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TRANSCRIPT
OF PROCEEDINGS

**PRODUCTIVITY COMMISSION**

**INQUIRY INTO REGULATION OF DIRECTOR AND EXECUTIVE REMUNERATION IN AUSTRALIA**

**MR G. BANKS, Chairman**
**MR R. FITZGERALD, Commissioner**
**PROF A. FELS, Associate Commissioner**

**TRANSCRIPT OF PROCEEDINGS**

**AT SYDNEY ON TUESDAY, 10 NOVEMBER 2009, AT 9.22 AM**

**Continued from 9/11/09**

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**MR BANKS:** Good morning, ladies and gentlemen. Welcome to the second round of public hearings to receive feedback on the Productivity Commission's discussion draft for its national inquiry into executive and director remuneration. The first participants this morning are Guerdon Associates. Welcome to the hearings. Thanks for participating and thanks again for your contribution in responding to the discussion draft. Your first submission was very helpful. We're looking forward to what you have to say in the second submission. I should ask you perhaps first just to give your names and positions.

**MR ROBINSON (GA):** My name is Michael Robinson. I'm a director with Guerdon Associates.

**MR McAULEY (GA):** I'm Peter McAuley, also a director with Guerdon Associates.

**MR BANKS:** Good, thank you. I'll give you the opportunity, as I said, to outline the key points you want to make.

**MR ROBINSON (GA):** Thank you, Mr Banks. Firstly, we welcome the opportunity to make this second submission and to appear at the hearing. We would like to first off just commend the Commission for an excellent draft report. I am sure you've heard it from many, and just to make sure you hear it from us, we think the first report was excellent. It covered all the issues very well. Despite the absence of data, I think you pieced it together well.

**MR BANKS:** Thank you.

**MR ROBINSON (GA):** In the submission, where we didn't mention a recommendation, just implicit in that is that we agreed with it. The comments we'd like to make, firstly on the board capability, the Commission recommended removal of the no-vacancy rule which we have no issues with at all. However, we don't know if that fully addresses or even addresses at all the board capability issue. We agree, first up, that board capability is critical to effective executive remuneration. In our experience, with better boards, the most knowledgeable boards have the best remuneration policies and therefore it goes that those with less capability don't have very good executive remuneration. We don't know if that's addressed enough and we think it's an issue to do with the supply side of directors. We don't know if there's been enough attention to remove the impediments on the supply side. The removal of the no-vacancy rule may have that effect but we don't see that particularly and while we don't know the answer here, we think that there's probably room for the Commission to address that more fully on the supply side.

Just one more thing on the capability, certainly at the larger company level, ASX 200 level, we're generally impressed with director abilities in terms of

intelligence, business knowledge and so on, but there's a wide degree or variability in their degree or knowledge of remuneration matters, so perhaps one aspect to improve capability of existing directors may be in the education sphere. We haven't addressed that specifically in our written submission, so we wanted to make that in our public submission here.

**MR BANKS:** Thank you. Would you prefer if we had some conversation about each of the points that you're making as you do?

**MR ROBINSON (GA):** Yes.

**MR BANKS:** I think that is an important one. I think, as you identify, we're sort of trying to find our way here and it's clearly an important issue, but like a lot of important issues, finding a way of satisfactorily making things better is the challenge. You talk about, in terms of the supply side, the need to focus on some of what you call imposts and liabilities that might be inhibiting supply and I just thought maybe you'd like to comment on whether there's some in particular that you think are problematic. You talk about the wide range of regulatory imposts at state and territory level that are being in principle addressed through the COAG processes and so on. Are there some of those in particular that you think warrant more attention than others, and in terms of liabilities, any comments you had there would be useful as well.

**MR ROBINSON (GA):** I think the AICD has made a point in its submission that there are over 600 different laws and liabilities applicable to directors across the states. I think COAG is certainly looking at that issue but they appear to be dragging their feet and if that's resolved, at least all the states are bringing their laws into line. They all have laws addressing safety, for example, that impact on directors. Instead of having seven different sets of laws and liabilities, bringing it all into one set would certainly help the process.

**MR BANKS:** There's two sorts of issues there; one is the differences across jurisdictions which are particularly problematic for national companies, the other is the nature of the requirements themselves. I think occupational health and safety is a classic case where you've got differences across jurisdictions, but in some jurisdictions the requirements are far more onerous than in others and so I think the reforms through COAG are trying to address both things. So I guess from your perspective, which of those two aspects do you see as more problematic?

**MR ROBINSON (GA):** As a general guideline, I think it's a materiality issue. You have criminal liabilities applying to directors to balance the fact that some of the penalties for companies for noncompliance may be deemed not material to the company in terms of the fines and so on that may be levied. Those things need to be looked at more carefully to get the balance right. Criminal liabilities are a serious

penalty to apply and yet some of the things don't seem particularly material or hurtful to shareholders or other stakeholders.

**MR McAULEY (GA):** I think one of the outcomes from this thing, it's the general body of regulation that seems to be discouraging - this is partly anecdotal, I might add - but the directors we deal with, many are saying just the sheer weight of regulation that's applying to them is making them think twice about their board duties and the responsibilities that they take on. Of course they've separately got pressures being brought to bear from various sources, arguing that they should spend greater amounts of time, which is fair enough, on individual companies which means sometimes relinquishing some of their other board responsibilities. That would translate in time to directors having fewer board responsibilities, obviously reflecting the fact that they're going to have to spend more and more time on each of their prospective company duties but it will reduce supply, we think, inevitably and that has its own ramifications for board capability generally.

**PROF FELS:** I suppose in arguing that point, another way of looking at it is, okay, there are more laws, they may or may not have some real effect, but it is also true that there has been an increase in the amount of litigation against directors you want to be more empirical about it and some stepping up of that and there's a wider array of sanctions possible under business laws against directors than there should to be. ASIC once only had criminal, ACCC once didn't have criminal and within them there's yet more director-specific actions that can be taken and I think that is flowing through into a higher rate of action against directors I think, but that's a casual impression.

**MR ROBINSON (GA):** We would concur with that. That's our subjective assessment that that's the case as well, so we agree. The direct impact of all the laws and the increase in regulation is those directors that are still directors that haven't got out of the game are just putting in so much more time to ensure compliance. Anecdotally I had one chairman of a rem committee for a major financial institution comment to me last week that that individual's time as a chairman of the rem co this year is three times greater than that person's time in the prior year in terms of the new APRA regulation and also the likely outcome of the Commission's finding. Three times more, 300 per cent greater time commitment and that person indicated that they don't see it reducing, they don't see it as an aberration, they see it as a permanent impact.

**PROF FELS:** There's a view, perhaps overseas, that maybe they didn't spend enough time on rem matters some directors but we won't talk about Australian ones.

**MR ROBINSON (GA):** It could be, Prof Fels, but the actual evidence, direct evidence on the GFC doesn't seem to indicate that remuneration was a direct cause in any way and also that if remuneration governance was better that the GFC would not

have occurred. I think the FSA highlighted, in terms of its causes, that remunerational compensation was down the list at number 5 and there was four ahead of that including liquidity risk and so on that weren't addressed. But, yes, it could be a precursor but there's no direct evidence.

**MR FITZGERALD:** Could I just flesh that out a little bit about the board capabilities. I agree that the issue about liability has been raised and it is subject to COAG reform or review at the moment. What we can't find is any significant evidence that it's actually having an impact on the number of people who wish to be directors. Indeed, the courses that the Institute of Company Directors run are in fact growing in the number of people that actually wish to be trained as directors. So we seem to have a confused position, that is, on the one hand people are saying that a number of factors are mitigating against people putting their hand up for directorship, on the other hand we seem to have an increasing number of people who wish to be directors but don't get appointed.

In some senses I don't think our inquiry can really deal with those sorts of issues but the picture doesn't seem to be completely clear about this. Is there really a shortage of directors who wish to become directors or are they simply not people of sufficient skill or calibre to warrant that appointment?

**MR ROBINSON (GA):** I think your observation is correct and what I'd put to you - and you've address this partly in your report where you talk about the passing of executive remuneration growth in large companies versus small companies and that's because the supply of confident executives dealing with ever large companies is so much less and it's a driver of remuneration growth. I think similar things would apply to the supply of directors for the larger companies, so when we're talking about capability gaps and the absence of supply, I think because we're exposed more to it, it would be the larger company and probably the supply issue is not as serious at the mid and small company so I think those observations have merit.

**MR McAULEY (GA):** My understanding is a number of the people that undertake those courses are also doing it for their own development for private company purposes as well.

**MR ROBINSON (GA):** But as your report indicated, the larger companies contribute so much to the economy, the ASX200, and that's where I think there is a shortage of directors. Maybe if I address a couple of other things. The director votes, there was a recommendation that undirected proxies not be utilised by directors. We feel that that recommendation may be misplaced. Already there are conflicts of interest regulations in the Corporations Act and that undirected proxies are proxies placed with the director because the shareholders have trust in that particular individual and that the director fiduciary duty to vote those proxies as he or she seems appropriate in the carrying out of those fiduciary duties. So we suggest

that the Commission perhaps review that recommendation.

**MR BANKS:** I think the point that you're making and I think the AICD makes the same point, is the distinction between a pecuniary conflict or direct conflict relating to the individual's concern and a perceived conflict where you have a group deciding on a policy and voting on it and you don't put much weight on the latter, I guess, relative to the former.

**MR ROBINSON (GA):** That's correct, yes. On pay disclosures there's a couple of things we have noted there. Two things, firstly, there was a discussion of what should be disclosed to key management personnel and you said actual pay in the recommendation and by that we think you probably mean what we've termed "realisable pay" which is the pay that actually vests to the employee in that year, which might be cash, superannuation, non-monetary benefits, equity and so on. We think you could be more explicit there.

Also you talk in the recommendation that the fair value be continued to be reported. Actually we made the point that fair value isn't reported currently, it is the accounting value which uses fair value as its basis but a lot of confusion arises because the accounting values include amortised values from the current and prior years for equity that may have been provided to executives. So you get a very confused picture of what was actually the pay policy in the fiscal year from a fair value point of view. It's mixed up with all the prior years. Canada was probably the last of the Anglo countries to look at this issue and two years I was watching the debate about should they follow the US model which was accounting value - which, by the way, followed our model, we were the first in this - and they decided to go on a fair value route.

The US, as a result of the GFC, has now reviewed all its executive compensation disclosures and its new draft disclosure requirements are moving away from accounting value and say, "Show us fair value because that will give us a better idea of what your pay policy was in the fiscal year you're reporting on." So we suggest you perhaps relook at that or refine the wording of the recommendation.

**MR FITZGERALD:** Sorry, just explain to me exactly what that means. What would be in the financial statements and what would be in the rem report?

**MR ROBINSON (GA):** The financial statements would, we suggest, continue to be the accounting value which is the fair value amortised over the service period. So you're expensing for, let's say, share options would be the expense attributable to service for the executives for a share options issued in that fiscal year plus all the prior years which still haven't vested and could have adjustments because you've changed the plan and so on. I don't know if that's clear at all. I could go a bit further into that.

**MR FITZGERALD:** No, but we may come back to you. We've had various suggestions in relation to that from some of the accounting groups as well, so just trying to get absolute clarity as to what goes into the financial statements and what goes into the rem report. We may need to go back to some participants and try to work through exactly what's required in that area.

**MR ROBINSON (GA):** Yes. As an example you might have a remuneration report that currently - you might have an executive that receives as part of policy, it's a standard policy being consistent for years, say, a third of that person's fixed remuneration be paid as a long-term incentive in equity, so $300,000 is $100,000. Yet in the current remuneration report it will not be shown as $100,000, it will probably be shown as $83,500 because it was a third of the fixed pay in that year amortised, so it may be a third of a third; plus a third of a third for the fixed pay in the prior year, and a third of a third of the - so it's totally confusing and it doesn't represent policy.

Also you may have a chief executive or an executive appointed to that position only one and a half years ago, so you get one a half years of amortised value and it again doesn't represent the policy or practice. It's a very confusing picture. Just a small point you make in the recommendation that equity holdings should be disclosed. That's currently in the accounting requirements under AASB 124. It's in the financial report. A lot of companies replicate it or move it to the remuneration report of an audit figure. It's already there, it's just a matter of where it's put.

**MR BANKS:** But do you support moving it forward?

**MR ROBINSON (GA):** I think it does give a good picture of it. The research seems to indicate there is a sweet spot in terms of management ownership of companies that seems to be correlated with share returns over time between 9 and 14 per cent of equity that's held by management. That was five or six years ago, or maybe seven years ago - always longer than I think it is. It hasn't been replicated. I don't think there's been attempts to do it but it's something worth keeping an eye on, I think. Again there's a balance about how much you disclose. Shareholders get sick of reading these big long remuneration reports.

On the external adviser recommendation we think probably some refinement may be due there. You're suggesting a change to the Corporations Act that ASX300 companies have a process for appointing external advisers, but there's no requirement that they have external advisers, so the easiest way is not to have an external adviser. We think both that recommendation and the following one - I think they're recommendations 10 and 11 - be rolled together and it not be an ASX listing rule but it be an ASX governance principle that on a comply or explain basis that companies have independent external advisers and disclose the method of appointment and the

degree of independence, because there's a lot of different definitions of "independence".

Small companies, of course, can opt out because they're small and they can't afford external advisers. We think that would be a more efficient way. We think having it as a listing rule would be difficult to monitor and enforce.

**MR BANKS:** Just to be clear about that, our recommendations are based on circumstances where the company makes use of expert advisers. You're saying they should be obliged to use expert advisers and then certain things would follow from that?

**MR ROBINSON (GA):** They should be advised to have independent external advisers and disclose the method of appointment or the process for that. A lot of companies would claim to have independent advice but we know from experience that the independent advice is from a very short list that management has put together and put to the board and they get to choose between two that may not be so independent as will be generally accepted in terms of what independence is generally regarded as.

**MR BANKS:** Just putting aside independence for a moment, you would see a requirement - although you're saying it would be under the Corporate Governance Council provisions of if not, why not - that there be external advice and then there be conditions on the nature of the adviser?

**MR ROBINSON (GA):** That's correct. I know this might seem self-serving but - - -

**MR BANKS:** It never would have occurred to me.

**MR ROBINSON (GA):** - - - we think there's an opt-out. I mean, obviously for smaller companies they can opt out and say, "Look, we have a very simple remuneration framework and we're a simple company and we don't need external advice."

**MR BANKS:** What if it's a large company with a lot of expertise within the remuneration committee itself?

**MR ROBINSON (GA):** The fact is large companies, almost all of them - I'd say about 7 or 8 per cent may not be - do get external advice. They do get external advice and I would say the majority is not independent, in terms of those advisers tend to provide a bulk - in terms of the bulk of the fees, comes from advising management.

**MR McAULEY (GA):** In some cases you can say there's several different sources, Particularly if they are a global company, as you might expect, they would source relevant expertise in a particular market.

**PROF FELS:** I suspect that if the recommendations that there is disclosure of remuneration advisers used and so on is adopted that that would put considerable additional pressure and disability on company decisions on this anyway.

**MR ROBINSON (GA):** I think you're correct. The UK has this requirement and what you see is there's a lot of focus on not just disclosing who the adviser is but some indication that they're independent. In the United States it's not a requirement but as a result of the congressional inquiry into remuneration advisers in 2007, the Waxman inquiry, most of the large companies are now volunteering information on their adviser and offering an opinion on their independence which varies widely. It's not unusual to have an adviser in the United States belonging to a large company that provides advice to management, but the board gives an opinion on that particular adviser's independence and why that person is suitable for them, but it's at least disclosed.

**MR BANKS:** I guess the approach that we obviously took was that that disclosure, that transparency, would have a beneficial effect in itself, at least in clarifying - letting people make a judgment as to whether they thought there was some conflicts or not.

**MR ROBINSON (GA):** Also if there are any advisers where behaviour needs to be improved, it would be one way to facilitate an improvement in adviser behaviour. They wouldn't want to be publicly associated with poor remuneration policy and choose to not provide advice.

**MR BANKS:** What do you say to the concern that has been raised - and you may well have raised this yourself in your earlier submission - of course, following on from what was just said, that boards make use of a number of advisory companies and they may not accept the advice, some or all of it et cetera. How is that most appropriately dealt with?

**MR ROBINSON (GA):** We have wrestled with this one and we know from experience - and you've talked to other advisers - much of the advice is not accepted. I think this just puts it on the adviser whether they want to remain as official advisers to the firm if they're not taking advice. We have, as a firm, decided or advised companies that we're not providing advice to them because it's a lost cause, they don't take it, why they have us? I mean, it is often a conflict amongst the board and maybe it's a board with not so independent directors, versus independent directors. But for whatever reason we've said it's perhaps inappropriate or a waste of your money to employ such - - -

**MR BANKS:** Just on that, do you ever get a disjunction between what the remuneration committee decides to do in terms of your advice and what ultimately the board decides to do or do you tend to see a one-to-one relationship between the two?

