whilst the ASA is mindful of the fact that shareholder registers can be misused, it would not support moves to restrict this information. On balance the importance of the legitimate reasons to access to register outweigh the privacy arguments. Shareholders are aware that they are investing in a public company. That the registers are open to abuse by predatory share

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90 Chartered Secretaries Australia, *Submission 8*, p. 17.

91 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 3.

92 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 3; Chartered Secretaries Australia, *Submission 8*, p. 18; ACSI, *Submission 11*, p. 8.

93 ACSI, *Submission 11*, p. 9.

94 CSA, *Submission 33*, p. 3.

> offers is clear, but the solution to this problem should not be found in restricting the legitimate rights of shareholders to identify and contact each other.[95]

3.111 ASA and ASX Limited both stressed that improving financial literacy is the most effective way to protect unsophisticated investors.[96]

3.112 The committee notes the work of the Financial Literacy Foundation in developing a number of programs aimed at improving Australians' financial knowledge.[97]

Committee view

3.113 The committee agrees that universal access to shareholder registers is inconsistent with the privacy of personal information generally. Further, the details of those who invest in funds that manage shares on their behalf are not accessible as the details of those who invest directly. The financially illiterate have been exposed to predatory share purchase offers, while shareholders who mistakenly believe the company is complicit in making the offer may avoid engagement with the company as a consequence. The committee supports proposals to amend the Corporations Act to limit access to the personal details of shareholders, in line with acceptable privacy standards.

Recommendation 9

3.114 The government should amend section 173 of the Corporations Act to limit access to the details of shareholders with non-substantial holdings, subject to a proper purpose test to allow access on certain conditions.

Obligations on small companies

3.115 Finally, the committee recognises concerns that the substantial corporate governance requirements imposed by the Corporations Act may impede small, closely held, entities from incorporating. The thrust of this disquiet is that the one-size-fits-all approach best suited to regulating large financial entities is not necessarily suitable for small businesses without a diverse group of equity investors to protect.

3.116 Family Business Australia called for an amendment to the 50 shareholder rule in section 113 of the Corporations Act, which provides that companies with more than this number of shareholders are required to become unlisted public companies. It claimed that family companies with successive generations of shareholders could exceed 50 shareholders; unfairly forcing them to relinquish family control as well as

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95 ASA, *Submission 38*, p. 4.

96 ASX Limited, *Submission 14*, pp 7-8; ASA, *Submission 38*, p. 4.

97 Treasury, *Submission 40*, p. 2.

triggering reporting obligations unsuited to family-run companies. It instead suggested a threshold of 300 shareholders.[98]

3.117 Treasury informed the committee that companies with more than 50 shareholders had a sufficiently diverse ownership base to justify greater governance requirements. They also noted that proprietary companies classified as 'large' due to their economic significance still face similar reporting obligations to unlisted public companies. Treasury did not accept that there is a 'compelling rationale' for amending the restriction.[99]

Committee view

3.118 A slight increase in the 50 shareholder limit for proprietary companies would address the difficulty some family businesses face when new generations acquire an interest in the company. The committee does not believe increasing the limit to 100 would have any deleterious regulatory consequences and suggests that this change be implemented.

Recommendation 10

3.119 The government should amend section 113 of the Corporations Act to raise the limit for shareholders in a proprietary company to 100.

3.120 The committee is also of the view that the broader issue of the framework for regulating small, closely held companies needs to be reviewed. The one-size-fits-all approach of the Corporations Act may be appropriate for large publicly listed companies with a diverse shareholder base with a considerable equity investment, but it places a significant regulatory burden on small companies and not-for-profit organisations for which the protection offered to investors by the Corporations Act is not as appropriate.[100] The government should therefore begin to investigate an alternative regulatory framework for small incorporated companies and not-for-profit organisations.

Recommendation 11

3.121 The government should investigate an alternative regulatory framework for small incorporated companies and not-for-profit organisations.

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98 Mr Christopher Johnston, Family Business Australia, *Committee Hansard*, Canberra, 15 April 2008, pp 36-37.

99 Treasury, *Submission 40*, p. 1.

100 This idea is explored in detail in a paper by Senator Andrew Murray titled 'A proposal for simplifying the legal form and regulation of small for-profit businesses and not-for-profit entities', April 2008.

Potential disclosure improvements

3.122 During the committee's inquiry the Australian equities market was undergoing a period of volatility and the practices of short selling and margin lending attracted considerable public attention. There was a widespread view that these activities are not subject to sufficiently rigorous disclosure requirements to ensure shareholders remain adequately informed.

Short selling

3.123 Short selling describes the technique of obtaining profit from the falling value of a stock by selling it at current market price with the intention of re-purchasing it at a lower price and retaining the difference. This allows investors to profit by trading shares they consider to be overvalued. 'Covered' short selling describes the practice where the shares being traded are borrowed, usually from fund managers or custodial owners holding shares on behalf of institutions. The shares are lent subject to a contractual agreement that they will be returned at an agreed time, for a premium. Typical stock borrowing agreements formally involve the borrower actually purchasing the securities from the lender and contracting to re-sell at an agreed time or on demand.[101] If within that time the short seller can re-purchase the shares at a lower price, then a profit is made. If they are re-purchased at a higher price then a loss is incurred.

3.124 'Naked' short selling differs in that it involves agreeing to sell a stock that is not held - neither owned nor borrowed - and subsequently buying it at a lower price, within the brief window of time that enables settlement obligations to be met. In other words, the later share purchase at a lower price needs to be completed soon enough to enable the seller to meet the original undertaking to sell the stocks that were not held at the time the agreement was made.

3.125 Lending stock for the purposes of short selling potentially enables fund managers and trustees to maximise shareholder returns; they can benefit not only when the value of their shares is increasing, but also when they are in decline. However, the practice has also been associated with nefarious activities such as insider trading and spreading mischievous market rumours.[102] For example, company insiders may offload stock prior to the announcement of a profit forecast downgrade and re-purchase soon after the price has fallen; or short sellers may seek to drive a share price down by spreading false rumours about a company's financial position. The judiciousness of lending a stock to somebody seeking deterioration in its value can also be questioned.

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101 ASX, 'Short Selling', *ASX Public Consultation*, 28 March 2008, accessed 9 May 2008 at: http://www.asx.com.au/about/pdf/short_selling_public_consultation_paper.pdf, p. 5.

102 See for example, Goldwasser, V. *Stock Market Manipulation and Short Selling*, Centre for Corporate Law and Securities Regulation, CCH Australia, 1999, pp 18-19.

3.126 While the committee notes that the ASX benefits from increased trading volumes generated by the practice, ASX has described short selling as 'a legitimate and worthwhile trading technique which contributes to market liquidity, efficiency and price discovery'.[103] This latter point refers to the capacity of the market to respond quickly to restore equilibrium where a stock has been overvalued.

3.127 In evidence to the committee, ASA commented that companies significantly affected by short selling have often been subjected to some 'initial distress' that caused them to be targeted.[104] They told the committee that:

> 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.[105]

3.128 In the context of shareholder engagement, two main areas of concern relating to short selling were raised with the committee:

1. The knowledge of shareholders (and the market generally) that shares in a particular company had been lent; and
2. Institutions' monitoring and control of stock lending by interposed entities and its disclosure to fund members; and the appropriateness of obtaining fund member consent.

Market disclosure of stock lending

3.129 The committee heard concerns about a lack of transparency of stock lending for covered short sales, rendering the undesirable practices that sometimes complement short selling difficult to regulate.[106] It should be emphasised that concerns raised during the inquiry related to disclosure, rather than the activity itself. The committee recognises that no widespread campaign to have short selling prohibited entirely exists.[107] However, disclosure is critical to regulators being able to

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103 ASX, 'Short Selling', *ASX Public Consultation*, 28 March 2008, accessed 9 May 2008 at: http://www.asx.com.au/about/pdf/short_selling_public_consultation_paper.pdf, p. 4.