**MR ROBINSON (GA):** We tend to deal with the larger companies, so one to one. The rem co chair and the board chairman consult very actively. The chairman of the board, looking at the balance of power, tends to carry the day.

**MR McAULEY (GA):** Within that, there are shades of grey. There are answers that are not necessarily purely right or purely wrong, so there might be something that's considered by the remuneration committee that's modified slightly, without changing the essence of it by the time it comes through, but that's really just a variation. But I'd agree with Michael that usually the composition of the remuneration committee is such that the good committees and good companies will dedicate quite a bit of time to their remuneration issues and then take them forward to the board. A number of full board members will attend remuneration committee meetings and other committee meetings for that matter, be in attendance because they see the responsibility as shared anyway ultimately, even though they may not be formally members of that committee.

**MR ROBINSON (GA):** To an extent, disclosure will assist the process that's in place for many large companies. Now there's a lot more shareholder engagement as a result of the rem vote, so companies now consult with the proxy firms and large investors and frequently they would say there's a disagreement with an investor or a proxy firm who would say, "We were advised by XYZ company," and we know that happens, and, "We don't want to be particularly associated with something we disagree with," in terms of their rem framework because we have a reputational risk with the investors as well, who often refer us to companies, so there's quite complex engagement processes of a business.

**PROF FELS:** It's kind of interesting that we're seeing at the moment more shareholder concerns about paying more, negative voting and so on and so you start to think about what it would be like inside these companies too, whether there's equal levels of dissent or not.

**MR ROBINSON (GA):** Yes, you certainly have healthy debate in the large companies, that's for sure. On securities lending, you did ask for comments on that. We're not experts particularly in this area but we do note that in the deeper markets in the UK and US hedge funds, there are some hedge funds that specialise in governance matters. They make a short-term buck by just improving governance by changes on the board typically and the stock price goes up. They use securities lending for that purpose. So when considering that, we would suggest that that be

considered. Securities lending sometimes has a beneficial purpose.

**MR McAULEY (GA):** I think there's probably almost universal congratulations from what we've read for advocating the removal of the taxation on cessation. This is something, as you're aware from our previous submission, that we've been wishing for for a long time. It is a real impediment to what we think is good remuneration practice, in the sense of being able to look for sustainability of performance by ensuring that departing executives continue to have some reward at stake and subject to performance hurdles extending beyond termination. But the clear problem at the moment is that those individuals in the year in which they depart will be required to include any value of outstanding reward in their taxation returns and whilst there might be a lag between the actual submission of the return and the payment, it still presents a problem.

Clearly, we're not alone. There are many others who have pointed out this issue and we just think that it would advance the cause of remuneration in Australia if that taxation point could be removed. We've now moved into a situation where we've got further complexity in our view added to the taxation of the employee equity plans which are so important in the sense of achieving alignment between the interests of executives and shareholders.

**MR ROBINSON (GA):** There's one aspect that is perhaps not addressed in the report. While you suggest removal of tax at cessation of employment, you haven't really mentioned the taxation of options. Now, we haven't specifically addressed that in our written submission and I'd like to raise that issue now in the hearing. Perhaps we glossed over it because it's not primarily an area that would impact us in a lot of our client dealings because it impacts mostly smaller and entrepreneurial companies that don't employ us as advisers.

**MR BANKS:** Is that where options are predominantly concentrated now?

**MR ROBINSON (GA):** Non-performance hurdled options. So you're starting up a small start-up company - in Australia it's typically exploration, minerals or energy, in the United States it might be technology but the same principles apply - you can't afford to pay someone with the experience and competence to run your small company because they're getting paid a lot more in their large company. You have limited cash flow and the best way to go about that is to provide them or issue them with equity. The most effective from a motivation point of view is share options that may have not much in the way of value at the grant, but over time if they do a good job, these experienced people, it's used instead of a cash payment and they grow value for their shareholders. They also benefit as a result.

At the moment, and while the Board of Taxation is reviewing this matter and they're due to report in February, currently as it stands, share options are taxed at

grant if there's no forfeiture conditions and certainly taxed at cessation of employment on the fair value of those options, which they may be underwater, so you can't sell them because they're underwater but get taxed on the value that they have. It's a fair value, because fair value looks at if they could possibly increase over time, over the term of their period. But the person at cessation of employment has got to pay tax on something that isn't in the money; they can't exercise them and sell them. If you're a start-up company or a small entrepreneurial company or a high-growth company, typically they are provided in lieu of cash salary, so you don't expect performance hurdles or forfeiture conditions to apply. They'll say, "Instead of $100,000 cash, we're giving you a million options," which might be worth not much at all, but they're immediately taxed on their fair value which maybe you can't exercise them, there's no market in the small company to exercise them and sell, and yet the individual is up for tax.

We feel from an economic perspective that this really has an impact on the country's ability to start up entrepreneurial ventures and if you look at the source of wealth in this country, particularly in the past 40 years, 50 years, it's been minerals and energy. These companies start up typically with people from larger companies getting paid swags of options instead of cash.

I worked in Silicon Valley for many years and I saw the same thing. Tax is exercised when someone realises income, they exercise the options. They get cash and they pay tax. That avenue has been cut off with the new tax laws.

**MR BANKS:** Did you say that the Board of Taxation is reviewing this specific aspect now?

**MR ROBINSON (GA):** Yes, but it's hard to reconcile how they can come up with - and maybe they will - an exception to the regulation that's currently being put through the house. At the moment it hasn't gone to the Senate.

**MR McAULEY (GA):** From the company's perspective, a further benefit of being able to use options in such situations is that however small it might be in some cases, there will be an injection of some capital and the options are actually exercised at the vesting point and in those cases it's much needed capital for that venture. So it's a serious issue and something we haven't addressed and they will regret not addressing it now.

**MR BANKS:** Good, thank you. Is there anything else, Peter?

**MR McAULEY (GA):** One other thing we did touch on earlier, chairman. You mentioned briefly - and Michael did also - the educational issue around remuneration, given that your focus has been on board capability but particularly as it pertains remuneration issues. I think it's clear to us that the AICD has been

promoting the need for improved education around remuneration matters and that's commendable. The reality is, I think, within Australia at least, of the total executive and board population there have been relatively few people who have been exposed to specialised remuneration issues. So it is an area that we didn't focus on in here but perhaps should have.

That is one area of capability that could perhaps be directly enhanced by considering the ways in which there may be greater expertise built around remuneration, because it's something that in the normal course of their careers, many current board directors would not have received a particular level of exposure to. That's something that probably can be addressed directly through various initiatives.

**MR BANKS:** Focused particularly on the members of the remuneration committee, do you mean?

**MR McAULEY (GA):** Whilst that might be a starting point in terms of logistics, I can't see a reason why that wouldn't be a standard to all board members or potential members. There are varying degrees. I think it's fair to say that there are varying degrees and levels of understanding the remuneration issues from our own observations, and that's not meant to detract from the general capability of board directors who, in our experience, are overwhelmingly capable individuals with expertise in a range of areas. Remuneration is one that - understandably in my view - they have not necessarily been exposed to during those careers.

**MR ROBINSON (GA):** Certainly the APRA regulations under the prudential guidelines, PPG 511 they say that remuneration committees must have expertise in remuneration matters. Certainly you get that amongst the big banks and so on, but the financial service sector is fairly deep and there is probably a lot of room to improve the remuneration expertise of boards. By extension you could do that outside the financial services sector. It's not unusual that we get asked - for example, on market data when we present just a very simple, "Here is what your peers pay" - "What is the percent on?"

**MR FITZGERALD:** But linked to that the Australian Human Resources Institute in its second submission, in a hearing in Melbourne, has again promoted the notion of a standard or code that would be developed by a number of key players in the corporate world to assist and guide boards in the setting of remuneration. Apart from that is the actual educational aspect. This came up in the first round of hearings but again they have come back and said that perhaps this time there should be, not a mandatory code but a voluntary standard established through perhaps the Standards Australia processes that would actually aid and assist remuneration practices in Australia.

There are mixed views about that. There are several codes and various

guidelines already out there, but I was wondering whether you have any response to that sort of suggestion that would go along with training; their point being, "We've now got standards in quality, risk and so on," areas that hitherto would never have been regarded as the province of - standards in the last decade have in fact become, as I say, standards themselves.

**MR ROBINSON (GA):** I think in general we would support that. If you're going to have a standard it would probably be the lowest common denominator standard, and these are the minimum things you need and that would be related to the smaller companies, but certainly needed. Yes, we would be supportive of that but again we're wary of a lot of regulation or compliance issues and so on which reduce your ability to attract and retain suitable directors. I'd rather have a director with financial nous than remuneration nous if you put it on the table.

**MR BANKS:** Sure. Are you saying to the extent that there's a problem, it's more at the lower end of the 2000 public companies, rather than the top end, where such a standard would be helpful or effectively provide guidance?

**MR ROBINSON (GA):** What we would say is it would be throughout.

**MR McAULEY (GA):** Yes, I would agree. I wouldn't want to draw boundaries around particular groups. One final thing that might appeal to you, having sat through your various hearings and other submissions, is that despite what I said, there are many, many people out there who believe they're experts in the field of remuneration.

**MR ROBINSON (GA):** Yes, it's not just directors. There's a high degree of variability across the advisory community. There are reasons for that. Some, for example - particularly deep in one area - might be tax. That's where they should be employed. Others get asked advice on other matters outside their direct area of expertise and it's often wanting. That's across the adviser community as well, so you might want to have a standard for the adviser community. We notice that the Walker review in the United Kingdom did set out a code of practice for remuneration consultants.

**MR FITZGERALD:** Can I just explore that with you because that has been proposed, I'm not quite sure formally, but certainly in some of the informal discussions we've had since our draft, particularly with directors of large companies who have raised issues around the standards of advisers, proxy advisers and others. Some have suggested there needs to be some code; others have said, "Even if that was desirable, it's almost impossible to come up with one that would work." If you could elaborate on your thoughts about that.

**MR ROBINSON (GA):** The draft code in the Walker review is mainly a

behavioural governance code. It's not really one about expertise. There are some aspects of expertise incorporated in the code but it's not its primary purpose. The primary aspects it focuses on is independence of advice. There's probably room - if you're talking about standards, there's certainly a standard for advisers in terms of knowledge and expertise. It's something we have observed.

If you're talking about priorities it should be the board rank of first, but it would be nice to see high levels of advisory standards from the adviser committee. There are some very high standards already but it's not consistent.

**MR FITZGERALD:** Sure.

**MR BANKS:** You make the comment under Improving Relevant Disclosure that you felt we could have said a bit more about the existing enforcement requirements centred on ASIC, for example. We haven't sufficiently addressed that. How is this best advanced? I guess what you're saying is there's a bit of a gulf between what should be happening and what is happening. How would you suggest we push that along?

**MR ROBINSON (GA):** Firstly, it is our view but it's also in many of the other submissions in the first round of submissions that people have said that the current 2M303 primarily has not been enforced. Now, why you've said that a detailed summary is required is not particularly prescribed. Well, it is actually, in our view, very well prescribed in 2M303, and companies do not provide enough detail that a reasonable person could understand how a particular remuneration outcome was arrived at, particularly on short-term incentives.

Now, if there was full compliance one of the outcomes would probably be even a lengthier remuneration report, so you've got to balance this up, but in our view there hasn't been compliance. There has been no enforcement from ASIC at all on compliance with this 300A and 2M303. We understand there are probably far more material matters for them to look at, and they have limited resources, but in our view these transgressions on these factors could result in the levying of a fine and this could be a profit centre for ASIC. They could outsource it, and I'm sure there would be many willing to enforce it. Many of the proxy firms would love to be enforcers. While you may have limited resources in ASIC now, the fine levying capability may be able to make it pay for itself, and be a good training ground for - - -

**MR FITZGERALD:** Can I just ask, are you aware whether or not ASIC has in fact received complaints but not acted on those, or is it there's simply failure to audit or oversight that is the greater problem?

**MR ROBINSON (GA):** I don't have enough information, and I think it's a good question you should ask ASIC. I haven't encountered any company that has been

audited from ASIC on these matters and we have dealt with 30, 40 per cent of the ASX300 of which we have noted to the company the major deficiencies in the remuneration reporting and they have not been approached by ASIC on these matters.

**MR BANKS:** I suppose I'm just thinking out loud. ASIC's approach, presumably like other regulators, is to take a risk based approach to where it concentrates its limited resources. It's something to think about, if you want to give us any further advice, as to how that would translate into this area which would be the companies where ASIC would want to perhaps focus its attention, given that it wouldn't be able to do it for every company, one of the 2000-plus companies necessarily, or that wouldn't necessarily be a good investment if it's scarce resources. That would be something to think about.

**MR ROBINSON (GA):** Certainly they can focus on the large companies looking at economic impact but again, as I said, if you're levying fines - and it's not difficult to find the holes in the remuneration reports, you just have to pick it up - you might say two out of three. We did an audit two years ago just on the description of long-term incentives and 80 per cent were noncompliant. This is the ASX50.

**MR McAULEY (GA):** The other thing about that I think is that the larger companies often become models for other companies. The reality is that many in the market will look to those market leaders to see the way they do things and whilst they're not just slavishly copying, they do generate ideas and follow in those practices, I think. If we can get that one important part of the market right then it would probably flow on as a natural course.

**MR BANKS:** In this area we had some discussion yesterday just on that point as to what extent we're seeing an evolution, for example, in the remuneration reports where some companies are being a bit bolder about making them intelligible and getting away with it in some sort of legal sense and whether that's having a demonstration effect on other companies.

**MR ROBINSON (GA):** It is. Many of those companies tend to be leading companies, we would say. They put all the compliance requirements in the back and out front they have a plain English report saying, "This is how it works. This is how it's related to the business strategy of the organisation. This is how we frame it to generate sustainable value for our shareholders." Some companies are outstanding examples of that, but they also tend to be good complying companies, so they stick the other stuff in the back. As rem consultants we often go to the back bit to get the detail.

**MR BANKS:** Thanks very much. I'm sorry for our delayed start.

**MR ROBINSON (GA):** Just one concluding comment. We've made a note in our letter, we're just concerned - while I know it's your brief, the regulation on - too much on remuneration could result in diversion of attention away from what we consider more material matters and I'm sure you have taken that - - -

**PROF FELS:** You think you're operating in a very important area yourself.

**MR ROBINSON (GA):** Obviously we do, but we do acknowledge that raising billions of dollars from shareholders or mergers and acquisitions might be a smidgen more important than remuneration matters.

**PROF FELS:** Isn't it the soft point though in the principal-agent relationship - I mean, that's a very important relationship - and the area which attracts the greatest concern is this very soft point on pay and that is why there is such community and shareholder concern. That's the one where the potential for things going wrong is relatively high and the sensitivities are greatest and therefore the boards do have some special responsibilities in this area. We trust boards and executives more on other dimensions of the principal-agent relationship and that is why everyone is so concerned about it.

**MR ROBINSON (GA):** Yes, I think you're right and I think all the boards would agree that the community has concerns and trying to address those. That's why we think it might be an expertise issue, a capability issue. They try and address it and they have not been succeeding.

**MR BANKS:** You raised, which is helpful to us, this question of the nomination committees and how they function and how they report. We won't go into that now, we'll explore that with the AICD later perhaps or others, but that's quite a helpful direction just to be thinking about, the process of board capabilities and diversity.

**MR ROBINSON (GA):** That's great. We don't think the no vacancy rule - there's obviously no reason to keep it there. We think it's probably a good thing to be removed. We don't think that would necessarily improve board capabilities or diversity and maybe that should be addressed throughout the hearings.

**MR BANKS:** Okay. Thank you very much.

**MR ROBINSON (GA):** Thank you for the opportunity to present at the hearing.

**MR BANKS:** We'll break for a moment before our next participants.

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**MR BANKS:** The next participants this morning are the Chartered Secretaries Australia. Welcome to the hearings. Could you give your names please and your positions?

**MR SHEEHY (CSA):** Tim Sheehy, the chief executive.

**MR ABRAHAM (CSA):** Peter Abraham, I'm a member of the legislation review committee.

**MS FOX (CSA):** Judith Fox, director policy.

**MR BANKS:** Thank you very much for attending and indeed for the submission that you've just provided to us on the discussion draft. You provided a very helpful submission in the first part of the proceedings and we thank you for that. You also attended the earlier hearings for which we thank you as well. As indicated, we'll give you the opportunity to outline the key points that you want to make.

**MR SHEEHY (CSA):** Thank you. First of all - and as we said in our letter - the overarching comments that we have is that we welcome the Commission's findings that it would be inappropriate and have an adverse impact on the economy to bypass the central role of boards in setting remuneration pay. Obviously it's a fundamental principle of this inquiry. It's a fundamental principle that CSA supports and we were very pleased to see that that was highlighted. Second, we support your findings that remuneration should remain a largely private matter to be agreed between executives and companies, notwithstanding that one is always applying the governance processes which protect the interests of owners. We're very pleased to see those two main principles.

We don't propose simply going through one recommendation after another. We're more than obviously happy to respond to questions. But there's a couple of points we wish to make. We feel that there were a number of issues within this report that were addressed that were outside the scope of executive remuneration. We said so in our paper, we're very happy to have them examined but in particular the issue of board diversity we think is something that is important enough that it deserves a focused examination of it as opposed to being just picked up in this.

I said to Judith I understand that the ASX Corporate Governance Council is looking at it and is meeting tomorrow on it, but we think it ought to be something which is separate. Then also there are a couple of matters on voting reform which are in the report and we most definitely think that the whole issue of voting is something quite separate. Our organisation has made a number of submissions under the previous government. We did it as part of a parliamentary joint report into shareholder participation. The issue of cherry picking is not straightforward and

simply all or nothing is not quite the right way to go, and the issue of undirected proxies is not straightforward. We think they're exceptionally important, that's why we're on the record in the past on them, but we think they ought to be looked at quite separately. Electronic voting as well, we support it, but that should be wrapped up in that.

The other main principle I wish to make is that there's a number of recommendations in the paper where perhaps the report suggests a listing rule and then there is also a sort of tangential discussion on whether or not the ASX Corporate Governance Principles could pick it up, particularly recommendations 2 and 3, composition of remuneration committees, and recommendations 10 and 11 around advisers. We are a very strong supporter of the ASX Corporate Governance Council and the concept of it and the if not why not. We would be prepared to see those things dealt with within the council.

We think in the years that that council has been in existence it has had a tangible demonstration in improving the quality of disclosure. We think shareholders are better off with that and asking companies to explain as opposed to either a listing rule or a law; in this case a listing rule, where they just comply with it or not and there's no explanation. So overarching, we're a very strong supporter of the if not, why not regime, and we would like to see recommendations drift in that direction. We're happy to respond to questions. We think it wouldn't be fruitful to just go through recommendations 1, 2, 3 et cetera.

**MR BANKS:** Okay. We probably each have some questions from your submission on some of the detail and so on. But just to come back to your introductory comment about certain matters being outside the scope of executive remuneration, in a narrow sense that may be true. I'll just make a couple of points. One is that it's not outside the scope of our inquiry if you have a look at our act. I guess the second thing would be to ask you how much progress you think is being made in those areas separately from this inquiry, including activities in the past. How much hope do you hold out that other mechanisms are going to deliver the comprehensive solutions that you're after?

**MR SHEEHY (CSA):** I think I could honestly say we're disappointed with the progress. If this inquiry were to nudge it along, we would welcome that, particularly in the area of cherry picking. Our organisation went to the extent of even drafting proposed changes to the act and providing those. We teased out the pitfalls around cherry picking and, yes, we have been extremely disappointed that it seems to have gone nowhere. If this nudged it along; fantastic.

**MR BANKS:** But isn't it therefore appropriate that whilst you may not be able to get movement across the whole of the areas in relation to some of those matters you've been promoting, using thin edge of wedge, things do in fact work. In fact

regulation by nature often starts with a thin entry point, gives us an opportunity to experiment with it to see whether it works before you have broader application. I am surprised by the conservative response that you've given to some of these issues because I would have thought we've been helpful in promoting some of your agenda in a way that would give not only a little momentum but a substantial momentum to those issues.

It does say that using the remuneration entry point is an appropriate entry point. Your approach seems to be, "Let's just do the whole lot, let's just move it along a little bit further." I would have thought the outcry from shareholders and others would indicate that a much more proactive response is required than that approach that hitherto today hasn't resulted in substantial change or improvement.

**MR SHEEHY (CSA):** Let me pick the cherry picking one, for example. On the face of it it's very easy to say that a proxyholder should exercise all of the proxies they hold when at a meeting - all the proxies they hold. We looked at that and said, "On the face of that, of course, who would not support that?" But then we were faced with the practicalities of occasionally a proxyholder who is not always the chair - usually is but not always - may have to have left the meeting; may have gone. Then to expect them to vote all the proxies when they have left the meeting is unrealistic. So we came back a bit and we came forward with the recommendation that if a proxyholder votes any proxies then they must vote all the proxies.

So we had a threshold where the person was there. I use that just as an example. All we're saying is, we certainly didn't say these issues were not important but we're saying that there is some devil in the detail in them. It is the same with undirected proxies; I think we brought out in our submission "may not know anyone to appoint as a proxy other than the chair" and that causes difficulties. We would prefer to see a more holistic examination of the voting process.

**MR FITZGERALD:** But that has been on the agenda for some time. In fact we take courage from your submission that these are issues that should be dealt with. I would have suggested that in fact our proposals - and whilst many of them need to be tweaked - would have been very much ways by which that agenda could be pushed and pursued and in fact advanced those agendas. In every single recommendation we make, or that anybody else makes, there's an outlier. There's always the extreme case. There's always the "if not", you know, "this might happen, that might happen", and one tries to constrain that as much as possible.

I go back to my point. Just in general terms, would not some of these changes that we've made in relation to undirected proxies in relation to director proxies, in relation to the way in which people vote, be helpful in terms of overall governance using remuneration as a legitimate and important entry point? That's really my concern, more than it is about whether or not you tweak each of the

recommendations which we are obviously open to doing.

**MS FOX (CSA):** I think that we wouldn't have a problem with the idea of it being used as a thin edge of the wedge, but it would be difficult to support if recommendations went forward, for example, on the voting ones around undirected proxies. We do have concerns with proposals that have been put forward. Tim has already outlined our concerns around the idea of cherry picking that you actually then attach liability to people. They might not even know they were appointed as a proxy. So there are issues that need to be teased out. We were worried that if it was just seen as part of remuneration, rather than it actually applies to every single resolution that goes before shareholders at a meeting - the remuneration resolution is just one of many - we were concerned that somehow those other nuances could be missed.

In the matter of the undirected proxies there is also the issue that shareholders appoint the chairman as a proxy quite frequently because they have confidence in the chairman and actually think the company is doing well. They're quite happy to give their undirected proxy to the chairman. In fact I think in the submission we made the point that in companies with a very large shareholder base you can have up to 70 per cent of undirected proxies given to the chairman. If those undirected proxies are not being allowed to be voted by the chairman, you have just disenfranchised a huge swathe of shareholders who actually were quite clear that they were giving an undirected proxy to the chairman. The notice of meeting spelt out exactly how the chairman was going to vote the undirected proxies, so there was no lack of information as to what is going to happen with that appointment of proxy. Then to say, "Well, the chairman can't vote those proxies," those shareholders are instantly disenfranchised. We weren't trying to be conservative in - - -

**MR FITZGERALD:** But conversely if they know they're not going to be voted then won't that change shareholder behaviour: firstly, to either appoint non-directors as proxyholders or, secondly, to actually direct the proxy. Perhaps that would be a good thing. Would it not be better for shareholders to take a more active interest in issues around remuneration? If that led to less undirected proxies, might that not be in fact a very good thing? At the moment, the reality is the chairperson, who is integral in the decision-making around the remuneration package, votes all of those in favour of his own position basically. We haven't heard a chairman who has used the undirected proxies to vote against his position.

At the end of the day what we've said is we believe that the influence of shareholders should be increased. What we've tried to do is to use mechanisms to achieve that. But part of that may be also to get shareholders to take greater responsibility and that might mean to increase the level of directed proxies over time. We would have thought that might not be a bad outcome. We're not compelling them to do that, but one of the positive consequences of our decision may be that.

**MR ABRAHAM (CSA):** I think there's an issue in that transition. I don't disagree with that being the long-term outcome but certainly my experience from being a company secretary and seeing on certain resolutions where the shareholders had to tick the extra box to make sure that their proxies to be in favour of the chairman worked, a vast number of shareholders just didn't get that. From memory we were losing 20-odd per cent of the shareholders who thought they were giving the chairman a tick, didn't tick that box as well.

If we go to that next stage I'm concerned that until the education process really works its way through there's going to be a very significant number of shareholders disenfranchised who may well be very supportive of the company but haven't actually fully grasped the process as to exactly what's required.

**MS FOX (CSA):** Also, just to follow up on that, we agree with you wholeheartedly about wanting to see shareholders more actively engaged, and we've been promoting direct voting for some years now. Direct voting really is that there is no intermediary or agent between a shareholder and the vote. The vote goes straight through to the keeper. We are in wholehearted agreement with you but we think there are other methods of actually encouraging shareholders to be able to voice their views.

**MR BANKS:** The other one where I thought I would ask you to comment a little bit more is in relation to recommendation 4 and your response where you support part of what we propose and not the other, and what you support is in relation to the recommendation that executive directors and executives be prohibited from voting their shares, but you don't support the proposal in relation to non-executive directors. You say that our proposal assumes a conflicts of interest for them where none exists.

You might have been here earlier when I was trying to tease that out a little bit with the previous participants. The perception of a conflict where you've got a board voting on a remuneration policy that it itself has signed off on, a lot of shareholders would see that potentially as problematic but you don't. I just give you the opportunity to comment on that.

**MR ABRAHAM (CSA):** It seems to me to be very much the case that pretty well everything that gets put forward by a board at an annual general meeting or extraordinary general meeting is something that the board is endorsing, whether it be an acquisition or a reconstruction of the company or whatever. So pretty much anything that goes into that category is going there with the board's endorsement. So I'm not sure why this should be distinguished from any other matter that goes forward and to somehow say that the directors have a different sort of interest in this, even though they don't have a direct financial interest in it. I don't understand the logic.

**MR BANKS:** Some might put the logic to the extent there's concern that executives have exerted influence over boards that in this area may be more problematic than in others where the influence would be benign because it relates to the broader strategic role of the company where the influence might be not so benign where it relates to the remuneration of the executives concerned. In that sense you could potentially look at these issues somewhat differently. I just put that as a proposition.

**MR ABRAHAM (CSA):** It's saying some pretty bad things about the board as a whole, I would have thought, and maybe raises other issues.

**MR SHEEHY (CSA):** In other parts of this there are issues around composition of the committee where you can deal with executives exerting influence over the remuneration committee. Putting that aside for the moment I would have to agree with Peter that it's making assumptions that are pretty strong, and the non-executive directors don't have a beneficial interest.

**MR BANKS:** Let's do the other, because other people have said to us that some of our recommendations may have unintended or perverse consequences. What is the harm in our recommendation? Let me just take that position. Acknowledging that we've taken a broad definition of conflict of interest, that is to be both indirect and direct, taking the notion that we've taken the view that those that have been involved in the decision-making should not necessarily be able to vote on that decision in relation to this, if the directors are not able to vote and, yes, of course they're disenfranchised from voting their shares, what harm would come from that? It would empower those non-director shareholders, yes, absolutely. That's pretty much the clear thrust of our report, that we want that to occur. We would think, yes, we acknowledge what you've said but I'm not quite sure where the harm would come from that.

If the directors are as confident of the package they're putting to the shareholders, they surely should have confidence that the shareholders will accept that package, in which case their own shares should have little relevance at all.

**MR ABRAHAM (CSA):** I think it's a matter of principle and it certainly gets magnified if that's then extended to undirected proxies as well where there really are other shareholders - however misguided others think they might be - who think they're actually supporting the board and they like what's going on and they intend to vote in that direction.

Let me give you a war story that indicates maybe why there are other issues at play here. I was company secretary of CSR and then Rinker after the demerger. We put our remuneration report to shareholders two years before we were required to and went for a non-binding vote in each of the two years prior to when we were required to because we thought it was a good thing and it was something we wanted to

support. That turned around and bit us in 2005. Rinker had 80 per cent of our business in the United States. It was a concrete and quarrying business in the United States. 80 per cent of our executives were in the United States and we were obviously competing for executive talent with US companies.

In terms of our long term incentive plan, our board was given very strong advice that to have the same thresholds that were regarded as appropriate in Australia, in the US was going to put us at a severe disadvantage in terms of recruiting and retaining talent because the threshold for being awarded long term incentives in the US was that you were still breathing at the end of the period. Our board agonised over this. We took umpteen remuneration experts' advice into account and ultimately, to try and sort of wean the US off this, they determined that it would be appropriate for our long term incentive plan to start vesting at the 25th percentile, rather than the 50th percentile, knowing full well that that wasn't what we really wanted in Australia, but to not put ourselves at too much of a disadvantage they did that.

One of the proxy advisory services - one out of the two main ones - supported that. They understood our rationale. The other one didn't, and recommended against. Notwithstanding that we actually explained, and our chairman explained to them, exactly what the logic was, they said, "No, this is black and white. If it doesn't start at the 50th we can't make any exceptions, that's that." They then exercised enormous influence. The initial indications were that we were going to get a no vote in the 40 per cent range. Our chairman rang each of the top 20 and spoke to them and explained what the logic was and why we were doing it that way. About half of them changed their view and supported the board. The other half, almost to a one, said, "Well, we've actually got a policy that we're going to follow what the proxy advisory service says, and whilst we hear and understand what you're saying, that's what we follow."

I guess the point of that is to say there's a non-elected body here who are providing advice who have enormous influence in this space. We're talking about diluting the influence of directors but query the influence of these other players and that they can actually distort the game. The postscript to that was that in the following year the board was between a rock and a hard place because the board was very concerned about its governance reputation and the company's governance reputation. There had been a very significant no vote. The board had to decide the lesser of the two evils. On the one hand, if they stuck to their guns and maintained what the independent advisers were telling them about recruiting in the US, they would leave it the way it was, but our reputation would take another very significant hit. In the end the board determined the lesser of the two evils was actually to go back, to drop the plan or change the plan, start vesting at 50th percentile, take the hit in terms of our employment of executives in the US, but to preserve our governance reputation. That was a hard call.

I guess it's just not as straightforward as saying we should give the shareholders more power and dilute the power of the board. There are other players out there who perhaps have more influence than is warranted that can distort the process.

**MR BANKS:** Could you maybe elaborate on why they have more influence than is warranted. Are there barriers to entry into the proxy advising business? How concentrated is it? Why do these people have - - -

**MR ABRAHAM (CSA):** As I understand it, it is. I'm not an expert and I've been out of it a couple of years now, but my understanding is that RiskMetrics has got the large part of the game, along with CGI Glass Lewis, and there aren't too many others apart from that. So my concern would be that you don't have those guys de facto determining the remuneration policy within companies. Especially if you up the stakes and reduce the other potential votes that might support it, your companies are going to be very, very keen to curry favour with those guys.

**PROF FELS:** I find that a very interesting story. On the other hand I would of course be interested to hear the other side of the story. What broke down in the communication process that you couldn't persuade them of something that on the face of it sounds clear?

**MR ABRAHAM (CSA):** I'm happy to elaborate on that as well.

**PROF FELS:** Yes. I suppose the other thing is that we are constantly hearing stories about how minority groups can pull strings and have various influences but also your story brings out that there are many things on the other side that can be done. In this case it didn't quite come off but the company chairman and so on can do many things to influence votes. We've been hearing a deluge of stories about the activities on the minority shareholders' side, but on the other side quite a few things can be done also.

**MR FITZGERALD:** This is a dilemma for us, the same dilemma. Why we're teasing this out with you is because you've come back again. You say in page 11 of your report, quite rightly:

> CSA agrees that it is in the interests of good governance to find a mechanism that strengthens that shareholder capacity to hold directors accountable for remuneration.

In that regard you then go on to say that you don't like our two strikes and you're out rule, but the first part of that is right. What I'm missing in your submissions is any mechanism by which it actually allows what you've said to

become a reality. In other words, if you believe that it is in the interests of good governance to find mechanisms that strengthen shareholder capacity to hold the board to account, we agree. You don't like many of our mechanisms to achieve that, but I'm not finding any alternative mechanisms that would achieve that. That's our dilemma. Let me be clear: it is not likely that in the final report the Commission is going to move away from a fundamental position that we actually believe shareholders should be able to exercise influence in this area.

We've obviously been very cautious in our approach by not recommending binding votes and so on and so forth, and being moderate in some of the recommendations and perhaps a bit adventurous in others. But I'm not finding in your second submission the mechanisms that would achieve what you've just said in that report. You'll have to help me with that.