104 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 23.

105 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 24.

106 See for example, Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 24.

107 The Australasian Investor Relations Association is amongst those that have called for naked short selling to be banned. See Durkin, P. 'Cover up: call for end to naked shorts', *Australian Financial Review*, 8 May 2008, p. 4.

identify and prosecute instances of insider trading and the dissemination of untrue rumours that may be associated with short selling.[108]

3.130 While the Corporations Act requires naked short sales to be disclosed to the market, ambiguity in the definition of short selling in section 1020B of the Corporations Act has allowed covered short selling to occur undisclosed. Australasian Investor Relations Association suggested that the Corporations Act be amended to provide for the mandatory disclosure of covered short selling, adding that the ASX should disclose stock lending through the CHESS clearing and settlement mechanism.[109] They stated that with up to 40 per cent of a company's stock on loan at any given time, engagement with those with an interest in the company is difficult.[110] This issue was discussed in more detail at paragraph 3.13.

3.131 AICD agreed that disclosure of stock lending for the purpose of short selling is appropriate.[111]

3.132 On 28 April 2008, the Minister for Superannuation and Corporate Law, Senator the Hon. Nick Sherry, stated that he considered short selling to be 'an important financial tool in promoting market efficiency and encouraging true stock prices'. He did reiterate, however, that the loophole would be addressed:

> In the interests of transparency, the Government will pursue legislative change to the Corporations Act to address any ambiguity around covered short selling and the requirement for disclosure.
>
> Treasury and ASIC are currently investigating the best legislative option to address these issues.[112]

3.133 In conjunction with the government's decision to close the covered short selling loophole, the ASX released a consultation paper on 28 March 2008 inviting comment on a range of improvements to the Listing Rules, including:

- facilitating the transparency of short selling volumes pending legislative change; and
- deterring irresponsible naked short selling by increasing the fee attached to a failure to deliver shares on time.[113]

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108 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 24.

109 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 68.

110 Australasian Investor Relations Association, *Submission 39*, p. 1.

111 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 64.

112 Senator the Hon. Nick Sherry, 'Corporate governance in today's volatile market condition', *Speech to Riskmetrics Group*, Melbourne, 28 April 2008, accessed 9 May 2008 at: http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/010.htm&pageID=005&min=njs&Year=&DocType=

3.134 With respect to addressing problems in the long-term, the ASX also recognised the need to address the 'definitional ambiguity' referred to during the committee's inquiry:

> The legislative definition of the transactions which need to be reported as short sales should capture both sell orders submitted when the seller does not own the amount of securities being offered and sell orders submitted when the seller only owns the securities through a borrowing agreement and is subject to a contractual obligation to return the securities to the lender.
>
> The legislative gap or loophole that currently exists in relation to short selling is that the prohibition is widely considered not to extend to sales of securities at a time when the seller owns such securities, even if the seller only owns them by virtue of having entered into a typical stock borrowing arrangement.[114]

3.135 Australasian Investor Relations Association advised the committee that the beneficial owner tracing provisions under section 672 of the Corporations Act were not typically able to be used to identify instances where stock has been lent.[115]

The role of institutions

3.136 Although the complex share ownership arrangements institutions enter into (discussed above at paragraph 3.13) mean that they do not directly lend their shares, institutional investors still have the authority to direct fund managers as to whether they want their stocks lent or not. This decision is taken in the context of trustees' legal authority to manage the assets of the fund on behalf of their members and their responsibility to perform this task for the benefit of fund members; that is, to maximise returns on members' investments. ASFA explained that share lending is undertaken responsibly on the basis of risk/reward calculations in accordance with these obligations.[116]

3.137 Treasury also advised that share lending must comply with trustees' legal obligations:

> [Superannuation funds] are under fiduciary and statutory obligations to deal with the funds in a way which best promotes the ultimate beneficiaries, the investors in the super funds. We would argue that that fiduciary obligation would involve trustees reviewing the appropriateness of investment

113 ASX, 'Public Consultation on Short Selling', *Media release*, 28 March 2008, accessed 9 May 2008 at: http://www.asx.com.au/about/pdf/mr280308_shortselling_consultation.pdf

114 ASX, 'Short selling', *ASX Public Consultation*, 28 March 2008, p. 4, accessed 9 May at: http://www.asx.com.au/about/pdf/short_selling_public_consultation_paper.pdf, pp 4-5.

115 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 70.

116 Mr Ross Clare, ASFA, *Committee Hansard*, Canberra, 15 April 2008, p. 32.

practices, such as scrip lending, and redetermining those policies from time to time as market conditions change.[117]

3.138 AFSA explained that approaches to stock lending varied between funds; some engaging in the practice and others not. They also indicated that, as beneficial owners, the funds were subjected to minimal risk:

> …the whole issue is one whereby superannuation funds, in terms of their individual situations, have been reviewing what they have been doing and what the risk-return structure is for them in how they do it. Generally, superannuation funds do not have direct dealings with the ultimate borrowers of the stocks. Often the arrangements are through their custodians, so their counterparty risk is with the custodians. It has been an activity with very minimal risk for the superannuation funds. Whether individual funds undertake such activity has been a matter for individual funds.[118]

3.139 The question of whether fund trustees should obtain the consent of their members before lending stock was raised at the committee's hearings. ASFA indicated that the present arrangement, whereby fund members delegate management authority to trustees, does not require consent to be provided. They added:

> Whether it should be is basically a matter for parliament to decide. The mechanics of getting that informed consent, either in general or on specific issues, would be challenging.[119]

3.140 The Investment and Financial Services Association (IFSA) supported this view of the fiduciary approach:

> What flows from that is that you have basically given that right to the person who is acting as the fiduciary in that capacity to exercise and to make those day-to-day decisions on your behalf in your best interest.[120]

3.141 ASA emphasised the benefits of disclosure in this area. They told the committee that in addition to observing their fiduciary obligation to maximise returns to members, institutional investors should disclose their lending policies:

> …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.[121]

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117 Mr Matthew Brine, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 76.

118 Mr Ross Clare, ASFA, *Committee Hansard*, Canberra, 15 April 2008, p. 27.

119 Mr Ross Clare, *Committee Hansard*, Canberra, 15 April 2008, p. 33.

120 Mr Martin Codina, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 8.

121 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 26.

Committee view

3.142 The committee is of the view that while short selling is a legitimate trading tool, it is necessary to ensure it is appropriately disclosed to the market to ensure that undesirable practices that potentially accompany short sales can be identified by regulators. Further, the committee does not oppose institutional investors lending their stocks to maximise returns, but considers that funds should be required to disclose their stock lending practices or policies to members.

3.143 The committee also notes that the Australian Government is examining this issue with a view to implementing legislative change to address disclosure matters.

Margin lending

3.144 Concerns associated with company directors holding shares tied to margin loans were also topical during the course of the inquiry. In basic terms, margin lending refers to the technique of borrowing to invest, thereby increasing returns when shares increase in value. The risk attached to margin loans is that borrowers also increase their exposure to losses; the potential for increased profits is accompanied by increased risk. If the value of the shares borrowed against declines to a specified level, lenders will intervene and make a margin call. This requires the holder of the loan to reduce debt as a proportion of the value of their shareholding by injecting cash to reduce borrowings, or to purchase additional shares.

3.145 A potential problem with margin lending arises when shareholders are unaware of situations where directors are facing possible margin calls on their own shareholding in the company, which can often be substantial. Such information has the potential to provide a trading advantage to those who are aware of it, while ordinary shareholders remain oblivious until it is too late. Thus, a company director's undisclosed exposure to margin loans significantly increases the potential for insider trading.