**MR SHEEHY (CSA):** We do state it in here. The principle which is in the law and has been in the law for a very long time is that 5 per cent of shareholders can put a resolution on the agenda of a general meeting. That has been there all along. We have been involved in a longstanding debate and discussion on what's called the 100 member rule which is to just call a special meeting. Putting that aside, we have always been clear and the companies we talk to have always been clear that no matter what we've said about the 100 member rule, we always want to keep entrenched the 5 per cent rule that shareholders can put on the agenda of a general meeting a proper resolution.

Now, you might sit back and go, "Oh my God, 5 per cent, how is that ever going to happen?" Well, if you couldn't get 5 per cent then it has no hope of going anywhere anyway, but the 5 per cent rule is the mechanism to voice your dissent. But in addition to that we still do have the 100 member rule which we would like to see changed but nevertheless it exists. You only need a hundred people to call a special general meeting. We're saying that there are very clear, well entrenched mechanisms which have the support of the major listed companies that can be used for shareholders to voice their dissent; they're there.

**MS FOX (CSA):** And that have not been used.

**PROF FELS:** Could you just analyse a bit for us the implications of that. You've made a good point there. It doesn't take more than 5 per cent et cetera to call a meeting, and then at that meeting a proposal can be put for a spill or whatever. Now, some people would say, "Why all the fuss about 25 per cent?" and others say, "Well, it's a much higher threshold." That's one view of it and there's another view of it too, that you've already got an adequate mechanism. The 25 and 25, if it were that, has a more substantial consequence because the minority can force it, but I wonder if you have any thoughts on this issue. Some people - I'm getting too complicated - say, "Well, look, if there's 5 per cent already what harm is there in having a 25 per cent

threshold? Why all the fuss about that?" I'm putting it in its simplest way. "Why all the fuss?"

**MR ABRAHAM (CSA):** Perhaps there are two different concepts here. One is saying, "There is one aspect or more about the remuneration policy of the company that we don't support." The other is to say, "This is so bad that we ought to be throwing directors out." Certainly one of the other experiences when we went through the tale I was telling you before, a number of shareholders said, "Well, this is non-binding. We actually love the directors and we think the Rinker directors are doing a wonderful job, but this is just an opportunity to give them a kick in the pants without any consequences coming from it."

I think the non-binding vote is performing a role where there can be a fine tuning of the dissent, that if you elevated it up to the next level to say, "Is this something so bad that we ought to be removing directors?" I think a lot of that, the 25 per cent or more, would evaporate quite quickly to say, "Well, no, no, we don't think it's that bad. The company is doing a lot of other wonderful things and this aspect of remuneration really doesn't warrant going to that stage."

**MS FOX (CSA):** You asked the question earlier about where is our mechanism. Our members have had incredibly robust discussion — we don't make that statement lightly but we think it is useful to find a mechanism that strengthens the shareholders' capacity. We have had discussions about whether it should be through the remuneration committee or remuneration committee chairman. There are real concerns about that because of the unitary nature of the board that it is meant to be taking decisions collectively, that if you start singling out individuals or elements of the board that you're actually undermining that very unitary nature of the board.

**MR ABRAHAM (CSA):** I think the other point is that if you have two no votes and then at the next general meeting there's a complete spill, that's a three-year cycle during which every one of the directors will have been up for re-election anyway because everyone has to come up at least every three years. Every director will have been re-elected in that three-year cycle anyway without having something as dramatic as a complete board spill which is going to be extraordinarily distracting to everyone involved in the governance of the company.

**MR SHEEHY (CSA):** You've moved into the two-strikes issue. Okay. But we want to make a point, which I hope I did, that we think there is a mechanism that does exist for shareholders to vent - call it what you want - their frustration, anger or whatever, and an effective mechanism.

**MR FITZGERALD:** Yet the shareholders are saying to us that they want a more effective mechanism. There is a disconnect in this conversation.

**MR SHEEHY (CSA):** Well, if they want it, why haven't they used the one that's already there?

**MR FITZGERALD:** But the shareholders are saying to us in the various submissions that they don't believe those mechanisms are sufficient for their purposes.

**MR ABRAHAM (CSA):** Talking with my colleagues - there are a couple of outliers but virtually every company, as did we, takes enormous notice of a significant no vote on a rem report and changes what they're doing. Sometimes it's the next best option, the lesser of the two evils. I'm not sure how much of this comment is caused by a couple of real rogue companies who have been thumbing their nose at the shareholders, versus the vast majority of my colleagues I speak with who say that their board really reacts quite strongly to any sort of significant indication from shareholders, they don't like it.

**MR FITZGERALD:** I don't want to be unduly adversarial about it, but it strikes me that if it is true that the vast majority, the overwhelming number of companies, take notice of a significant vote, even at 5 or 10 or 15 per cent, even if our recommendations were adopted with a 25 or 50 per cent threshold, on the one hand many people are saying, "We do respond," the chances of it being used are infinitesimal. The unintended consequences would be almost zero, because if what you say is true - and directors say that to us endlessly, we accept that - it would never be used.

On the other hand, directors say, "It has terrible consequences," they don't jell. Either corporate Australia is exceptionally responsive - which we think they are largely, we don't have too many very high second votes, no votes - then our mechanism would simply be there as a mechanism that would in fact pick up the rogues, those where shareholders feel totally aggrieved. In that case I have to say that I think it's appropriate that shareholders should have a mechanism they can easily use. As you rightfully say, 99.99 per cent of the time it would never be used. Is that not a fair case where you pick up the rogues where there is significant aggravation by the shareholder, they want an easy mechanism? Whether or not they re-elect the same directors is up to them. It seems to me that our compromise actually achieves that aim. It allows the 99.99 to continue to respond and it picks up the outlier who, for various reasons, has caused shareholder outrage.

**MR ABRAHAM (CSA):** The illustration I gave before about what happened at Rinker probably highlights where this can come to grief.

**MR FITZGERALD:** But is that not the case that you were more concerned about the influence of the proxy adviser there - and we've heard that from several participants already.

**MR ABRAHAM (CSA):** But ultimately the board was forced with the decision to say, "Our reputation versus what logically seems to be the most appropriate sort of incentive structure." If you up the stakes and say, "Well, it's more than a reputation, you're all going to potentially be thrown off the board," it distorts that decision-making process even further. You've actually got a gun at their head to say even if they strongly disagree with what is potentially just a view of one proxy advisory service - they can get 25 per cent over the line. If the board strongly disagrees with that, it's basically saying they can't actually stand on their dig and take the hit and argue the case because the ante has been upped very dramatically.

**MR BANKS:** Okay. On recommendation 10, your response to that on page 7, I was puzzled in that I think you see consequences flying from that that I didn't think were connected with that recommendation. This is the one that relates to the use of expert advisers and where a remuneration committee does make such use they be commissioned directly by the remuneration committee, the advice provided to them et cetera. You then seem to segue into saying that you don't support a regulation that makes boards responsible for the remuneration of all operational staff within a company, and for the life of me I couldn't see how you give that - - -

**MR ABRAHAM (CSA):** I think it's more of a practical issue. We had a number of different remuneration consultants; some advising on the pay structure for the concrete truck drivers and quarry workers and others for clerical staff. There was a range of remuneration advisers and I guess what I thought the thrust of that was trying to say was that at those levels there really isn't a conflict and there really isn't an issue about management engaging those advisers. The conflict arises when you get up to the executive level and I think we're agreeing that if the board is going to engage an adviser to the board, it should engage their own adviser to advise them on pay at those executive levels. If somehow the board had to engage all of the advisers it would be quite unworkable in terms of the board trying to set that whole structure throughout the organisation.

**MR BANKS:** We'll look at the wording again but that certainly was not our intention. I guess what we did want to make a bit more transparent is where you had an advisory firm providing services to the board, but also providing services to management, that that be transparently declared.

**MR ABRAHAM (CSA):** No quarrel with that.

**MS FOX (CSA):** We didn't have an issue with that. As it was worded it was actually all remuneration, it wasn't just executive remuneration. We also feel that these issues would really be dealt with better in the ASX Corporate Governance Council guidelines and it's for the reason that Tim set out earlier. It's that window for shareholders being able to understand the decision-making process. A listing rule

— you simply have to comply. There is no dialogue or explanation with shareholders. But if you bring these issues in about independent advice being received by the board into the ASX Corporate Governance Council guidelines, you automatically then start to have a vehicle for explanations to shareholders as to why you've made certain choices, as to why you have commissioned the advice, that you don't have to accept the advice but then the shareholders get to hear that you didn't accept the advice. I think there are much better ways of dealing with it where you give shareholders that opportunity to have a window into the decision-making process.

**MR BANKS:** But if you took out the extreme you would have no listing rules. Everything would be if not, why not. I mean, clearly there are some listing rules which have a black letter dimension to them because some things are being seen as more absolute than others and so there's a judgment call as to whether something like this - you know, if we put to one side any confusion about the language, the notion that the remuneration committee would commission their own independent advice. What would be the exceptions to that, if you could imagine, for the top 300 companies where that advice shouldn't be going direct to the remuneration committee but should be going through management? It's hard to think of good reasons for big companies to do that.

**MR SHEEHY (CSA):** True, but there's 2000 or so companies.

**MR BANKS:** Yes, but we're talking about the top 300 here though.

**MR SHEEHY (CSA):** This is another issue of ours that there is one exception in the ASX Corporate Governance Council guidelines for the 300 companies that have to have an audit committee. We would not be keen to see another 300-company exception. We think it's best dealt with within the guidelines for all companies. If we carve out another 300-company exemption that's not the intent of the guidelines and I don't think it's healthy. It's not healthy that the companies are 299, 300, 301. I heard the previous speaker say that most other larger companies get the advice but we also are not comfortable with the 300 carve-out.

**MR BANKS:** You said because there are companies either side of that who may move within the net and outside and so on, but all that would mean is that for those sort of companies they would simply ensure that they always met that requirement which is not an onerous requirement by the way.

**MR SHEEHY (CSA):** It's a minor issue compared to the concept of continuing to carve out something special for 300 companies.

**MR ABRAHAM (CSA):** The flip side of that is, if you've got an if not, why not, it's applying to all listed companies rather than just the 300. So if you focus on

saying, "It's a good thing that the independent consultants report directly to the board on executive remuneration," I mean, I'm not sure why that changes after company 300. So if there are if not, why not disclosure around, "Hey, if you haven't done it that way, please explain why," then I would have thought that's a universal principle.

**MS FOX (CSA):** It's actually we think a better governance outcome because the issues dealt with in your recommendations 10 and 11 are issues that the council guidelines are really set up well to be able to unpack, so that's where we're coming from, that those two things really should be dealt with by the council and it provides that opportunity for explanation.

**MR FITZGERALD:** Correct me if I'm wrong, except I think recommendation 10 picks up the fact that executives should not be on remuneration committees at all.

**MR BANKS:** No, this is just in relation to advisers.

**MR FITZGERALD:** Advisers; yes, all right. That's fine. Sorry, the other carve-out we've got is in relation to the situation on the rem committee, where we've said for the ASX 300, all members should be non-executives. Do you have a problem with that particular carve-out there? The reason for that is that some of the top 300 companies do in fact have executives on their remuneration committees which we find problematic.

**MS FOX (CSA):** So do we.

**MR FITZGERALD:** Yet when we go down to the lower companies, we can understand that they are closely-held corporations or most are closely-held corporations in the way they operate, so there is a difference.

**MS FOX (CSA):** But the beauty of the if not, why not, is that those companies that have executives on their rem committee have to explain to their shareholders - - -

**MR FITZGERALD:** Yes, but we actually don't think they should be on it. We've actually come to a view that for the larger corporations, this should not be an if not, why not. We actually don't think they should be on it. The executives should not be on the remuneration committees, so in our view, it's of a higher order. So how would we deal with that, if we have actually formed a view that they shouldn't be on it? That's our point.

**MR ABRAHAM (CSA):** It's difficult to argue - - -

**MR FITZGERALD:** We've actually come to a conclusion that the if not, why not is not appropriate because we actually think for that particular group - now, I admit

the 300 versus the 200 or whatever the figure is is simply trying to use a consistency that already exists, so I'm absolutely clear that there's no magic in 300 per se. But we've actually come to a view that they shouldn't be on it and we don't think it's a matter of - - -

**MR BANKS:** A preliminary view.

**MR FITZGERALD:** In the draft.

**MR ABRAHAM (CSA):** It's hard to argue with that view. It's difficult to see a justification for executives being on the rem committee but I think it's difficult to see that all the way through, but I would have again thought the same principle ought to apply to all companies. At the very least, there ought to be an explanation required of companies below 300 as to why they do it, which I think there's a slight disconnect between the if not, why not test that you're proposing there and the hard and fast rule for the top 300. No-one here is going to support the fact that we ought to be having executives on the rem committee, but I think for consistency we ought to be looking at saying that the if not, why not test ought to apply on the same basis; ie, if you've got executives on your rem committee, you should be doing an if not, why not, even after the top 300.

**MR FITZGERALD:** Okay, good.

**MR BANKS:** I think we've run out of questions but I should say the fact that we're debating these with you reflects the usefulness of your submission because we do need to test all these ideas, so we do appreciate that.

**MS FOX (CSA):** I would like to just refer to one issue that I actually heard in the earlier session where you talked about that there had been a proposal for a standard from Standards Australia on remuneration. I think that is a problematic proposal. Standards originally came into being around things that were very easy to look at in a step-by-step process, so for an electrician, how to put things together, or plumbing or whatever. It then progressed into other areas, and it was mentioned, such as risk management. In fact there aren't any governance standards, there are handbooks and that's because when the governance committee for Standards Australia met, they realised that governance doesn't lend itself to that sort of black and white step-by-step process which is what a standard is. It did lend itself, however, to a handbook which was much more along the lines of guidelines, so that you actually had a framework within which to work. The ASX Corporate Governance Council guidelines - we've actually said in our submission we think the council is a really good body to perhaps be putting together some guidelines around remuneration in the same way they have actually got guidelines around how you report against principle 7 on risk management. But the idea of a standard which is a very step-by-step process is I think inherently problematic because there are issues to be

considered, there are contexts that have to be thought about, but I don't think it's necessarily a step-by-step process that you can just apply to every company in the same way.

**MR BANKS:** Okay. Thank you very much. We appreciate you appearing today. We'll break now for a little while before our final participant this morning.

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**MR BANKS:** Our next participant this morning is the Australian Institute of Company Directors. Welcome to the hearings. Could I ask you please to give your names and positions.

**MR LEE (AICD):** Thank you. My name is Richard Lee. I am a newly elected chairman of AICD. John Story, who I think appeared before you some months ago, retired last week, so the baton has just been passed. I think you know John Colvin. We are here to present on the AICD position and John will run through a few of the points later on.

I think you know who we are and who we represent. We have about 25,000 individuals as members and their directorships cover a wide range of companies from the top end of town right through to proprietary companies, not-for-profits, charities, public sector bodies and the like, so we're a pretty broad church. My personal position, I'm on four listed company boards as an independent director. They range in capitalisation from a few hundred million to 16 billion and in a range of industries. I sit on one APRA-regulated body and have sat on one in my executive life. I also sit on the board of a national sporting body, so I've got a reasonably broad involvement in directorship. Being an independent, I am either a rem committee member or a chairman on all of the boards I sit on, so as a background, I hope that I'll be able to answer some questions from a director's perspective.

I think just in introducing John, I'd like to say that all boards and rem committees I think are obviously very aware of these inquiries and, dare I say, on the edge of their seats, wanting to get a level of certainty about some of this stuff because we have been in, some of these areas obviously, somewhere in transition in a whole range of these issues which are quite important issues. Certainly I can speak for the boards I'm on that I know for the vast majority, they're all taken very seriously and so people are watching and certainly asking us lots of questions.

The governance and compliance framework is obviously very important. I think also important is to ensure that it isn't simply a compliance process because there is a lot more to a lot of these remuneration issues than simply imposing a kind of rigid framework on things. To the extent that there is uncertainty, it does inevitably lead to difficulties and over-prescription certainly can lead to problems of itself, so it's really striking a delicate balance that is the challenge for yourselves and obviously the government in responding to your recommendations.

I'd just like to conclude by saying that in any transition, we are also dealing with matters of contract, so from a board perspective, wherever we might like to end up, we're dealing with contracts that are in place now, so moving from where we are today to where we would like to be can't be done unilaterally and can't be done

overnight because executive contracts are in place and negotiating amendments to that unilaterally is not straightforward all the time. With that, if I can hand over to John and lead you through the highlights of our key views.

**MR BANKS:** Thank you.

**MR COLVIN (AICD):** Thank you very much. Thank you, commissioners, it's good to be back here again.

**MR BANKS:** Good to have you back.

**MR COLVIN (AICD):** Thanks very much. I handed a copy of our summary of our positions against the summary of your recommendations. I think the good news is that we are probably in the majority on a lot of areas; we're in either agreement or agreement subject to a few comments. But I would like to put on the record really our appreciation of the Productivity Commission's approach to the current inquiry. From our perspective it's been rationally based, it's been balanced, it's been well researched, it's factual and consultative. This process is a good example of that. I've said that several times. It doesn't seem to get a run in the press because they move on to the sort of areas where there might be some controversy, which no doubt we'll get to this morning.

But I'd just like to perhaps highlight some of the areas where we agree and they are the following: (1) the recognition given to the important and central role of boards in setting executive remuneration; secondly, the rejection of legislative-imposed remuneration caps; thirdly, the rejection of the notion that non-binding shareholder votes on remuneration reports should be made binding; fourthly, the desirability of greater transparency around voting decisions on remuneration issues by institutional owners and also, lastly, the strong case for removing cessation of employment as a trigger for taxation of equity based payments.

We also note the Commission's findings in line with the comments the AICD made in its earlier submissions and that is that Australia's corporate governance rates very well, not only here but also internationally. Australian executive remuneration levels generally remain below those in the United States and the United Kingdom and have been more in line with smaller European countries; as a sporting nation, I'm not sure that's where we want to be but maybe in executive remuneration, we do. Also, I think the other aspect is, highlighting I think what we also put forward, many or if not most of the rock and roll in this area is in the top listed companies, in the top, say, 50, and arguably in the top 20 which has been highlighted by your report.

We do have some difficulties however with the number of positions adopted by the Commission. I will just go through those and it's no surprise to say that the

two-strikes proposal is one which we don't agree with in its current form certainly. The proposal that shareholders must approve the maximum number of directors, we think that by itself is not particularly constructive for remuneration, but we'll come back to that. The Commission's preliminary views on the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, I think we've set forward our ideas on that before. However, it might be worthwhile just reiterating some of those shortly.

Mandating remuneration committees with compositional requirements for all ASX 300 companies, we sort of agree in principle with some of that but not the mandated aspect of it for the top 300 for reasons we'll come to; prohibiting the company's appointed representative, usually the meeting chairman, from casting its proxy votes on remuneration resolutions put to shareholders and also proposed prescriptive requirements relating to hedging and expert advice.

Given that we've put in writing submissions covering all these points and I think they're relatively straightforward, in the time available and for our opening comments, we'd just like to concentrate on the first three of those. So the first one of those three is the two-strikes proposal which is draft recommendation 15. We have a number of significant concerns with the two-strikes proposal as suggested by the Commission and these include, firstly, the potential disruptive effects on the company, remembering that an effective, fully-functioning board can take years to build and to rebuild. Secondly, we don't think this mechanism will satisfy shareholder concerns regarding remuneration levels, particularly where a company provides a significant proportion of remuneration in the form of equity securities, as is commonly accepted practice. Also, as a result of that, market movements come into play, 20/20 hindsight on evaluations then come into play, and existing contractual arrangements remain on foot through that period. So they're just some of the areas that we'd like to highlight on that report.

Shareholders' concerns regarding the executive remuneration have tended to relate to some larger ASX 100 companies which have been put in your report. But the two strikes will apply to all companies, as envisaged now, that are required to put a remuneration report forward for a non-binding vote. Also, the disproportionate emphasis being placed on remuneration as a trigger for a board spill, there are arguably bigger and better issues where you might be able to do that. Also, we would argue that the Corporations Act at the moment allows shareholders to spill a board on a hundred shareholders, as you're aware, or the percentages referred to in that Act. We don't see why we need to sort of put another layer of, if you like, legislative requirements specifically for remuneration in this area.

There are also practical issues with the two-strikes requirement. Once the board is gone, who will nominate the directors after that board spill? How does the proposal relate to a managing director? There's a luscious example, I suppose, of the

board being perhaps overly generous in an aspect; it is then voted out on this proposal. The whole board goes and the recipient of the largesse is the managing director left - not that being a managing director, my own position, I think is a bad position, but from a board perspective, the board goes, but the person who's been given the largesse will probably have a contract in force and will not be tainted in this area on one view. That seems to be a strange result, the end practical result.

**MR BANKS:** Could you characterise that as leaving Dracula in charge of the Blood Bank?

**MR COLVIN (AICD):** Yes, you could, or maybe winning a lottery by default, one of those. Also, we've raised in our submissions and it's been talked about elsewhere that the potential for the mechanism to be used as a stalking horse for individual shareholders or vested interest groups, for example, as part of a hostile takeover strategy. One thing I think is probably worthwhile there, I'd just like to hand up a document which just in its very simplistic form shows what happens if you take generally effective votes of 55 per cent of total votes cast, and I think you can just see what might happen on it, and you'll see that we've highlighted that assuming 55 per cent of the total votes are cast, you only need 13.75 to get to 25 per cent on that simple mathematics. That's about as far as I go with mathematics because I did law, because I couldn't do mathematics, but that chart I think just highlights one issue which is therefore a low threshold of a minority shareholder could actually cause damage and actually get, on one view, pressure on a board in addition to other pressures it might try and put on in a takeover situation, for example.

Another issue will be how will boards deal with employment contracts which may have initially been supported by shareholders but subsequently receive a first or a second strike? In other words, they've voted in favour of it. It's gone through the shareholder approval process and may have been in some cases - not usually but in some cases boards put up the whole contract, not just, say, the equity, long-term incentive, but put up the whole contract. It then gets a resounding vote in favour and then you have subsequent votes when, in a recession, for example, like we've just had, things change and investors take a different view. So you've already had it approved and then you go through this process where I think it would cause difficulties.

In relation to the thresholds contemplated, we would say that the 25 per cent in terms of the next threshold - maybe for the first one in terms of the reporting threshold - we don't hold too much of a difficulty with in terms of that would be a trigger for boards to come back to their shareholders to argue the next time to say, "What's happened?" We think that disclosure and that reporting may be all right. We have real objections, I think, to them mandating this as a part of law for all the sort of consequences that we've put forward.

It also needs to be remembered, we would argue, that there's a rational apathy on the part of a fair number of shareholders. No doubt Stuart Wilson will say a few words about that later on - no, he's ducked out for our presentation - which means that a 25 per cent no vote, if based on votes actually cast, could represent considerably less, as per that schedule just handed up. I think it's wrong to then say that those shareholders who didn't vote are necessarily anti. If they were really anti, there's an opportunity for them if they have, on one view you can argue, responsibility for them, to actually vote in this respect. So if they don't vote, I don't think you can either say categorically one way or the other that had they voted, they would have voted against or had they voted, they would have voted for, but the fact they didn't vote could mean and arguably could mean that they didn't feel compelled enough to get off their backside and tick the box.

So they're some of the areas, and whilst we don't support the two-strike proposal, I guess we put the alternative which is, should the Productivity Commission recommend this we would consider that as a minimum at least two consecutive majority votes greater than 50 per cent would have to be there before a board spill is triggered; not only because of those practical results we've just indicated - and we're not sure of the answer to what happens when the board has spilled - but also the reporting trigger threshold, we would argue, as I've just said before, could remain at 25 per cent at a particular period, subject to maybe saying, "Well, once you've already approved these things you can't come back and have another go at this," otherwise you put total uncertainty into boards of directors putting up a proposal, getting it voted and you can't come back and vote again.

Like, we can't go back and now vote Kevin Rudd out of power, we've got to wait till the next election; the same with all the others. We can't see any rationality in that area.

**PROF FELS:** Just on the mechanics of that, your suggestion of 2 50 votes but a 25 reporting vote, you'd have one vote at the first meeting, if it was 25 it would trigger a reporting requirement. If it was 50 it would trigger a reporting requirement but also be - how shall I put it - one nail in the coffin.

**MR COLVIN (AICD):** Yes.

**PROF FELS:** Is that the way you would do it? It would all be done at the same time.

**MR COLVIN (AICD):** Our definite and strong view is that we shouldn't have any of those proposals, but in the event that you don't see our argument as being a good one - and we have canvassed this amongst many of our directors, and I certainly have as late as last night with the ASX roundtable. Their view is they are definitely anti this proposal because of all of the - - -

**PROF FELS:** The directors, yes, I imagine they would be.

**MR COLVIN (AICD):** Well, you'd hope they would do it in the interests of the company as well, just in terms of the practicality of it.

**MR FITZGERALD:** A couple of things about the practicality: firstly, we're not talking about the spill, we're talking about the directors standing for re-election, so at no point the board disappears because each of the directors is in fact not re-elected. So this notion that there's suddenly no board doesn't exist in our proposal. The other point is we already acknowledge that we wouldn't be including in this the managing directors. We should have made that more clear in the draft, but we've been explicit since the draft came out that the managing director obviously doesn't get caught up in this. We're not talking about a spill per se, what we said is they would stand for re-election. The mechanism would be that each individual would be re-elected so there's no hiatus.

**MR COLVIN (AICD):** Can I just put the argument to that proposition. If it got to that stage and the proposal is to vote out the board - because you would have a situation where the board is collectively responsible - two things are going to happen, it would appear to me - prospects, maybe possibilities - one is that the shareholders may vote the whole board out in which case you do have the issue.

**MR FITZGERALD:** One by one, yes.

**MR COLVIN (AICD):** Another issue is the board may say, "This is an untenable position to put ourselves. We'll fall on our swords and go."

**MR FITZGERALD:** Would you not accept a proposition that a company that in fact one by one lost all of its directors would be in serious problems well beyond anything to do with remuneration? The trigger point may be for remuneration but let's assume for a moment your second strike is 50 per cent as you've indicated your - not preferred position because you don't prefer any.

**MR COLVIN (AICD):** No.

**MR FITZGERALD:** It goes beyond imagination to believe that you have a 25 per cent vote, a 50 per cent vote and then every single director that stands isn't elected, and then to put the proposition, "Well, the directors were in fact doing a great job," it just simply defies imagination that that could happen. If, for example, you take your proposition of 50 per cent, it's incomprehensible you'd end up with a situation where there would be no directors left standing unless there was a cataclysmic breakdown between all directors and all shareholders effectively.

**MR COLVIN (AICD):** I don't necessarily agree with that proposition obviously.

**MR FITZGERALD:** Well, give me an example.

**MR COLVIN (AICD):** Let's say that there's a substantial shareholder who wants to manoeuvre the position so that they get into a better position for a takeover and - - -

**MR FITZGERALD:** They can get a 50 per cent on the second vote on your proposition.

**MR COLVIN (AICD):** Well, it would make it much easier for them to get to the position they wanted to do without going through the process of getting a hundred other shareholders, for example, under the Act. Our argument would be, arguably this is leap-frogging legislation because there already is in the Companies Act a provision to allow shareholders to call a vote to get rid of the board. If it an issue as serious as you've indicated, there is a mechanism already in the Companies Act - - -

**MR FITZGERALD:** Sure, but we're aware of that mechanism. I just want to deal with the actual two-strike policy.

**MR COLVIN (AICD):** Yes.

**MR FITZGERALD:** Assuming the second vote is 50 per cent - just assume that - the majority of those who vote - and I notice you've said that would be a majority, taking into account recorded absentee votes.

**MR COLVIN (AICD):** Yes, you would.

**MR FITZGERALD:** It seems to me if that vote is that high - - -

**MR COLVIN (AICD):** I think a board is in serious difficulty.

**MR FITZGERALD:** - - - the board is obviously in serious difficulty. But then there has got to be another process; that is, they have each got to stand for re-election. It doesn't spill so there's no black hole which some people have been indicating. The chances of all of the board not being re-elected would indicate surely that the company was already in serious difficulty, and I can see no examples where that is likely to occur. I know in all regulation you have to be concerned about the unintended consequences but one of the things we don't do is we don't make regulation that looks at the one exception or the complete outlier that is almost never likely to occur. I understand your concerns about this strike policy but are you not pushing the argument to the extreme?

**MR COLVIN (AICD):** No, because we would say - I know a lot of people take

remuneration as the be all of corporate governance. It is one incredibly important part. It is one that worries non-executive directors incredibly in all my discussions and advising them for 30-odd years. They try incredibly hard. There are some paradoxes in executive remuneration which I think we will have probably forever. But one example of the paradox is whilst ever you've got equity, or equity-like structures, you're always going to have a system where the company can control some aspects of remuneration - fixed and, if you like, cash. As soon as you put in an equity or an equity aspect to it, you then take it outside nearly of the control of the company and you put that into the control of the market. This is not brand new science but it's something that the leading chairmen of remuneration committees are concerned about.

I'll come back to this point. Let's say the board say, "Let's take a view of just cash because we can control that. We know exactly what it is." They will probably be voted down by proxyholders because there's not enough skin in the game in relation to the way it's structured. That's a reasonably good argument, probably even a very good argument, that you want to align executives with shareholders. But as soon as you do that leap some of those areas start getting out of control of what the board can control, versus what markets can control. That is going to be an issue which is going to travel no matter what system we put in place.

**MR FITZGERALD:** Can I put it to you that even in the current voting season where we've seen fairly substantial high votes, the high votes have been in a very small number of companies. None of them to date have met your test of 25 per cent in the first vote and 50 per cent in the second vote; none, even in this current climate.

**MR COLVIN (AICD):** I think there might be one.

**MR FITZGERALD:** Doesn't our policy in fact hit exactly the right balance; that is, it picks the rogue, the one in which there is in fact a complete disconnect between the directors and the shareholders for whatever reason, but it leaves intact the vast majority of companies who tell us - and your organisation tells us and I absolutely believe this - that the vast majority of companies spend a lot of time trying to explain to shareholders why they have done certain things. They respond to significant votes, as low as 10 per cent. All of that continues on. This actually picks up those where that behaviour is in fact missing, or in the eyes of the shareholders that behaviour is missing.

**MR COLVIN (AICD):** Can I put the argument back the other way, the same argument the other way, which is if that's correct we're talking about maybe one company. Why do we need to have further regulation and black letter law on this issue? We get back to the same sort of argument which is, roughly, 90 per cent of companies are doing pretty well and on your report are doing this reasonably well. Corporate governance is incredibly high here. You do have an issue, as soon as you

get up into the top 50, which is absolutely right in your area, and we would argue that when you get into that area you're starting to deal with international companies on any view. Once you do that, then you're starting to get into a marketplace which is an international marketplace and you start putting Australian restrictions, and we would argue on some of these areas, you're putting Australian companies on the bleeding edge of the corporation and not on the cutting edge.

So there's an issue as to what would be the best long-term interests, and we would argue strongly that further regulation in this area, in a country that has safe pay, unlike, say, America, in a country that has incredibly high governance and in a country which also has incredibly high education in this area, the best solution would be, I would argue, putting more effort and time into trying to get greater education and leadership in the top companies where the problems maybe are. But even then, you've got to say, "Which are the problems?"

So I suppose I'm saying to you this is an incredibly complicated area. All of those people who work in this area every day have to face the conundrums of, "Well, there's equity," so the very point I just put before is an issue; how we structure this is an issue. Often you will find that over the years, you've had formulas which people think, "This is the panacea," and people follow TSR, all these things, and then we find that there's a plate shift, and some of those areas aren't as good. So I guess that's a very long way of answering your point, I'm sorry.

**PROF FELS:** Okay, I understand that and I also understand that you're not in favour anyway of a two-strikes rule of any kind, but just going down that path a little bit all the same and maybe drawing a slightly different conclusion, you're sort of saying there's no problem or it's a very small problem that doesn't warrant - - -

**MR COLVIN (AICD):** No, we're not saying there's no problem.

**PROF FELS:** Yes, okay.

**MR COLVIN (AICD):** There are problems but it's inherent in the nature of the beast you're dealing with, which I think your report goes into all those sort of issues. What we're saying is: that's the problem. What is one of the solutions? We're saying we don't think this particular solution is necessarily a pragmatic and a good one, I suppose.

**PROF FELS:** But there are quite a large number of safeguards. In business and most walks of life, if you make a mistake, there's an immediate consequence. You may even lose your job. Now, here, we're in business but the safeguards for the directors under these rules are pretty considerable. First of all, they know in advance what the rule is. If they get something wrong in the remuneration report, they're on notice. They may get a vote against it. By the way, they usually have a chance

before meetings to talk to people who are opposed to them. That's another safeguard. So they get to the meeting and let's say that there is a 25 per cent vote against them, okay. There's a whole year then to work on the problem, to have further consultations. Then after a whole year more, we come back to another meeting. Then there's a further vote which may be 25 or 50 or somewhere in between, whatever, so they get all that, and then what's the consequence? The consequence is that there's yet another meeting after that, maybe a year later or maybe three months later, where finally you have a majority voting. I mean, aren't there a tremendous number of safeguards in there? There are a number of jobs I've been involved in where I would have loved to have had all of those fall-backs spread out over several years.