3.146 On 29 February 2008 the ASX released a statement on director-shareholder margin loans, which stipulated that such arrangements may be of material significance under Listing Rule 3.1 and subject to market disclosure requirements:

> Where a director has entered into margin loan or similar funding arrangements for a material number of securities, ASX advises that listing rule 3.1, in appropriate circumstances, may operate to require the entity to disclose the key terms of the arrangements, including the number of securities involved, the trigger points, the right of the lender to sell unilaterally and any other material details. Whether a margin loan arrangement is material under listing rule 3.1 is a matter which the

> company must decide having regard to the nature of its operations and the particular circumstances of the company.[122]

3.147 CSA informed the committee that this guidance was inadequate:

> …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.[123]

3.148 The committee notes reports that the Australian Government has prepared a green paper proposing that ASIC takes over the regulation of margin lending practices.[124]

Committee view

3.149 The committee does not consider that leaving an assessment of the materiality of a director's margin loan arrangements to the company itself is sufficient. The government's corporate governance green paper should clarify this important disclosure issue.

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122 ASX, *Companies Update*, No. 02/08, 29 February 2008, accessed 9 May 2008 at: http://www.asx.com.au/resources/newsletters/companies_update/archive/CompaniesUpdate_20080229_0208_HTML.htm

123 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 1.

124 Taylor, L. 'ASIC to police margin lending', *The Australian*, 23 April 2008, p. 1; Drummond, M. 'ASIC shifts to closer watch on markets', *Australian Financial Review*, 9 May 2008, p. 3.

Chapter Four – Improving corporate accountability mechanisms

4.1 This chapter discusses the shareholder decision-making and accountability aspect of engagement. Shareholder voting on director appointments and other resolutions at company meetings is an important tool for shareholders to ensure the accountability of company boards. The following discussion examines issues raised during the inquiry concerning possible deficiencies and potential improvements to the framework for corporate governance accountability. In broad terms, these issues fall into two categories:

- the efficacy and integrity of different voting mechanisms; that is, the vote lodgement and recording process; and
- the capacity for shareholders to exercise their voting entitlements effectively.

Voting mechanisms

4.2 Aside from voting in person at an annual general meeting (AGM), the mechanics of which are fairly straightforward, there are two mechanisms for lodging and recording absentee votes: via proxy representatives or direct absentee voting. Issues of concern relating to these voting mechanisms are examined below.

Proxy voting integrity

4.3 In the absence of a direct voting system (discussed later at paragraph 4.32), appointing a proxy is the only mechanism for a shareholder to lodge a vote when absent from the AGM. The previous government's CLERP 9 reforms to sections 250B and 250BA of the Corporations Act allow proxy votes to be submitted electronically and an amendment to section 250A permits proxies to be appointed by electronic means as well.[1] If utilised, electronic proxy voting will reduce the extent of paper handling involved in the process.

4.4 Despite these improvements, though, the committee was informed that the system still contained deficiencies that could potentially interfere with proxy voting intentions being properly reflected in the outcomes of votes. A number of further recommendations for reform were made to the committee.

Roundtable concerns on proxy voting

4.5 During 2006 and 2007, Investment and Financial Services Association (IFSA) held two roundtables on the proxy voting system. Participants included a number of

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1 Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004.

contributors to this inquiry: the Association of Superannuation Funds of Australia (ASFA), the Australian Council of Super Investors (ACSI), the Australian Custodial Services Association, the Australian Institute of Company Directors (AICD), the Australasian Investor Relations Association and Chartered Secretaries Australia (CSA).[2] Roundtable participants were concerned about the integrity of the proxy voting system, which they attributed to a number of 'key risks', including:

- the absence of an audit trail for lodged proxy votes;
- time constraints;
- the role of intermediaries/custodians; and
- paper-based manual processing.[3]

4.6 IFSA reported that the following recommendations emerged from the roundtable process:

1. Superannuation trustees and fund managers should request that issuers receive their proxy votes electronically;
2. ASIC should clarify the lawfulness of issuers accepting electronic proxies without amending the company constitution;
3. An electronic proxy voting capability should be developed to provide an audit trail from issuers to shareholders and other intermediaries;
4. Parliament should amend the Corporations Act to extend the record cut-off date to five business days before the meeting, allowing time to reconcile votes lodged against actual holdings; and
5. The ASX should consult with industry to develop a template for the standard disclosure of proxy voting results including the proportion of issued capital voted.[4]

4.7 Some of these suggestions were elaborated on during the committee's hearings. In particular, IFSA described the relationship between disclosing proxy voting activities and having an audit trail as being particularly important:

> …a superannuation fund or investment manager is unable to confirm whether their voting instructions have been accepted by share registry service providers.
>
> …

2 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 3.

3 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 3

4 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 4.

> Increasingly, fund managers and superannuation trustees are being more transparent and reporting openly to their constituents about their proxy voting activity. This process will have more meaning where the existence of an audit trail from the issuer back to the lodgement agent (e.g. a custodian) is in place.[5]

4.8 From an implementation perspective, IFSA suggested that establishing an electronic voting system is relatively straightforward:

> ...it is not rocket science. It is really building on what is already there. A lot of companies do have some electronic interface but, unfortunately, there are still faxes sitting behind some of that. There might be an electronic interface between, let us say, the first two or three people in the proxy voting chain but then somewhere along the line that electronic processing breaks down and turns into a manual process. It may be between a custodian and a registry or it may be somewhere else in the chain. What we are trying to say is that the only way you will get real-time audit trails so that people can have confidence in the votes they have lodged and know that they were the votes that have been recorded at the other end—they have effectively voted in that way—is through some kind of real-time electronic system.[6]

4.9 It also indicated that cost was not an impediment to introducing an electronic scheme, instead blaming inertia for a disappointing take-up:

> ...we have not had any participant in the roundtable actually say to us, 'The cost of this is prohibitive.' I think what you are seeing is inertia rather than a case of somebody having actually looked into this thoroughly and worked out that this is a massive overhaul of perhaps what they have already got.[7]

4.10 As reflected in IFSA's second roundtable recommendation, the committee heard of concerns that electronic proxy voting may be unlawful if not provided for in the company constitution, despite the CLERP 9 reforms. In their evidence Australasian Investor Relations Association supported IFSA's recommendation that ASIC clarify it would not take action against companies offering electronic proxy voting although it is not explicitly provided for in the company constitution.[8]

4.11 IFSA's recommendation to move the record cut-off date stems from the narrow 48 hour window of time currently available to reconcile lodged votes against voting entitlement. They argued that inevitable last-minute reconciliations increased

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5 IFSA, *Submission 16*, p. 4.

6 Mr Martin Codina, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 5.

7 Mr Martin Codina, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 11.

8 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 73.

the likelihood of errors when processing proxy votes.[9] IFSA's submission suggested the following amendment:

> …the Roundtable recommends an amendment to regulation 7.11.37(3) of the Corporations Regulations 2001 to extend the record cut-off date to "5 business days before the deadline for receipt of proxy appointment set by the company". The Roundtable also supports the adoption of the ASX Listing Rule definition of "business day" for this purpose.
>
> This will provide sufficient time for the reconciliation process to occur such that a more effective audit can be undertaken between the registered holder (custodian) and share registry service provider to ensure that all votes lodged are received and voted as instructed.
>
> In the event of any discrepancy or uncertainty, this will also allow for the relevant share registry service provider to contact the registered holder (custodian) and for the custodian to then contact the relevant clients who provided the voting instructions.[10]

4.12 Treasury indicated that the idea of extending the cut-off date 'may be a very valuable reform', but that it had not been raised with Treasury directly and they had not had the opportunity to consult with industry on the matter.[11]

Committee view

4.13 The committee agrees that the integrity of the proxy voting system could be improved if more companies established an electronic proxy voting capability that provides a clear audit trail. Evidence suggests that the cost is not prohibitive, while processing votes via a paper-based system is outdated and prone to error. The Australian Securities and Investments Commission (ASIC) should confirm that companies are able to do this without amending their constitutions and institutional investors should pressure the companies they invest in to allow electronic proxy voting. The committee is also of the view that changing the record cut-off date might limit mistakes caused by hasty reconciliations. This suggestion should be considered by the government, subject to consultation with industry.