**MR LEE (AICD):** Can I make a couple of points?

**PROF FELS:** Yes.

**MR LEE (AICD):** One in relation to the general issue of the two strikes and you're out and let's say you get through whatever the first threshold is and you get everyone next year up for re-election. I think there is a reasonably large body of directors who would respond to that by saying, "I'd rather just not be here," and not necessarily renominate. If that is the case - I mean, from a personal point of view as a director, and thankfully I've not had the personal experience, but dysfunctional boards are not the most enjoyable entities to be part of, so if you're heading down a track - and whether this is simply the shareholders en masse voting or it might be one particular group of shareholders who have an agenda that may or may not be seen to be in the interests of the company as a whole, you don't know what the circumstances will be - the danger is that you get the independent director who is really there not representing any particular group but says, "Look, I'd rather go off and do other stuff," because I think from a personal point of view and from a kind of publicity point of view, certainly the reward side of it is not the primary driver for most of these people. I think the danger is you will effectively create situations where you do get dysfunctional boards and how you then encourage people to nominate for that board who are taking the broader interest into account rather than looking at a specific kind of objective, I think there is an issue there. Even if it's 12 months later, depending on how the different parties behave over that 12-month period, whatever the engagement is, I think there is an issue there. Whether it applies to 1 per cent, 10, I've got no idea how much it would apply, but I think just to assume that it is a trivial issue for directors in that position to say, "Yes, I will put my hand up and nominate again" - because they do have other things to do.

**MR FITZGERALD:** Sure. That links into your no-vacancy rule because you've also opposed our proposal there, but I suppose you draw an interesting issue. At the end of the day, taking that to its logical conclusion, shareholders really shouldn't vote on directors at all. I'm on not commercial boards but other boards and I absolutely

agree with you - you know, independent or other aberrant directors are very difficult. But at the end of the day we either accept the proposition that shareholders have a right to vote in directors or the directors have the right to vote in directors. What strikes me at the moment is that we're moving dangerously close to a situation of really saying directors vote in the directors and that's it.

**MR LEE (AICD):** Certainly that's not what we're saying.

**MR FITZGERALD:** I know, but you get to that point. So at the end of the day, you either take the risk that on a very rare occasion somebody may in fact get on to the board, unlikely that that might be, I might say, given the votes you've got to get, or you actually do in fact create a situation where in practice, the directors are appointing themselves. Now, it seems to me that we're straddling two at the moment. If you look at the voting, the vast majority of directors get back with well over 90 per cent, absolutely, so we understand that. But I'm just trying to put a proposition and obviously you're concerned. A fundamental view that I would have is that shareholders still in Australia have a right to be able to choose the directors they want.

**MR COLVIN (AICD):** But they do.

**MR LEE (AICD):** They do.

**MR FITZGERALD:** Yes.

**MR COLVIN (AICD):** That's how the system works. We're not arguing against it. That's how the system works and you can get directors voted off. You can get situations where three go up, one gets up and two don't.

**MR FITZGERALD:** Sure.

**MR COLVIN (AICD):** That's the system which everybody signs up to. As I understand it, there's about a three-year period where that can happen. The three-year period has pluses and minuses. A three year is one where you have some certainty, where you've got a job or you can get on at least hopefully longer term in the best interests of the community, assuming that you may be re-elected. But it also has another I suppose issue which is also the board itself can't get rid of difficult areas, which comes back to probably another point that we're talking about later on which is if you're trying to bring in areas of differences, for example, you always have a conservative element which will say, "Look, whoever I bring on to this board, I will have for a set period of time," unlike employment contracts, for example, where you don't necessarily have them. I think I'm sort of moving off the original area though.

**MR BANKS:** Just on that, my understanding is that in the USA and increasingly in the UK, you will have annual re-election of board members. I will just to get you to comment on that. The circumstances would be different because it would be more automatic; it wouldn't be an implied wrongdoing that was dragging the board to be re-elected.

**MR COLVIN (AICD):** Before I get on to that, I'm just reminded of the point that I was going to make to Prof Fels which is he was saying this is not such a big deal because you've got three years to get ready et cetera, but the contracts with the CEOs and the senior executives can be five years. Now, if you go back to your shareholders and say, "We entered into this contract," and let's assume it might have been approved just after it - you know, go back to my original point - and then circumstances change, but the contract goes for four or five years - I think the average tenure of a CEO is something like just under four or around about four years. So let's assume a maximum term contract has been added into it, in other words can be terminated in the interim but expectation for this other five years. If you go back to the shareholders and you say, "We entered into this contract to get this particular CEO, this was the deal we entered into in good faith, how do you suggest we now break this contract?" One of the issues would be, with this proposal would you have legislation that the board could actually override a contract? That's gets into some pretty difficult territory.

**MR FITZGERALD:** But in truth the problem with the remuneration report at the moment is people vote in a binary way yes or no to a whole complex range of issues. If you go down that path, isn't there a danger that advocates would start to say, "Well, what you need to do is break the remuneration report into different bits, the CEO's salary," and all that. That would be a much more complex arrangement than what we are suggesting. We have avoided binding, we've avoided breaking the remuneration into a thousand different bits.

**MR COLVIN (AICD):** Wisely too, we argue.

**MR FITZGERALD:** Therefore, what we're proposing, I think, is perhaps at least an arguably reasonable way forward to avoid some of those pitfalls. If you take the proposition that shareholders want and are entitled to greater influence, if you take the proposition that shareholders have sufficient influence as it is, you wouldn't agree with my proposition at all. But if you believe that there should be greater influence, of all the options available, this one seems to us to - yes, it has some complexity to it, but a lot better than having binding votes on different parts of remuneration reporting and so on.

**MR LEE (AICD):** Certainly support that.

**MR COLVIN (AICD):** If you ask us to rate the - - -

**MR FITZGERALD:** I'm not asking that.

**MR COLVIN (AICD):** We would be in wholehearted agreement in terms of rating those. But our job is to argue what we think is in the best interests of corporate governance, not just for listed companies - although this is mainly listed companies - but the whole area of listed, unlisted, charities, et cetera et cetera but this is in the listed space. But the area of concern - and we've argued this in a lot of areas - the area of our concern is if there is a problem, then you need a rapier to deal with that problem. You don't need a sabre to bash everybody which we will come back to on termination payments.

**PROF FELS:** Could I comment on, just take your own view that there should be no two strikes or, alternatively, that it should be two 50 - or less preferred two 50s, either way it's arguable that emasculates the whole idea. So I just speculate on something and I wonder if you'd agree with me or not and after all it would follow a period of controversy and Productivity Commission report and legislation not getting through on your views. I wonder if that would drive people a lot more to use the 5 per cent or a hundred shareholders rule. I suspect it could actually. It would be an interesting side effect.

**MR COLVIN (AICD):** Could I give a real life example and I guess it's trying to point out some of the imperfections of the world we live in a sense and it's a company of a board I sit on, a company called Newcrest Mining which is a goldmining company. We have, I think over a long period of time, had from a corporate governance perspective got good ticks over a long period. Two years ago with the remuneration vote, the shareholders' association voted or came out and voted against the Newcrest remuneration report or recommended voting and the basis of that was that our - we were on relative TSR system at that point and that our bonuses, long-term incentives, kicked in at 50 per cent, not 50.1 per cent and they had a matter of principle that it should be past the median not at the median and voted against it.

That led to a vote of 1-point something or other per cent against the remuneration report because Newcrest essentially is owned more than 80 per cent by foreign institutions and hedge funds. It's a goldmining company. So the kind of shareholder world there, to the extent that you can measure it, and it moved pretty quickly, in a company like Newcrest clearly didn't see that as a particularly important issue but the shareholders' association did. We had been dissatisfied with relative TSR ourselves for some time because it was a bit of a lottery in a goldmining company. Who is your peer group? It doesn't go up and down with the ASX, it goes up and down with the gold price and your own performance and things. So we did a lot of work and consulted shareholders and moved to a performance that wasn't relative TSR, it was a combination of our position on the global cost curve and

Newcrest is one of the lower cost producers, our capacity to replace and add to the reserves and resources, so by succeeding in exploration and the return on the capital that we invest. So they were three measures that we believe were fundamentally the drivers of value for a goldmining company.

We went to the AGM a couple of weeks ago with a group, we consulted with all of the people through that process and we were not aware of anything until a few days before a group that we had not engaged with came out with a report, clearly no consultation with the company, and had recommended to their clients to vote against it. We tried to engage, they told they had rung the day that they actually submitted the report. We had no record of that phone call. We engaged with them and clearly there had been a misunderstanding in terms of their understanding of what is a relatively novel awards system. I mean, it's an unusual industry and because of that it's an unusual set of KPIs. The vote was 22 per cent in the end.

Most of the people they provided that report to had no governance section. You couldn't engage with them. They had a policy that said, "Once we receive that report, we have to follow that recommendation," and we couldn't get the entity involved to modify their report and reverse their recommendation.

**MR FITZGERALD:** This was one of the proxy advisers.

**MR COLVIN (AICD):** This was one of the proxy advisers.

**MR FITZGERALD:** But you hadn't engaged with that particular - - -

**MR COLVIN (AICD):** We had not had any dealings with them before, they were new on the space.

**MR FITZGERALD:** I see.

**MR LEE (AICD):** We engaged with others and we were not aware as a company that we were in a spotlight, if you like, and we had engaged with shareholders and the shareholders' association and the global shareholders to get this new system because we recognised it was a relatively novel system and dealt with the incentive arrangement away from what we thought was an inappropriate relative TSR. So some of these systems are quite complex and the ability of some of the advisers to understand what you're getting, particularly if they don't engage with you ahead of time, is actually quite - hopefully over time that industry will develop its own standards and guidelines so that you can avoid situations like that. But we then have to ring around at very short notice a whole range of the shareholders who had all approved this thing and we got the vote down to 22 per cent.

But it could well have been a train wreck from a practical point of view. But

we believe and I think our shareholders believe that that set of award structures is highly appropriate for global mining company. I just think we've got to be quite careful with some of these things because the institutions we're dealing with, a lot of the small ones don't have corporate governance experts, they've got a portfolio manager who delegates that totally to outsiders and we know that with the number of listed companies those people are very busy, they're paid fees for producing reports and quite often they don't engage and it's quite a complex area unless you then just - and I think there is an element around boards where they shrug their shoulders and say, "Look, it's not worth fighting. We will just do what everyone says, you know, relative TSR and the fact that you're peer group is irrelevant." It becomes a lottery. It is an incentive for employees and the whole thing kind of doesn't work, doesn't hang together.

**MR BANKS:** You certainly wouldn't want to stop innovation. One of the issues that people have raised with us is the vanillarisation of executive remuneration frameworks would be, you know, certainly a perverse outcome. John, I think we stopped you part-way through your presentation. Am I right?

**MR COLVIN (AICD):** Yes.

**MR BANKS:** We should give you the opportunity to - - -

**MR COLVIN (AICD):** I was up to the no-vacancy rule. I thought I'd take something noncontroversial like that too. I suppose it's no surprise because we have already told you and our report says we don't support the no-vacancy - we understand the rationale that's been put froward in the report but a few points we'd just like to have noted is it's currently within the power of shareholders as a group to introduce a provision into the company's constitution to the effect that the maximum number of directors be set only at a general meeting of shareholders. So if they have that capacity now, one question you have to ask is, if it hasn't been used or it's not being used maybe that's not required.

Secondly, we would argue the best position to assess the appropriate number of directors for the company in terms of what works and how that board dynamics actually works and, going forward, that's part of their job to do succession planning, it's part of their job to make sure they've got the right skill base and the shareholders will vote on what the total remuneration is. So divided by whatever it is the remuneration, especially to non-executives, won't change.

We don't believe that the adoption of this proposal will have much effect on remuneration which is, as I understand it, the main focus of this inquiry, and we don't actually think it will necessarily produce better remuneration outcomes for the many reasons we have gone through in our first report, in this second report, but also the practicalities of the sort of issues that Rick has just spoken about. We don't think

that by itself will have much effect on remuneration.

**MR COLVIN (AICD):** If it's to deal with other things, other than remuneration, eg, diversity or something, I think you'll see there are moves and investigations and issues which are dealing with that and over the next month or two you might find changes in that area in any event. That's being looked at, for example, by the ASX Corporate Governance Committee, it's being looked at by us in a serious way. So we would say this is not the place to put a proposal like this if you think you're going to get better remuneration.

**MR BANKS:** If I could just pause and comment there, I think you have agreed with our interpretation that the boards are front and centre of all of this and that obviously led us to the question of board capabilities and so on. You're right, that's a far wider issue that remuneration. On the other hand you would probably agree that remuneration is a pretty central issue and it's connected to a whole bunch of other things to do with the life of the firm et cetera. It was an opportunity to think about that and I agree that whatever we would say there would want to be complementary with other moves that are going on. The main point I'd make is that if you had any thoughts about some other ideas that you think could well be canvassed in this inquiry, at least we provide a concrete opportunity to take these things forward.

For example, some have been talking to us about the nomination committees and the processes around them and the extent to which they explain what they're doing and why and so on. There are promising avenues.

**MR COLVIN (AICD):** There are some promising avenues. For example, one of the things that we've developed and hopefully will be coming out shortly will be training at a higher level for remuneration committees to have these sort of aspects. We have the conferences and the briefings. These things are going on regularly. We do 750 something or other events a year, and remuneration has certainly got a large amount of discussion. I think you'll find that this Productivity Commission report by itself will be in the boardroom front and centre and will be looking at not only the recommendations which we're doing now but also your analysis, some of the figures and about some of the issues which have come up. Everybody is trying to make sure they do this better. It's axiomatic.

Boards are meant to be acting in the best interests of the company and they're not meant to be paying any more than they absolutely have to. There are mistakes and there are areas where boards get it wrong but not just in remuneration. Governments also get it wrong sometimes.

**MR LEE (AICD):** Certainly at AICD and I think around the vast majority of boards there is recognition that the appointment of new directors, the role of nominations committees, the engagement with search industry participants and with

candidates, there are a whole range of issues that clearly corporate Australia or listed corporate Australia, on the basis of evidence, can do better than it's doing now. But I'm not sure that prescribing a particular set of protocols is the way to go. Certainly from the perspective that I have and talking to board colleagues, every boardroom is looking at that issue quite hard. They will come up with a whole range of different solutions. Certainly there aren't any silver bullets, I don't believe, but I think it is an issue that's well and truly on board agendas and I would hope - and certainly AICD will be looking at this very hard, not just to identify what the issues are but to try and move them forward in a way that will get better outcomes.

It's been an issue for a long time but if you look at the statistics we haven't really made a lot of progress. It's your role to work out - from the view of this inquiry - how that gets woven into the fabric of the recommendations. But be assured, however you do that, it is on the agenda of boards anyway. Certainly we realise it's one of those areas that we just have to do better.

**MR COLVIN (AICD):** I'll just quickly finish those few points on that. We probably should have started off with all the parts we agree so - a warmer feeling but anyway - - -

**MR BANKS:** We feel pretty warm anyway.

**MR COLVIN (AICD):** Briefly, about some of the unintended consequences of trying to regulate board numbers. First of all, let's just assume it's too tight, too small, that would give a reduced capacity for boards to appoint exceptional candidates and maybe also slow down the appointment provision of succession planning in remuneration committee chairs, chairmen, and also possibly diversity because you don't have as many areas. Also when it's too tight, as I said, it's the smooth succession plannings and anticipation in advance of where you want to go. Where it's too large, larger boards than necessary, there's a cost issue and there's also a functionality of how you're meant to run these boards.

As you would imagine, boards in the top listed space, one of the things is - and I think Rick can comment on this better because I haven't been a director for a large extent of the year - I suppose a thing which many chairmen fear most is dysfunctional boards - certainly when I was practising as a lawyer that was one thing - because that reduces value and causes problems in terms of corporate governance probably more than others. I don't think it's an argument which is without substance, also without real concern.

One last aspect on my opening is termination payments. We still continue to have difficulties with this termination payments legislation. This might be our last gasp because I think it's going back to the Senate for approval very shortly. I guess it would be unlike us not to put this to the Productivity Commission to put our views in

this area. One of the areas we argued before the Senate - and I would like to reiterate the point - is that this legislation applies to all companies. It doesn't apply to listed companies. Your report, as we have said several times today, has focused on where the issue is. You'd have to say the issue is in the top 100 companies, if there is, and maybe can take it up to 20 or 50 on your report.

We have been arguing that if that's right then why do we need to have charities, school boards, not-for-profits caught up with this type of legislation? It seems to me to be over-regulation and over red tape because it's a very easy mistake to make for a small company who just doesn't get the approval of shareholders to make a termination payment, charity boards, hospital boards or something and they go over a relatively small sum. Then under this legislation we've increased the penalties substantially and there has been no evidence that there has been a breach of the previous sections. On top of that you get to a situation where you've got up to six months' gaol. We think that is for the non-listed space with the ability to have legal advice and company secretarial sections and general counsel. You could argue that that group should know all about this and they have mechanisms in place. I think it's a bridge too far to say this should apply across the board to these areas.

**MR FITZGERALD:** Can I clarify that our report only deals with disclosing entities and that is listed companies. In relation to that group our position was that we didn't make a recommendation for or against what the government proposes but said that it seemed reasonable. Do you believe that excluding school boards and not-for-profits and non-listed companies our approach is reasonable, or are you actually saying that even for listed companies the government's approach is unreasonable and therefore our report should reflect that.

**MR COLVIN (AICD):** I was just hoping you might slip into your next report, the non-listed basis, something the government might like to look at, bearing in mind there's a timing issue there. I think I argued it last time so I don't want to bore you again but we would argue that we've gone out on a limb by ourselves in Australia. No-one else has followed us. The US, Europe and the UK haven't followed listing. They haven't put in a 12 months' base pay. You don't have to, I don't think, be a genius to work out what's the likely consequences, assuming boards don't want to have issues and fights.

It seems to me the logical area is to increase base pay and/or put in place other mechanisms which will get around it. If the end result is to bring in or lower or bring a greater structure around termination payments then we would argue it doesn't do that. It's not internationally competitive and it won't have the result. But we will have legislation which we will all have to live with.

**MR BANKS:** But, see, you could argue from the shareholders' perspective that if you're right and what we see is a change in the composition of the package, that's fair

enough because that will be voted on and it will be in the remuneration report et cetera. It's the nature of the termination payment that comes on the end where many shareholders can't see value for money that is a big source of angst.

**MR COLVIN (AICD):** I would agree with that and I would agree with the angst of paying people who don't perform for large amounts of money. That seems to be the catchcry, "We're not paying for non-performance." But that doesn't look at how you structure contracts generally and how you get rid of somebody prior to their term expiring. There are economic arguments which you've heard in lots of other places about that area. It's an area of what happens in practice, where were we before. As I said, AICD had a provision out there saying one year, but you then have to deal with short-term incentives, long-term incentives. We're just putting an argument which is, on a prescriptive approach, we don't think is going to be beneficial long term.

**MR BANKS:** I think where there is a potentially significant efficiency issue it's hard to pin this down, and it's the point you just made about getting rid of somebody who might have been an inappropriate appointment that only revealed itself as inappropriate two years down the track.

**MR COLVIN (AICD):** It may be an inappropriate appointment for one, two or even three years out of the five, a change in company or structure, and that's no longer - - -

**MR BANKS:** What would happen with such a person under the new rules? Under the old rules they may have paid a bit more on the termination payment to get that person to go quietly and smooth the transition et cetera. If that avenue was not open to a company, what would happen?

**MR COLVIN (AICD):** I can tell you one thing that my old profession will be working very hard, working out what the end result of all these laws will be in terms of complexity. When I was advising in 200A it was one of the most complex areas in the Companies Code. That hasn't gone away. It has internal inconsistencies already. Adding another layer of difficulties is going to make boards - and I know they're getting advisers now - struggle to work out what the end result is going to be. That's the first issue which is a complexity and an agency, if you like, cost.

For small companies who don't have a lot of money, they have already done their costs budget. It's going to be tricky. The next thing is you're going to have to get structures where you will be negotiating and saying, "You can only have 12 months' base pay." The top end of the scale, the international end of the scale you can say, "In America I can do three times. In England I can do an if not, why not of one year," so if there's a good case for it you can say, "Here we go." For example, it was quite common when I was drafting these contracts to have higher provisions at the beginning and then none at the end. That was a sensible way. I think I gave the

example of a bank having difficulties and then employing somebody from overseas.

**MR FITZGERALD:** But the truth of the matter is, isn't it, the government is actually seeking behavioural change here. It's read correctly that the largest level of concern in the community is around termination pay, your reward for failure. We would agree that seems to be the flashpoint for many of the concerns of the community. The second thing it says is, "Well, we've got these particular parameters which we're now going to enforce." But the consequence of that is in fact to bring about behavioural change; that is that you don't back-end load termination payments. So if it does bring about a change in the way in which remuneration packages are designed - - -

**MR COLVIN (AICD):** That might be a good thing.

**MR FITZGERALD:** - - - it may well be in fact exactly what the government's intention is to achieve. I acknowledge your point that in the transitional arrangement you may have contracts which fall foul of that, so that's a problem, but taking it out three or four years all organisations will have accommodated that law in some way, shape or form. So you've got a transitional problem which we'd acknowledge, but in a sense the government's approach - without trying to defend it - would seem to me to be geared to bring about exactly what you're saying, a behavioural change in the way in which remuneration packages are likely to be developed.

**MR LEE (AICD):** There's no doubt, even the debate about it is doing that because ultimately there is negotiation between buyer and seller in this situation, and in terms of new hires it is in the back of both employer and prospective employee. The behaviour issues, regardless of legislation, it is simply the fact that boards themselves are wrestling with the appropriate way to deal with these things. Again I'm not sure that a kind of prescriptive approach is going to necessarily - given the market realities - do more than create some other inconvenient consequences down the road.

**MR COLVIN (AICD):** The squeezing of the balloon effect, I'm not going to go there. The only good news I'd like to tell the Commission is that I was using "squeezing the balloon". I was in England recently and I was reading something from America and it had "squeezing the balloon" in it, so these ideas travel pretty quickly.

**MR BANKS:** I think it's our balloon.

**MR COLVIN (AICD):** Yes. The other aspect is, I agree with you, it's good politics. I guess what I would say is I'm in the Keating school on this which is I think good policy is good politics longer term and I think that's a debate which we'll just have to wait and see.

**MR BANKS:** One of the bits of information in assessing whether it's good policy, as well as good politics, is to what extent it would be disruptive in practice, once things adjust to it. Our understanding - and we reported it in the report, and I can't find the page now - was that the practice was more or less not too inconsistent now. It would have been five years ago but the termination payments are predominantly within the one to one approach.

**MR LEE (AICD):** I think the issue from a practical point of view rests in the extent to which bonuses, if any, have been earned and a pay determination. That's the reality and - - -

**MR BANKS:** What's in the net.

**MR LEE (AICD):** Exactly. I think if you look back at contracts that were done three or four years ago, most of them will include some component of the incentive structure. Now, there will be an element of - some of them you can measure. It will be pro rata'd and all of that, but I don't think too many of them would have cut it purely at base pay because the reward structure is a contractual component anyway.

**MR COLVIN (AICD):** The issue was - I think it was 2004 - we put out a guideline which was 12 months and then make provision for these, and most companies were falling into that line. I guess had we known there was going to be a lengthy prescription on it, 12 months' base, we would have argued a lot stronger with government about that. I think it's an area where if you think it's appropriate to comment, you know, it's an area.

**MR BANKS:** I suppose the other thing - just from something you've said here - is in areas sometimes where it's not clear what the effects of the regulation will be, an exposed review is highly desirable. Assuming that it sails ahead et cetera would you see that as being a bit of a safeguard and, if so, how would you know a couple of years down the track whether it was a success or not, in a sense?

**MR LEE (AICD):** Two years, I would think, is a touch early because you will be still transitioning on a lot of these issues. It is always useful when you're changing the regulatory landscape to have a chance to do a post-audit of it. I mean, at the risk of creating consequences that were not desirable or are not desirable and perhaps weren't perceived as being relevant is quite high because it's a complex enough world out there and certainly when you apply it across the board, whether it's all listed companies or certainly all companies, the smaller companies' capacity to respond to a lot of these things is pretty limited.

**MR COLVIN (AICD):** We would agree - in our submissions - with a sunset clause, not the one that was put forward, but a general sunset clause which was, in other words, you look at in five years.

**PROF FELS:** So you're foreshadowing a further inquiry into executive pay?

**MR COLVIN (AICD):** No, just a sunset clause.

**MR BANKS:** I know we're out of time but we're going to delay the first after lunch session a little bit. I'll just check very quickly. We did get your submission relatively late. I guess the only comment would be whether you might permit us to get back to you outside these sessions if there's something in the submission we want to follow up on.

**MR COLVIN (AICD):** I think they're relatively straightforward after the ones we have just dealt with.

**MR BANKS:** All right. I didn't have anything else. Thank you very much. We will now break for lunch and we will resume at 1.30.

(Luncheon adjournment)

**MR BANKS:** Welcome back everyone. Our next participant is CPA Australia. Welcome to the hearings. Could I ask you to give your name please and your position.

**MR PURCELL (CPA):** Thank you. Good afternoon, my name is John Purcell. I am a policy adviser, corporate regulation.

**MR BANKS:** Thank you very much for attending today. We also have a submission from you on the discussion draft. I'll give you an opportunity to raise the key points.

**MR PURCELL (CPA):** I'll make some introductory remarks if I could. On behalf of CPA Australia I would like to thank the Commission for the opportunity to appear here at today's hearing. CPA Australia supports the broad thrust and many of the details contained in the Commission's discussion draft. We acknowledge in particular those recommendations pertaining to the strengthening of the ASX Corporate Governance Council, the principles recommendation as a supplement to those specific draft recommendations numbers 2 and 10 relating to the listing rules.

On these matters we are pleased to defer to the specific comments of the ASX Corporate Governance Council itself . Similarly, it is noted that a number of draft recommendations, numbers 8 and 9, pertain to strengthening disclosures around section 300A of the Corporations Act. The comments on these issues in our submission have been prepared in consultation with the Institute of Chartered Accountants in Australia with whom we work closely on matters of financial reporting regulation. It is understood that the ICAA gave evidence yesterday on these matters.

Turning to draft recommendation 15, it is perhaps here that we reach the heart of the problem in the balancing of shareholder interest, board executive decision-making and good corporate governance. CPA Australia supports those measures directed at strengthening shareholder oversight of the setting of executive remuneration. On what has been considered by some commentators as a contentious issue, two strikes, spill of board positions, CPA Australia would like to present the following possible modifications which could achieve the intent of the draft recommendation whilst adding some better certainty.

Firstly, it is suggested that consideration be given to the introduction of this provision into the Corporations Act as a replaceable rule. Replaceable rules, whilst providing a convenient basis for corporations to operate without a formal constitution, do provide a mechanism of specific regulation of the internal operations and affairs of a company. Presentation in this form of a replaceable rule could allow members to positively choose whether or not they adopt the power. Members'

powers could alternatively be enhanced through other mechanisms. These possibly are in the realm of member remedies in relation to conduct of controllers which are not in the interest of the members as a whole, or alternatively through enhancing capacity to seek information about executive remuneration in a manner similar to that currently applicable to directors' remuneration. Both these avenues, however, could take the law in a direction where caution is required.

I conclude my introductory remarks and will be very pleased to provide comments on the details of our submission.

**MR BANKS:** Thank you for some innovative suggestions there and I will maybe just get you to talk a little bit more about those and in particular the replaceable rule and how you would see that operating.

**MR PURCELL (CPA):** If you put the current situation of corporations law in context we do have a situation now with fairly fixed understandings of relationships with particularly strong divisions of powers under which, through the benefit of limited liability, shareholders don't have direct involvement in the management of corporations. Interestingly, obviously, through the activities of institutional shareholders there are shifts in this balance.

Nonetheless the law is fairly precise in the limits of what members can do in terms of involvement in company management and in terms of questioning the regulation of corporate behaviour through the internal rules. What we have tried to do is to look at what is obviously the intention behind recommendation 15 as we see it to enhance, strengthen, members-shareholders' engagement with the executive remuneration without actually giving them a direct say. We're not looking at any sort of capping or veto but a staged set of rules which allow shareholders to have a greater influence.

If you look at the conditions of a replaceable rule they, as we indicated, are a substitute for the corporate constitution. The corporate constitution, once adopted, overrules the replaceable rule and the constitution becomes the rules under which the internal affairs of the corporation operates. The corporate constitution and/or the replaceable rules operate as effectively, while they're stated to be by the Act, to the effect of a contract between the company and the shareholders, between the company and the directors.

A proposal that we have come up with which would suggest maybe the two-strike rule, the first step in recommendation 15 obviously is highly commendable because it compels directors to report back to members on their rationale in relation to the setting of remuneration. However, the creation of a power in the hands of the shareholders we believe is something which may be enhanced by allowing the company's shareholders to decide whether they have that power or not.

By placing as a replaceable rule it then would necessitate an amendment to the corporate constitution either to overpower that replacement rule or if it was silent the replaceable rule would operate with the two-strikes mechanism.

**MR BANKS:** Embedded in the legislation?

**MR PURCELL (CPA):** Embedded in the legislation. If it wasn't embedded it would no longer operate as part of the corporate constitution. If the corporate constitution deliberately articulated the principle, the rule, the two-strikes rules would not apply. Now, this is moving the replaceable rules and the law in a direction incrementally, though it might be where maybe the replaceable rules were not originally conceived to operate. The replaceable rules, their rationale as part of Corporate Law simplification was to allow companies to operate in a very simple manner without a formalised constitution. Conceding that this treatment, use of replaceable rule, maybe somewhat innovative, we believe perhaps - well, not perhaps, reasonably confidently is a good mechanism which adds to the shareholders powers, put the directors on notice clearly that the power exists and can be used by the shareholders and perhaps is less invasive in corporations' affairs than other mechanisms.

In our submission we mention briefly the possibility of using member remedies as a means of allowing shareholders to directly seek/court involvement in the operation of the corporation related to the setting of remuneration. Now, that probably is an incremental step further than using, we suggest, a replaceable rule mechanism.

**MR BANKS:** Are there other precedents for use of the replaceable rule in the kind of innovative context that you're now proposing as opposed to what looks likes more an interim or transitional environment for a particularly company?

**MR PURCELL (CPA):** Personally not that I'm aware of. It obviously would pose particular challenges in terms of its drafting but I think it is a worthwhile mechanism for, we would respectfully suggest, the Commission and for government to contemplate.

**MR BANKS:** Your motivation for it obviously is that you think that the two-strikes proposal as it is, with whatever threshold, is too generic or binding and you're looking for scope for companies on a case by case basis to consider how to change it?

**MR PURCELL (CPA):** Yes, to choose whether they adopt the power or not and having chosen the power, see that it is the shareholders who dictate the terms of the corporate constitution, they are the ones who should be in a position to choose whether they have this power or not. Moreover, to emphasise the point, it clearly

puts the directors of those particular companies on notice that the power exists and potentially is going to be exercised under the circumstances specified.

**MR FITZGERALD:** You might be able to tell me and just refresh my memory about if the replaceable rule stays, it has the effect that we've proposed, if it goes what's the vote that's required for a replaceable rule to be replaced? What's the requirement for the change in constitutions?

**MR PURCELL (CPA):** Bare majority.

**MR FITZGERALD:** It's a bare majority?

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** If you removed it and wanted to bring it back again, the shareholders would have to in fact vote to bring it back.

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** Okay. I'm not quite understanding why you think this is a significant improvement. That is, I understand that you're saying that it empowers shareholders to make a clear decision as to whether they wish to opt out of this provision because the vote is to say, "We don't want this rule."

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** But in a sense, even if this was just part of the Corporations Act, it sits there and lays dormant until such time as you get a significant double vote. So I'm not actually sure why this advances the issue we're trying to get to.

**MR PURCELL (CPA):** I believe it brings shareholders closer into the decision-making process. It allows them to consider whether they believe the rules should be applicable to their particular company.

**MR FITZGERALD:** Part of the problem there is in a good period you might well get the shareholders on side to knock out the replacement rule and the company a few years later doesn't quite perform in the way in which shareholders want it.

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** What we have heard is it's very hard for shareholders to initiate action and it's very hard to actually get resolution of more than 50 per cent, particularly if the directors were predisposed to not want it.

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** So getting rid of it actually may suit the current shareholders, but shortly thereafter the next generation of shareholders might be disadvantaged by not having it as part of the actual Corporations Law or as part of a constitution and we know it's very hard for shareholders to instigate constitutional change later. So is there not a risk that you disempower a future group of shareholders?

**MR PURCELL (CPA):** In putting forward the recommendation, we have sought to balance achieving a reasonable level of power for shareholders and at the same time address what have been a number of criticisms in the public domain about the two-strike rules; that it can potentially be used by shareholders in a destructive manner and on the basis of perhaps even vexatious conduct seeking to interfere with the operations of the corporation. Now, in terms of balance, yes, I must concede that treating it as a replaceable rule, having it, so just going to sit there dormant unless used, but if the constitution overrides that, yes, admittedly it's going to be hard to get that power back into the corporate constitution.