Recommendation 12

4.14 ASIC should clarify that companies are permitted to receive proxy votes electronically where it is not provided for in the company constitution.

Recommendation 13

4.15 The government should consult with industry on amending the record cut-off date.

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9 IFSA, *Submission 16*, p. 5.

10 IFSA, *Submission 16*, p. 6.

11 Mr Matthew Brine, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 72.

4.16 The committee also considers that the disclosure of proxy voting results should be clear to investors, but it does not support mandating a standard template for achieving this. Institutional investors should continue to press companies for improved disclosure in instances where they are unsatisfied with current practices.

Cherry picking

4.17 Cherry picking refers to the practice where a proxy holder has been directed to vote some directed proxies in favour of a motion and some against, but chooses to only exercise those votes that serve their own interests.

4.18 Chartered Secretaries Australia argued that there is lack of transparency in the proxy voting system. They said that appointing a proxy temporarily transfers voting rights to another party, which does not of itself guarantee that the voting intention of the shareholder will be reflected in the way the appointee exercises that right.[12]

4.19 AICD proposed a minor amendment to the Corporations Act to ensure that meeting chairs be required to vote in accordance with the wishes of the shareholder/s on whose behalf he is voting.[13] However in a later submission to the inquiry they downplayed the potential for cherry picking by chairs:

> Shareholders who direct their proxies to the chairman can be confident that their voting preferences will be exercised by the chairman at the meeting. It is regarded as a good practice for chairmen to exercise their proxies as instructed. If a chairman did not exercise proxies and this inaction improperly influenced the outcome of a vote, then the resolution may be open to challenge in the courts on the grounds that the chairman was in breach of duty.
>
> AICD is not aware of any systemic problem of 'cherry picking' of votes by chairmen.[14]

4.20 Section 250A(4) of the Corporations Act stipulates that the meeting chair is required to vote the proxies they hold as directed, but the provision leaves other proxy holders the option to withhold some votes and cast others. An exposure draft of the Corporations Amendment Bill (No. 2) 2006 proposed an amendment to provide that these non-chair proxy holders still have the discretion not to vote directed proxies, but that if they do then they must vote them all, rather than voting them selectively.[15] This bill was not presented to the parliament prior to the 2007 federal election.

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12 Chartered Secretaries Australia, *Submission 8*, p. 6.

13 AICD, *Submission 25*, p. 54.

14 AICD, *Submission 35*, p. 4.

15 Explanatory Memorandum, Exposure Draft Corporations Amendment Bill (No. 2) 2006, p. 9.

Committee view

4.21 The committee notes that a proposed legislative amendment intended to prevent cherry picking proxy votes has not been presented to the parliament. The committee recommends that the Corporations Act be amended as per the proposal in the exposure draft of the Corporations Amendment Bill (No. 2) 2006.

Recommendation 14

4.22 The government should amend the Corporations Act to prevent non-chair proxy holders from cherry picking votes.

Integrity of close results

4.23 The committee also heard concerns about the confidence shareholders can have over the integrity of close votes. ACSI noted that currently 'there is no requirement for independent verification of votes cast at a accompany meeting'. They recommended that members – subject to meeting certain threshold requirements – be able to call for an independent report on a poll.[16] In response to a question on notice from the committee, they suggested that a recount of a disputed ballot be triggered at the request of five per cent of shareholders. In their response ACSI also suggested that 'proxy forms regarding director elections should be held for the length of their term [three years] in case there is a dispute raised during the tenure of the relevant director'.[17]

4.24 Riskmetrics indicated that a review process conducted by an 'independent arbiter' would be preferable to the only avenue currently available, which is to complain to ASIC after the result has been declared. They supported ACSI's suggestion of the five per cent threshold for triggering an independent review. Riskmetrics also suggested that those with an interest in the voting outcome should not be able to oversee its implementation.[18]

Committee view

4.25 With regard to contested results, the committee received no evidence justifying legislative change. It is of the view that until it can be demonstrated that ASIC's responsibility for responding to complaints about company voting processes is carried out deficiently, then this mechanism for resolving such disputes should remain. However, the committee is of the opinion that to assist in the investigation of contested votes companies should be required to maintain voting records for a reasonable period after the ballot has been held.

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16 ACSI, *Submission 11*, pp 2-3. This would reflect recent changes to the UK Companies Act.

17 ACSI, *Submission 36*, p. 1.

18 Riskmetrics, *Submission 42*, p. 2.

Recommendation 15

4.26 ASIC should periodically and systematically audit companies' vote recording and storage practices to ensure transparency and establish whether further regulation is required.

Vote renting

4.27 Vote renting describes the process where an investor borrows shares in order to secure voting rights to influence the outcome of a company vote.[19] A discussion of securities lending occurred in the previous chapter from paragraph 3.122 onwards. In evidence to the committee, the Australian Shareholders' Association (ASA), IFSA and Australasian Investor Relations Association all expressed their opposition to the practice.[20] In response to a question on notice, ASA explicitly supported its prohibition.[21]

4.28 Australasian Investor Relations Association told the committee that the practice further complicated companies' already difficult task of identifying who holds voting rights at any given time:

> …beneficial ownership tracing [under s672B of the Corporations Act]…just gives you an angle on who has a relevant interest. That does not necessarily mean that that tells you who has voting authority. …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.[22]

4.29 The committee notes that the Future Fund Management Agency does not lend securities for voting or any other purpose.[23]

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19 Technically, shares are purchased with an agreement to re-sell at a later date.

20 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 27; Mr Martin Codina, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 7; Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 73.

21 ASA, *Submission 38*, p. 2.

22 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard*, Sydney, 16 April 2008, p. 73.

23 Mr Paul Costello, *Committee Hansard*, Senate Finance and Public Administration Committee, 28 May 2008, p. 111.

Committee view

4.30 The committee shares the view of a number of contributors to this inquiry that vote renting should not be permitted. Paying for the voting entitlements attached to securities to achieve a desired voting outcome in no way contributes to good corporate governance. The committee is of the opinion that institutional investors should advise their fund managers not to engage in this practice and this policy should be clearly expressed to members. It also holds the view that the government should investigate an appropriate regulatory framework for ensuring that voting rights are retained by stock lenders.

Recommendation 16

4.31 The government should investigate the most appropriate regulatory framework for ensuring that stock lenders retain the voting rights attached to the lent shares.

Direct voting

4.32 An obvious mechanism for bypassing the proxy voting system and its associated deficiencies is to enable absentee shareholders to vote on resolutions directly. However, the inquiry was told that despite its advantages companies had not been greatly supportive of direct voting. According to CSA, only 13 per cent of the top 200 publicly listed companies had amended their constitutions to allow direct voting.[24]

4.33 This failure to implement direct voting on a larger scale is not due to it being a new concept. For example, a June 2000 report by the Companies and Securities Advisory Committee titled *Shareholder participation in the modern publicly listed company* discussed the benefits of direct voting and recommended that the government encourage its adoption by expressly providing for it in the Corporations Act.[25]

4.34 CSA commented that 'it is no longer necessary to appoint an intermediary'.[26] They stated that direct voting would remove problems associated with proxy voting:

> 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

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24 CSA, *Submission 33*, p. 3.

25 Companies and Securities Advisory Committee, *Shareholder participation in the modern publicly listed company: Final Report*, June 2000, p. 75.

26 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 2.

> better engagement and a better relationship and not involve regulatory change.[27]

4.35 They indicated that companies can adopt direct voting without regulatory change; all that is required is for the company constitution to provide for it.[28] In evidence to the committee, CSA speculated that the stumbling block of obtaining constitutional change is preventing many companies from adopting direct voting:

> 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 … [you] would tend to wait until [you] 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.[29]

4.36 Treasury confirmed that there were no legal impediments to companies implementing direct voting. They too suggested that inertia may be a more relevant factor limiting its use:

> Our long-time understanding is that there has been no legal obstacle to the adoption of direct voting mechanisms by Australian companies. We have liaised with Chartered Secretaries Australia on this issue for a number of years, and they have put out advice to companies containing some draft provisions they might include in their constitution to facilitate direct voting. I think it is correct to say that there has not been a great take-up of that initiative. It may be that companies are more comfortable with the traditional approaches to corporate decision making. We are not aware of any regulatory obstacles to the development of that type of framework.[30]

4.37 AICD noted that direct voting could encompass voting by post, fax or electronic means.[31] Global Proxy Solicitation proposed that shareholders be allowed to vote via telephone.[32]

4.38 Although AICD supported its implementation to provide shareholders with another voting option, they cautioned that direct voting would not necessarily overcome the problem of complex share ownership arrangements.[33] This issue is discussed in further detail at paragraph 4.52. They also noted that the logistics of

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27 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 4.

28 See also Companies and Securities Advisory Committee, *Shareholder participation in the modern publicly listed company: Final Report*, June 2000, p. 72.

29 Mr Peter Abraham, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 5.

30 Mr Matthew Brine, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 73.

31 AICD, *Submission 35*, p. 3.

32 Global Proxy Solicitation, *Submission 27*, p. 3.

33 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 61.

processing large numbers of votes from institutions would need to be addressed, 'whether it be for direct voting platforms or proxy voting technology platforms'.[34]

4.39 During the committee's public hearings, a proposal to incorporate direct voting into the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, to operate on an 'if not, why not' basis, was put to witnesses. Both ASA and CSA offered their support for this initiative.[35]

Committee view

4.40 Widespread implementation of direct voting would overcome many of the problems associated with proxy voting as identified during the inquiry. Companies should be encouraged to amend their constitutions to provide for direct absentee voting, which could be assisted by the ASX Corporate Governance Council including an 'if not, why not' provision on direct voting in its Corporate Governance Principles and Recommendations.

Recommendation 17

4.41 The ASX Corporate Governance Council should include an 'if not, why not' provision on direct voting in its Corporate Governance Principles and Recommendations.

Exercising voting entitlements

4.42 The committee received a number of submissions that raised issues pertaining to shareholders' ability to establish an informed voting position on matters subject to a vote at company meetings, and to exercise this entitlement in a way that ensures accountability and improves corporate governance outcomes. These issues included:

- the benefit of company meetings in providing information on which voting positions are reached;
- the role of intermediaries in determining voting positions; and
- the effectiveness of shareholder voting on board representation and executive remuneration.

Company meetings informing voting

4.43 As referred to in the previous chapter at paragraph 3.71, there are concerns that the voting process does not currently enable the information conveyed at company AGMs to inform the voting decisions of shareholders. Low attendance at

34 AICD, *Submission 35*, p. 3.

35 Ms Claire Doherty, ASA, *Committee Hansard*, Sydney, 16 April 2008, p. 28; CSA, *Submission 33*, p. 4.

AGMs dictates that most votes have been lodged by proxy prior to discussing resolutions at the meeting.

4.44 CSA suggested separating the deliberative and decision-making (voting) functions of AGMs to better allow the former to inform the latter, reflecting the original purpose of company meetings: discuss, deliberate and vote. They proposed that this 'decoupling' be achieved by opening voting on resolutions at the commencement of the meeting and allowing it to remain open for a specified period of time after the meeting had closed. In their discussion paper *Rethinking the AGM*, CSA wrote that 'informed' decision-making would be facilitated:

> Decoupling the deliberative and decision-making functions of the AGM would enable shareholders, particularly retail shareholders, to have the opportunity, even if they are physically unable to attend the meeting, to reflect on the questions posed at the AGM, the directors' responses to those questions and any other issues that were raised on the day, prior to voting.[36]

4.45 CSA proposed postponing closing the polls one or two weeks after the meeting, giving institutional investors a reasonable opportunity to consider their position. While CSA preferred the option of mandating this proposal through the Corporations Act, they also suggested that it could be incorporated into the ASX's Corporate Governance Principles and Recommendations and implemented on an 'if not, why not' basis.[37]

4.46 Mr Stephen Mayne also proposed keeping proxy voting open until after the AGM. He claimed that allowing shareholders to vote on resolutions following reports of the AGM debate would give the deliberations greater significance. Mr Mayne said:

> The board is fully aware of the voting situation before the debate even begins at the AGM and only a very small proportion of resolutions ever go to a poll. This situation is akin to having a political leaders television debate after the polls have closed – particularly given the tiny proportion of retail and institutional shareholders who actually attend the AGM.[38]

4.47 He also argued that some companies hold their AGM at inconvenient times when seeking to avoid scrutiny on a controversial resolution. Mr Mayne suggested that companies hold evening meetings in the major capitals to improve attendance rates.[39]

4.48 The 100 member rule and other issues relating to shareholder engagement at company meetings were discussed in Chapter Three from paragraphs 3.64 to 3.91.

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36 CSA, 'Rethinking the AGM', *Discussion Paper*, Additional information provided to the committee, 2008, p. 9.

37 CSA, 'Rethinking the AGM', *Discussion Paper*, Additional information provided to the committee, 2008, p. 10.

38 Mr Stephen Mayne, *Submission 18*, p. 2.

39 Mr Stephen Mayne, *Submission 18*, pp 3-4.

Committee view

4.49 The capacity for shareholders to make informed voting decisions would be greatly enhanced by allowing them to vote after the close of a company AGM. Accordingly, the committee is of the view that the government should give CSA's proposal careful consideration and should consult with relevant stakeholders. If mandating postponed voting is not considered to be appropriate, the requirement could be included in ASX's Corporate Governance Principles and Recommendations on an 'if not, why not' basis.

Recommendation 18

4.50 The government should consult with industry on the implementation of postponed voting after the close of company AGMs.

Institutional arrangements: proxy voting by custodians

4.51 As referred to in the previous chapter, complex share ownership arrangements involving institutional investors, fund managers and custodial share owners means that the responsibility for determining voting positions is often delegated to intermediaries. This raised a number of issues for the committee to consider:

1. How and when institutional investors, as beneficial share owners, choose to exercise their voting rights,
2. The role of proxy advisory services in assisting institutional investors to reach voting positions; and
3. Whether the tracing provisions in the Corporations Act discourage institutional investors from actively exercising their voting rights.

Delegated voting

4.52 The delegation of voting rights to intermediaries means that the extent to which beneficial share owners determine voting positions varies. The complexity of share ownership arrangements often renders ascertaining a beneficial owner's position on a vote a difficult task. AICD explained the effect of this complexity on determining proxy voting positions:

> 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.[40]

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40 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 61.

4.53 The committee notes that IFSA standard no. 13 requires members to vote on all resolutions and for public retail offer schemes to publish their proxy voting record. The standard also requires schemes to establish guidelines under which proxies are voted.[41] This means that while institutional investors may exercise their voting rights via custodians, the extent to which this represents a 'hands on' approach is dependent on each fund's policy on proxy voting.

4.54 The proposition that members of superannuation funds or other managed funds should themselves have an input into their institution's voting policy did not receive support. For instance, IFSA stated that it was unnecessary, complex and inefficient for institutional investors to seek advice from members on voting intentions:

> ...the principles of a collective investment vehicle, be it superannuation or otherwise, are such that you join like-minded people with regards to the type of investment portfolio that you go in. And then the principle is that either the trustee or the company director has an obligation under law to act in the best interests of either the member of a superannuation fund or the direct investor. Part of that is to clearly disclose the type of investment portfolio that one is going into. To take the informed consent back to the final investor would put complexity into the system which would take out a lot of the efficiencies of the collective investment.[42]

4.55 It added that it was most appropriate for voting instructions to be negotiated between each fund manager and the institutional investor in the context of the fund manager's stated guidelines on exercising proxy votes. The outcome of these discussions would mandate the matters over which institutional investors wanted to exercise voting control, and those over which they are content to leave voting to the discretion of the fund manager.[43]

4.56 ASFA described the prospect of superannuation funds securing consent from their members for particular voting positions as 'challenging'.[44] Regnan described it as 'unworkable in practice' and unnecessary in the context of superannuation funds' responsibility to maximise returns in accordance with the *Superannuation Industry (Supervision) Act 1993*.[45]

The role of proxy advisory services

4.57 The breadth of investments held by institutions means that they do not possess the resources to consider all the company resolutions they are presented with for

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41 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 3.

42 Mr John O'Shaughnessy, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 6.

43 Mr Martin Codina, IFSA, *Committee Hansard*, Canberra, 15 April 2008, p. 6.

44 Mr Ross Clare, ASFA, *Committee Hansard*, Canberra, 15 April 2008, p. 33.

45 Mr Erik Mather, Regnan Governance Research, *Committee Hansard*, Sydney, 16 April 2008, p 49.

voting. Consequently, institutional investors regularly delegate this function to specialist firms providing advice on assessing corporate governance.

4.58 The committee heard concerns that the absence of capacity that makes proxy advice necessary also means that it is often followed without independent review. AICD claimed that the increasing demand on proxy advisory services from institutional investors was leading to inaccurate reports being released to the market:

> 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.[46]

4.59 CSA also complained of errors of fact contained in proxy advisory services' reports on companies. Given the potential influence these reports can have on institutional investors, CSA called for greater transparency and consultation with companies:

> …there is a need for greater transparency in the decision-making processes that [the] 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.[47]

4.60 The Business Council of Australia (BCA) also complained about inaccuracies preceding voting recommendations. They suggested that 'proxy advisory firms should … be contacting companies to discuss their results and allowing companies adequate opportunity to provide explanations'.[48]

Effect of the Corporations Act tracing provisions

4.61 The ability of companies to force custodial share owners to disclose institutions' voting instructions was also cited as discouraging institutional investors to engage. Under s672B(c) of the Corporations Act (the 'tracing provisions'), custodial share owners may be directed to disclose voting instructions of the beneficial owners of the shares, including fund managers.

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46 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, pp 60-61.

47 Mr Tim Sheehy, CSA, *Committee Hansard*, Sydney, 16 April 2008, p. 2.

48 Business Council of Australia, *Submission 29*, p. 8.

4.62 Riskmetrics claimed that this provision extends beyond the original intent of the tracing provisions; to enable companies to identify 'those building a significant shareholding interest through interposed entities'.[49] Its potential effect is to enable companies to discriminate against institutional shareholders who vote against management, which discourages them from taking a stand against board positions. At the committee's hearing they suggested that:

> There appears to be no compelling reason as to why the management of listed companies should be able to compel custodians to reveal this information, and it may discourage institutional investors from engaging with listed companies or voting their shares for fear that they may lose access to the company if they are known to have voted against management.[50]

4.63 Riskmetrics recommended that the 'tracing provisions as they apply to voting instructions should be removed'.[51]

Committee view

4.64 The committee recognises that although it is impractical for fund members to have a direct input on voting of company resolutions, it is important that institutional investors such as superannuation funds declare their voting policies to members, upon which they can determine their choice of fund if so desired. Institutional shareholders should engage with companies by exercising their discretion on important votes. The committee is also of the view that institutional investors should seek to clarify, with company boards, the basis for adverse voting recommendations given by proxy advisory services.

4.65 With regard to the tracing provisions as they apply to voting instructions, the committee will continue to monitor developments in this area.

Voting on directors

4.66 As discussed previously, the accountability of the board to shareholders is an important facet of shareholder engagement. ASX Listing Rule 14.5 requires an election of directors to be held every year.[52] However, contributors to the inquiry suggested that there were two significant impediments to shareholders exercising this function:

1. the problem of director entrenchment and an absence of 'new blood' on company boards; and

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49 Riskmetrics, *Submission 13*, p. 4.

50 Mr Martin Lawrence, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, p. 45.

51 Riskmetrics, *Submission 13*, p. 4.

52 ASX Limited, *Submission 14*, p. 5.

2. a lack of useful information on which to base board voting decisions.

4.67 ASX Listing Rule 14.4 requires that directors hold office for no more than three years without re-election. The ASX Corporate Governance Council's Corporate Governance Principles and Recommendations states that board renewal 'is critical to performance, and directors should be conscious of the duration of each director's tenure in succession planning'.[53]

4.68 Despite this, ACSI told the committee that the 'director's club' is 'well and truly alive':

> …in the last year or two, 70 per cent of new appointments to S&P/ASX 100 companies are directors who already occupy a directorship in another S&P/ASX 100 company. I think the issue really goes to the heart of how hard and how far a company is looking beyond the usual suspects to make a real effort to broaden the gene pool. I think that is the real challenge.[54]

4.69 Riskmetrics explained the impediment to new board appointments created by the no vacancy rule:

> …a company's constitution will say, 'We can have up to 10 directors,' but the board will make a policy that says, 'We are only going to have five.' Then I nominate [you] to stand for the board. You stand for the board and the board makes the decision that there is no vacancy. You are still put forward for election but in order to defeat an incumbent you have to get a supermajority, basically—you have to score more absolute votes than they do to win, which is very tough.[55]

4.70 In contrast, AICD emphasised the importance of balancing the need for experience with the need to bring in new people. They told the committee that a board comprised of people without previous experience would 'be in a lot of difficulty', so the task of introducing new people on to company boards had to be undertaken methodically.[56] AICD recommended that nomination committees 'publish their methodologies for selecting and appointing directors on company websites for the benefit of shareholders'.[57]

4.71 ACSI also cautioned against imposing unwanted candidates on boards, due to the risk of undermining 'collegial decision making'.[58]

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53 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 2nd Edition, August 2007, p. 18.

54 Mr Michael O'Sullivan, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 62.

55 Mr Dean Paatsch, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, p. 55.

56 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 61.

57 AICD, *Submission 25*, p. 37.

58 ACSI, *Submission 36*, p. 2.

4.72 While supporting greater diversity at board level, Nowak and McCabe warned of the risks associated with new appointments as a consequence of 'emerging hedge fund activism':

> While the increased competition for director appointment which this entails may be useful in increasing diversity there is a proviso in that hedge fund representatives may represent the particular interests of the funds rather than the interest of all shareholders, especially where there is divergence in time frames and taxation implications of decisions. This trend needs to be carefully watched.[59]

4.73 The other difficulty in enforcing accountability on company boards is the problem of shareholders developing specific voting positions on directors with the company information available to them. Riskmetrics told the committee that it is difficult for shareholders to hold individual board members to account:

> From the outside, it is a very hard thing for an institutional shareholder to work out, for each individual director, the answer to the question, 'Is this individual director a great guy on a board that is a dud?'[60]

4.74 The problem of a lack of information on board candidates was also raised. Nowak and McCabe contended that unless investors are able to attend the AGM, proxy voting decisions are made without the benefit of adequate information on the resolutions. On director elections they noted that: 'At present there is often no information beyond the named person who is nominated or has been renominated'. They proposed that companies provide objective data on director candidates to give shareholders some basis for their decision.[61] AICD agreed that it is 'reasonable to expect' companies to provide information on proposed candidates for election in their notice of meeting.[62]

Committee view

4.75 The committee is of the opinion that the choices shareholders make on company directors should be based on proper information about their experience and qualifications for the role. It is not appropriate for shareholders to be confronted with the name of potential candidates in the notice of meeting without further information.

4.76 Although the election of board candidates is a matter for companies and their shareholders, the committee also maintains the view that board patronage and dominance by an entrenched few is unhealthy for the good corporate governance of any company and contrary to the interests of shareholders. The committee is of the opinion that the process for nominating and electing directors in Australia could be

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59 Nowak and McCabe, *Submission 5*, pp 3-4.

60 Mr Martin Lawrence, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, p. 55.

61 Nowak and McCabe, *Submission 5*, p. 2.

62 AICD, *Submission 25*, pp 38-39.

substantially improved in many companies to ensure better quality candidates are appointed to company boards. To begin to rectify the shortcomings in this area the committee suggests that ASIC should develop a best practice guide to company constitutional recommendations and practice governing the nomination and election of directors.

Recommendation 19

4.77 ASIC should develop a best practice guide to company constitutional recommendations and practice governing the nomination and election of directors.

Voting on remuneration

4.78 Shareholders' entitlement to express their views on the remuneration paid to company executives is seen as an important expression of shareholder accountability on corporate governance. However, the committee received evidence that shareholder engagement on remuneration was potentially being undermined by the following:

- the ability of shareholder-directors to vote on their own remuneration packages;
- a recent amendment to Listing Rule 10.14 on shareholder approval for share grants purchased on market; and
- a lack of transparency about external management agreements.

Non-binding vote on the remuneration report

4.79 The previous government's CLERP 9 reforms amended the Corporations Act to facilitate shareholder participation in the setting of executive remuneration packages. New section 250R(2) of the Corporations Act provides the opportunity for shareholders to vote on the director's remuneration report tabled in accordance with s300A. Although the vote is non-binding, it offers shareholders the opportunity to engage with directors on executive remuneration issues. New section 250SA requires the chair to allow shareholders a reasonable opportunity to comment on or ask questions about the remuneration report.

4.80 The committee took evidence indicating that the remuneration vote had been a major catalyst for engagement between institutional shareholders and company boards.[63] Riskmetrics agreed that in conjunction with increasing interest from institutional investors, the non-binding vote had encouraged companies to become more willing to engage on corporate governance matters.[64]

63 See for example Mr Phil Spathis, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 59.

64 Riskmetrics, *Submission 13*, p. 3.

4.81 The non-binding nature of the vote raises interesting questions about how company boards might respond to an adverse result. Given the short history of the reform there is not much precedent for it, though Telstra provides an obvious example. At its 2007 AGM 66 per cent of shareholders' votes were against Telstra's remuneration report. The board proceeded with its executive remuneration package as it was originally presented.[65] AICD indicated that the Telstra board had maintained that its remuneration package was appropriate despite shareholder opposition and that shareholders subsequently have the option of removing all or part of the board if they feel sufficiently aggrieved at having their remuneration vote discounted.[66]

4.82 ACSI indicated that courage would be required to subsequently vote out a board that had ignored shareholders' views expressed in a non-binding remuneration vote:

> …a number of institutional investors … who were very brave about non-binding votes for remuneration who may be less brave about tipping out the directors of Telstra in a period when Telstra is such a key player in what might be major government policy delivery and a lot of other issues.[67]

4.83 They told the committee that ACSI would prefer to resolve remuneration issues with Telstra than vote out the directors.[68] This reflects the Business Council of Australia's approach to influencing corporate governance issues more broadly, as was described in paragraph 3.6 of the previous chapter.

4.84 The major concern with the remuneration vote was the ability of shareholder directors to vote on their own remunerative arrangements. For instance, Riskmetrics asserted that the purpose of assessing the opinion of external shareholders on the company's remuneration policies is undermined by including the votes of directors.[69] Particularly in companies where directors have substantial shareholdings, they claimed that these votes can be significant:

> There have been a number of instances where … the remuneration report has been voted up, it has been approved, where it would not have been had shareholders associated with directors and key management personnel not voted.[70]

4.85 Riskmetrics and ACSI both recommended an amendment to the Corporations Act to exclude directors, executives and their associates from voting on the report, which would better reflect support amongst shareholders with no direct interest in

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65 See for example Blue, T. 'Telstra directors face savage pay retribution', *Australian Financial Review*, 10 November 2007, p. 38.

66 Mr John Story, AICD, *Committee Hansard*, Sydney, 16 April 2008, p. 66.

67 Mr Michael O'Sullivan, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 66.

68 Mr Michael O'Sullivan, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 67.

69 Riskmetrics, *Submission 13*, p. 5.

70 Mr Martin Lawrence, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, p. 53.

remuneration issues.[71] Although ASA supported this measure, they added that consideration would need to be given to the issue of how open proxies voted by the Chair are to be treated.[72]

4.86 Treasury indicated in evidence that these concerns had not previously been raised with the department, though officials said that 'it is probably an issue that needs to be examined into the future'.[73]

4.87 ACSI also raised concerns about the potential for undisclosed conflicts of interest stemming from connections between remuneration consultants and company management. They recommended that company annual reports be required to include information on the appointment of remuneration consultants.[74]

Executive share remuneration

4.88 Some contributors opposed an amendment to Listing Rule 10.14 that occurred in October 2005. As a consequence of the change companies are no longer required to seek shareholders' approval to grant shares as part of a director's remuneration package, if they are purchased on market. Listing Rule 10.14 currently states that an entity must not allow directors or their associates to 'acquire securities under an employee incentive scheme without the approval of holders of ordinary securities of the acquisition'. It adds that the rule does not apply to securities purchased on market.[75]

4.89 According to Riskmetrics, the on market exemption was much wider than that anticipated; that is, to have enabled share purchases through salary sacrificing arrangements without the requirement for shareholder approval. They told the committee that shareholders were only discovering that shares had been granted on generous terms well after the event, both as a consequence of the amendment and due to waivers granted by ASX prior to the change.[76]

4.90 Riskmetrics also speculated that the exemption had the potential to be misused:

> We are really concerned about a nightmare scenario where, say, a smaller listed company raises money in a general placement and, having forewarning of, say, a great drilling result, uses some of that general placement money to buy shares on market for its key executive team. That

71 ACSI, *Submission 11*, p. 6; Riskmetrics, *Submission 13*, p. 5.

72 ASA, *Submission 38*, p. 5.

73 Mr Bede Fraser, Treasury, *Committee Hansard*, Canberra, 15 April 2008, p. 76.

74 ACSI, *Submission 11*, p. 3.

75 ASX Listing Rule 10.14, accessed on 26 May 2008 at: http://www.asx.com.au/ListingRules/chapters/Chapter10.pdf

76 Mr Dean Paatsch, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, pp 48-50.

> is a nightmare governance scenario where, effectively, shareholders' money is underwriting insider trading. In the current scenario, we think that basically you should not be able to buy those shares on market without shareholder approval for genuine insiders like that. We just think it is a fundamental governance precept that is being ignored.[77]

4.91 ACSI recommended that:

> …the current version of [ASX Listing Rule] 10.14 should be revised to require shareholder approval of any acquisition of securities by a director outside of a genuine salary sacrifice arrangement.[78]

4.92 The ASX informed the committee that the amendment had not altered the purpose of the rule, which is to prevent the dilution of shareholder value caused by the issuing of securities. They stated:

> …it is difficult to justify shareholder approval where directors' securities are purchased on-market. This is because shareholders are arguably in the same position as if the director has been paid a larger cash salary and used the money to purchase shares on-market. In both scenarios, the value of existing investors' share holdings is unaffected.[79]

4.93 In response to concerns about the potential conflicts of interest, ASX commented:

> It is recognised that directors may face a potential conflict of interest in approving a new issue or on-market purchase of securities. However, ASX notes the ASX Corporate Governance Council commentary which states that a director should not be involved in determining their own remuneration. The Principles and Recommendations also contain guidance relating to the composition of the board remuneration committee, which is an additional mechanism for managing conflicts of interest.[80]

4.94 The ASX stated that, following a recent review of Listing Rule 10.14, they had 'formed the view that this rule is working effectively as ASX intended, and that no changes are required'.[81]

4.95 The committee notes reports that the issue of share-based remuneration for non-director executives will be included in the government's review on directors' corporate governance responsibilities.[82]

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77 Mr Dean Paatsch, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, p. 49.

78 Mr Phil Spathis, ACSI, *Committee Hansard*, Canberra, 15 April 2008, p. 59.

79 ASX Limited, *Submission 37*, p. 1.

80 ASX Limited, *Submission 37*, p. 1.

81 ASX Limited, *Submission 37*, p. 1.

82 Durkin, P. 'Executive share issues to face vote', *Australian Financial Review*, 30 April 2008, p. 1.

External management agreements

4.96 Finally, Riskmetrics stated that shareholder participation in listed infrastructure vehicles is impeded by a lack of transparency over long-term external management agreements. They submitted that these contractual arrangements, the details of which are lodged with the ASX, are not disclosed. The agreements include the remuneration paid to external managers, payments that may fall due to them on termination, and potentially, special voting shares that enable external managers to control the composition of the board.[83] In evidence to the committee Riskmetrics indicated that these entities have argued against disclosure on the basis of commercial-in-confidence considerations, but noted that such agreements must be disclosed in the United States.[84] They did not recommend legislative change but implied that the issue could be addressed by the ASX through its Listing Rules.[85]

4.97 The ASX informed the committee that, in conjunction with ASIC, it was considering a listing rule change to require issuers to disclose the terms of management agreements in a concise, user-friendly summary. At the time of writing, ASX had circulated a draft guidance note setting out these requirements for public comment.[86]

Committee view

4.98 The non-binding remuneration report vote provides an excellent opportunity for shareholders to express their views to the board via a vote, without taking the more drastic measure of replacing the board itself. The committee is of the view, though, that this initiative has the potential to be undermined by the influence of shareholder directors voting on their own remuneration. This is particularly relevant where directors have a substantial holding. Accordingly, the committee considers that the Corporations Act should exclude them from participating in this vote.

Recommendation 20

4.99 The government should amend the Corporations Act to exclude shareholder directors from voting on their own remuneration packages either directly or by directing proxies.

4.100 On the matter of Listing Rule 10.14, the committee recognises that the rule is designed to prevent the dilution of shareholder value through share issues to directors. In this context, the exemption for shares purchased on market is reasonable. However, the committee acknowledges concerns about the potential for improper activities that may stem from the exemption. The committee therefore suggests that the government

83 Riskmetrics, *Submission 13*, pp 1-2.

84 Mr Martin Lawrence, Riskmetrics, *Committee Hansard*, Canberra, 15 April 2008, pp 47-48.

85 Riskmetrics, *Submission 13*, p. 2.

86 ASX Limited, *Submission 37*, p. 2.

examine this issue as part of its green paper review on corporate governance regulations.

4.101 The committee is similarly of the view that the non-disclosure of external management agreements should also be considered as part of the green paper review.

Recommendation 21

4.102 The government examine the on market exemption to Listing Rule 10.14 and the disclosure requirements pertaining to external management agreements as part of its green paper review of corporate governance regulations.

Mr Bernie Ripoll MP

Chairman

Appendix 1

Submissions received by the Committee

1	Ms Annette Day
2	Association of Superannuation Funds of Australia
3	Family Business Australia
4	Responsible Investment Consulting
5	Nowak and McCabe
6	Australian Custodial Services Association
7	Institute of Chartered Accountants
8	Chartered Secretaries Australia
9	Insurance Australia Group
10	Principles for Responsible Investment
11	Australian Council of Super Investors
12	Australian Investor Relations Association
13	RiskMetrics Group
14	ASX Limited
15	Australia and New Zealand Banking Group
16	Investment & Financial Services Association
17	Department of the Treasury
18	Mr Stephen Mayne
19	Australian Shareholders' Association
20	CPA Australia Ltd
21	Law Council of Australia
22	Regnan Governance Research

23	Dr Shann Turnbull
24	Australian Council of Trade Unions
25	Australian Institute of Company Directors
26	Finance Sector Union
27	Global Proxy Solicitation
28	Colonial First State
29	Business Council of Australia
30	Boardroomradio
31	Jacoby Consulting Group
32	QBE Insurance Group Limited
33	Chartered Secretaries Australia
34	Family Business Australia
35	Australian Institute of Company Directors
36	Australian Council of Super Investors
37	ASX Limited
38	Australian Shareholders' Association
39	Australasian Investor Relations Association
40	Department of the Treasury
41	Association of Superannuation Funds of Australia
42	RiskMetrics Group
43	Regnan Governance Research
44	Boardroomradio
45	Australian Institute of Company Directors

Appendix 2

Public Hearings and Witnesses

TUESDAY 15 APRIL 2008 – CANBERRA

Department of the Treasury

BRINE, Mr Matthew, Acting General Manager, Corporations and Financial Services Division

FRASER, Mr Bede, Manager, Corporations and Financial Services Division

KLJAKOVIC, Ms Marian, Manager, Corporations and Financial Services Division

HACKETT, Mr Greg, Policy Adviser, Governance and Insolvency Unit, Corporations and Financial Services Division

RAM, Ms Ronita, Policy Analyst, Corporate Reporting and Accountability Unit, Corporations and Financial Services Division

Association of Superannuation Funds of Australia

CLARE, Mr Ross William, Director of Research

Investment and Financial Services Association

CODINA, Mr Martin, Senior Policy Manager

O'SHAUGHNESSY, Mr John, Deputy Chief Executive Officer

SORBY, Mr Joseph, Senior Policy Manager

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

Family Business Australia

JOHNSTON, Mr Christopher Lloyd, Nominated Spokesperson

TAYLOR, Mrs Philippa, Chief Executive Officer

RiskMetrics (Australia) Group

LAWRENCE, Mr Martin, Lead Analyst, Australia/New Zealand

PAATSCH, Mr Dean Anthony, Director, Asia-Pacific

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

Australian Council of Superannuation Investors

O'SULLIVAN, Mr Michael, President

SPATHIS, Mr Phillip Arthur, Executive Officer

Boardroomradio

MURRAY, Mr John, Chairman

GAIR, Mr Bill, Managing Director

WEDNESDAY 16 APRIL 2008 - SYDNEY

Chartered Secretaries Australia

ABRAHAM, Mr Peter Brooking, Member, Legislation Review Committee

SHEEHY, Mr Tim, Chief Executive

Australian Institute of Company Directors

CONLON, Ms Kathleen, NSW Division Councillor

McCANN, Mr H Kevin, AM, Corporate Governance Committee Member and NSW Division Councillor

STORY, Mr John Douglas, Chairman

Australian Shareholders Association

DOHERTY, Miss Claire, Policy and Research Manager

Regnan Governance Research and Engagement

FABIAN, Mr Nathan Alexander, Head of ESG Research

MATHER, Mr Erik, Managing Director

Australasian Investor Relations Association

MATHESON, Mr Ian, Chief Executive Officer

Responsible Investment Consulting

NOBLE, Mr Gordon, Principal

Appendix 3

Additional information, tabled documents, and answers to questions on notice

Additional Information

Chartered Secretaries Australia: CSA, 'Re-thinking the AGM', Discussion paper, 2008

Tabled Documents

Australian Institute of Company Directors: AICD, 'Opening statement from AICD', tabled Sydney 16 April 2008

Australian Institute of Company Directors: James, D. 'Boards walk the talk', BRW, September 20-26 2007, tabled Sydney 16 April 2008

Australian Institute of Company Directors: AICD, 'Corporate Governance: Roles of Shareholders, Boards and Executives', tabled 16 April 2008

Investment and Financial Services Association: IFSA, 'IFSA's opening statement', tabled Canberra 15 April 2008