But I think treating it as replaceable rules brings the issue out into the open to enable those involved in the corporation to make a conscious choice as to whether the power should apply to their company or not.

**MR BANKS:** Is part of your concern the fact that the whole board would be standing for re-election and, if it is, maybe get you to comment on whether you think, as some have suggested to us, that you could have something like the two-strikes rule focused more on, say, the chair of the remuneration committee or indeed the chair of the board or indeed the two chairs together. Would that lessen the kind of adverse implications that you envisage or not?

**MR PURCELL (CPA):** I'm not too sure. Certainly that recommendation would have merit, narrowing down to whom the two-strike rule applies. But I would have thought that board decision-making is a collegiate decision, that they are the decisions, the executive remuneration, notwithstanding the structure of committees is a decision of the board itself and it is a board decision which the board is responsible for. So to say perhaps the chair and the chair of the remuneration committee are the one subject of the two-strike rule perhaps is problematic in those terms because the decision about executive remuneration is a power which resides with the board itself. The remuneration committee advises the board and the board, I understand, is responsible for that decision.

**MR BANKS:** That is true of the board as a whole, which is an example against, for example, just having the chair of the remuneration committee but you don't see the chair of the board in a sense representing the board or reflecting the broader perspective of the board?

**MR PURCELL (CPA):** It certainly does reflect the perspective of the board, but I would revert to the idea it is the board's responsibility to determine the executive remuneration and, therefore, they are the ones who I believe have to bear responsibility for the criticism and for responding to shareholders in a meaningful manner.

**MR FITZGERALD:** We're still struggling with the remuneration report itself and you may or may not be familiar with some of the discussions we've been having with different groups about how you best report on the value of the equity rights that are granted to the shareholders and what have you. I just want to clarify your position about what ways we should be seeking to improve the remuneration report, if I can.

**MR PURCELL (CPA):** There are a number of recommendations in our submission which I believe are mirrored in those of the institute concerning key management personnel. We felt that it is a little bit problematic to isolate out and identify top key management personnel as a distinct group. Similarly there is strong consensus with respect to the top five executives. We believe that that should be overcome and not be one of the thresholds applied. In terms of the actual measurement, particularly in relation to equity rights, there is a recommendation made that this in fact mirror actual and realised levels of remuneration with reference to taxation rules. So that what is contained in tax law is mirrored within the Corporations Law. Obviously there may be some consequence with respect to the AASB 124 related party entity disclosures because there's a number of Australian specific statements in those which also would need to be stripped out.

**MR FITZGERALD:** Can you explain to me - and I haven't read the submission in detail - but you've then in your current submission, your draft submission, a capacity to obtain information about executive remuneration separate to the remuneration report.

**MR PURCELL (CPA):** Yes.

**MR FITZGERALD:** Can you just explain to me what additional capacity to obtain information you're seeking to give to shareholders.

**MR PURCELL (CPA):** Okay. This is included in our submission, not necessarily as what our preferred position is. Our preferred position is actually around treating it as a replaceable rule. What we've sought to do then, to add to the debate and the possible considerations is possible advancement in the area of member remedies. Again, that's pushing the law in a direction where it hasn't previously been applied. With respect to allowing shareholders to obtain information about remuneration, what we've looked at is some of the statutory rules in relation to shareholders' capacity to get information and call meetings in relation to director fees and

remuneration.

The way the law has developed is to create, as we see it, quite a clear dichotomy between shareholders' powers and rights in relation to directors fees and remuneration as opposed to shareholders' rights in relation to executive remuneration which forms a decision within directors' powers. So if you try perhaps to break down some of this clear dichotomy between the two, potentially there's a scope to give shareholders some power in relation to seeking direct information and calling for meetings related to executive remuneration. Now, if the law were to go in that direction, there is potentially problems because that is giving shareholders greater power and scope to interfere in the actual management decision-making of the corporation.

So if such power were granted to shareholders to gain information about executive remuneration outside of the reporting process and to call meetings in relation to how to question directors in these matters, we believe it would have to be covered by a series of additional rules which limit the scope of its application. So the shareholders, for example, would have to show that they are acting bona fide in exercising these sorts of powers but then that poses a further question.

**MR FITZGERALD:** I presume that when the remuneration report regime was established, the disclosure regime, and the ability to have a non-binding vote, the purpose was to provide sufficient information for the shareholders to actually be able to understand what's happened and to cast a non-binding vote on that. So some might say that if you needed to give shareholders greater powers to obtain information then maybe the fundamental problem goes back to the remuneration report and in fact it's sufficient or it's overly complex or it's incomprehensible.

So is the real problem that the disclosure regime at the moment is inadequate or insufficient rather than actually giving the shareholders greater powers to extract further information. I just want to get this clear because if you want to give them more powers to get information, very simplistically maybe the remuneration report is the problem.

**MR PURCELL (CPA):** Given the position which shareholders have as the owners of the corporation with limited involvement in management, their best means of understanding how the corporation performs is through robust reporting mechanisms. Now, the principal mechanism for reporting to shareholders is around statutory financial statements. These are augmented by other disclosures which directors are responsible for, one of which is the remuneration report. Clearly, a transparent, readily understood remuneration report in the best of all circumstances should satisfy shareholders.

It is repeated it is problematic to grant shareholders powers in relation to a

matter which is a function clearly of management. So we have put this forward in our submission, not so much as a firm recommendation, but as an alternative where the law may develop but it has problems.

**MR FITZGERALD:** Can I just clarify, you're only putting forward a suggestion that the additional powers for the shareholders would be to obtain information, but not to interfere in the actual design - - -

**MR PURCELL (CPA):** As it stands at the moment there is a 5 per cent or a 100-member rule applicable to, I believe, calling meetings. Those rules, however, don't apply to allow members to question directors in matters of management. The law principally, after a number of cases for development, is quite emphatic that it doesn't entertain shareholders calling meetings to question directors in matters of management. Now, you make an exception to allow shareholders to call a meeting to question specifically on the issue of remuneration. Maybe that's treating executive remuneration in a particularly special manner out of proportion to the other areas that directors are responsible for and clearly are concerns of shareholders where they don't have any scope to question management.

As I repeat, there's tensions in the law, it can go in certain directions, but it has consequences that need to be considered. Clearly, looking at the two-strike proposal in more detail actually it is starting to narrow down the problem, puts it in a fairly constrained context where shareholders, through meetings, are engaged with directors. Our proposal with respect to the replacement rules just, we believe, add some clarity about whether the members wish to have that rule or not.

**MR BANKS:** Thank you very much for that, for your contribution and the submission that you provided is still in draft form?

**MR PURCELL (CPA):** No, I understand that a final signed copy will have been dispatched from our chief executive's office probably today.

**MR BANKS:** Good, thanks very much.

**MR PURCELL (CPA):** Thank you.

**MR BANKS:** We will just break for a moment before our next participant.

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**MR BANKS:** Our next participant today is the Australian Shareholders' Association. Welcome to the hearings. I'll just get you to give your name please and your position.

**MR WILSON (ASA):** My name is Stuart Wilson. I'm the CEO of the Australian Shareholders' Association.

**MR BANKS:** Thank you for taking the time to appear today and for the submission which you've sent on the discussion draft. I also take the opportunity to thank you obviously for the first submission that the ASA put in which was very helpful and leave you to perhaps give us a summary of the key points.

**MR WILSON (ASA):** Thank you very much for having me. I think it's an interesting time in the world of governance. It's only really during times of crisis where we get significant leaps forward in the development of best practice corporate governance and that is what we have now. Although after a recession we barely had and a market recovery that is well on its way, my big fear is that the lessons that we have seen and have learnt are not heeded in the future. I think it's a very important part of what the Productivity Commission is doing is to get some of these ideas over the line and into a final report.

I think many of the submissions in response to the draft have commended the Commission on its approach on the depth of its research and on the level-headedness of the recommendations. Clearly there are some in the community - and also retail shareholders, indeed some of our very own members - had expected that you would go further with your recommendations, make them a little bit more tough, and then there are the industry players and those on perhaps the receiving end of some of the remuneration rebukes over recent years that have been calling for more moderation.

I would suggest, therefore, that you have probably got the balance quite right and that if the final report is somehow tidied up in some areas but the thrust of it is in the same moderate response, I think it's to be commended.

**MR BANKS:** Thank you.

**MR WILSON (ASA):** Now, I have the draft submission here from the ASA. It has been released to the Productivity Commission and it's on the web site. Would you like me to address some of the key points or would you like to ask me questions directly from it?

**MR BANKS:** It might be useful, just for the sake of the transcript, for you to give the highlights or the main points very briefly and we can pick up a few of the ones we want to talk about.

**MR WILSON (ASA):** I apologise if I don't go in order here. If I could start with draft recommendations 2 and 3 surrounding the composition of remuneration committees. We agree with draft recommendation 2 in its entirety. There has been some argument put to us that the limit of the ASX300 is somewhat arbitrary and that perhaps the ASX100 would be a more suitable number and that as a result of the level of interest of shareholders in those particular companies. It has also been put to us that perhaps the ASX500 would be a better limit to set so that the top quartile of ASX listed companies by market capitalisation would have this more onerous requirement.

We would prefer there to be no limit whatsoever so that the listing rule applies to all companies but we acknowledge, in the smaller end of the market, that some of the boards that run the companies simply aren't large enough. Even the cash isn't there to make those sorts of things happen. Therefore, we would agree that the ASX300 is the right place to be. It coordinates quite nicely with some of the rules surrounding audit committees and therefore it should be quite understandable.

Moving on to number 3, we would expect that the ASX Corporate Governance Council would use very similar if not the same wording in its recommendation of best practice. Therefore, we would suggest that it includes a statement whereby all of the members of the remuneration committee be non-executive directors. We don't see any reason why in an if not, why not regime you should lower the bar for ex-300 companies. If they don't have it, then they can simply explain as to why.

We would also go as far as to say that there perhaps should be some additional guidance or a recommendation from the council to suggest that the remuneration committee actually meets during the year. This is on the back of one listed company whose remuneration report was voted down the prior year and then the committee didn't meet at all in the subsequent 12 months. It may be a one-off and an overreaction, nonetheless we would consider that to be good governance at least once, perhaps three times a year.

**MR BANKS:** Just on your response to 3, I guess what you're saying is that under an if not, why not regime you can maintain the standard at a higher level, and obviously companies that are at the bottom end of the publicly-listed range would have a pretty good reason for why not, so they would be covered.

**MR WILSON (ASA):** Yes, indeed, that's exactly what I'm saying.

**MR FITZGERALD:** If I can just clarify, you've supported our position in relation to the ASX300 being compelled to these guidelines. You will be aware that today we've had a couple of presentations - and yesterday - from groups that have indicated that they're opposed to that view, that the whole lot should be an if not, why not

arrangement. Again some people have questioned the 300 but, putting that aside, I was wondering whether you have any responses to those views that believe that the whole regime should be an if not, why not and wherever the threshold is, it's an arbitrary threshold and, frankly, it has little merit. I was wondering about what your views were about those sorts of comments that we've heard.

**MR WILSON (ASA):** Yes, I have heard some of those arguments. I've also heard questions from the commissioners probing the reasoning behind that. The main question is under what circumstances should a CEO be sitting on the remuneration committee. From sitting in this room I haven't heard a very good argument as to why a CEO should be sitting on a remuneration committee. I also think, stepping back more generally, there isn't a great deal of research in this area. However, I suspect that the vast majority of ASX300 companies don't have executives sitting on the remuneration committee. Therefore, I don't think it would be a huge leap to have it in as a listing rule in any event. It's simply good governance to keep the CEO off the remuneration committee. Certainly invite the CEO to address it, certainly consult with the CEO about broader strategies, but leave the CEO off the committee.

The ASA has also been concerned about what the ASX may do, and perhaps the Commission should give some thought to what should happen in the event the ASX does not come forward with a rule as in recommendation 2. Also, what if the ASX Corporate Governance Council doesn't come forward with a recommendation as structured in draft recommendation 3? That is something that's exercising our minds as well.

Draft recommendations 4 and 6 we broadly agree with. However, we don't support extending the recommendation 6 to other undirected proxyholders. The ASA would be one of those other undirected proxyholders and we wouldn't like at all to be excluded from participating in a vote.

**MR FITZGERALD:** Can I just raise that. You will again have heard in the last couple of days - and it's our opportunity to throw these back at you so that's good - - -

**MR WILSON (ASA):** Sure.

**MR FITZGERALD:** That some of the participants, particularly the directors and the company secretaries, have objected to us disenfranchising shareholders that either want to put their faith in the directors in relation to undirected proxies and that we somehow or another, I suspect, are denying those shareholders the right to be able to put that faith in those particular chairs or directors. I was wondering if you have a direct response to that.

**MR WILSON (ASA):** The response I would have is, my understanding is that all you are requiring is that if - institutional shareholders understand that boards are

recommending the remuneration report and that the chairman of the meeting is invariably going to be voting in favour of it. Therefore, I wouldn't consider it being disenfranchised by being forced to tick a box saying "for", rather than leaving it blank altogether. That is not onerous, it's simply a matter of procedure and therefore I really can't see how that argument holds water.

**MR BANKS:** Good.

**MR WILSON (ASA):** All right. We agree with recommendation 5 and we support recommendation 7. Recommendation 7, just as a note, does have some impact on the Australian Shareholders' Association. We are quite often proxyholders and in this instance we would be forced to vote those shares. Now, we're a largely volunteer organisation and sometimes meetings can run for many hours and sometimes can be quite late at night, and given our demographic of self-funded retirees that can be problematic. Nonetheless, we think it's a good principle and we support it and we will make additional efforts to make sure that every vote that we receive is voted at an annual general meeting.

We support draft recommendation 8. I think we would urge you to be cautious about how that is actually worded. Executive remuneration is increasingly complex and therefore it's important that the right results come out of it. I would be guided, believe it or not, by some of the remuneration consultant submissions on how to get the true value out of what's being paid.

**MR BANKS:** You will see there are a number of suggestions that have come forward. Looking at our web site, if you want to comment on any of those later you should feel free to do so.

**MR WILSON (ASA):** Yes, if I could take that on board and I'm happy to do that. All right. We don't particularly support draft recommendation 9. I think it's the only one we have reservations with. The definition of key management personnel in our view is too narrow. We have seen circumstances where shareholders ought to know how much an individual is paid, despite that person not being a key management personnel. We would prefer a term such as "key personnel" or something along those lines. Nonetheless, the current regime where sometimes a person who may have been with the bank, for instance, for 50 years and have a substantial payout at the end of his middle management career ends up being one of those reported.

At the same time though, if there is a key individual within the company the disclosure of that person and their remuneration gives shareholders information about key person risk. It also shows how that person may be remunerated for the long term and it could apply to a small number of companies - funds management companies; it could apply to inventors; communications companies where there's a key person on the air. Those sorts of companies we would expect to see that

additional disclosure.

It also has shown that there was one company, a bank, where an individual was paid a termination payout of over $30 million and that disclosure would not have been made if it had been a key management personnel disclosure only.

**MR BANKS:** What was the nature of that payment? That was someone at a bank who was not a KMP?

**MR WILSON (ASA):** Correct.

**MR BANKS:** That was a termination payment?

**MR WILSON (ASA):** It was, yes.

**MR BANKS:** Which had a whole lot of components to it, presumably.

**MR WILSON (ASA):** Correct. Recommendations 10 and 11 we generally agree with. The use of advisers, we believe, ought to be disclosed. The reason for this is that we wanted to see board accountability for remuneration decisions. All too often when shareholders are asking companies how did they arrive at the methods that they're using, the response is, "We used an independent expert remuneration consultant," and then shareholders have no idea who that consultant is; whether they are truly independent; how much other work they do for management; how much they were paid in relation to those things and really don't have much of an idea on where they're at.

We agree that, firstly, the remuneration consultant should be appointed independent of management. We think if that is to be the listing rule then there should be some disclosure around that as well. But we would also hope that the Commission extends recommendation 10 along the same lines as those in recommendation 11. We think it would be a very interesting exercise, very useful information for shareholders, to see after a remuneration vote was voted down, whether the remuneration consultant was retained the next year. It would also, in our view, be an early warning signal to other companies using a similar remuneration consultant if the other company had a large "against" vote because we've found that remuneration consultants have particular strengths and weaknesses and ways of recommending things that end up being ingrained in company culture.

We support recommendations 12, 13 and 14 and also 15. There's two points on recommendation 15 and the first is that it requires the 25 per cent vote. Special resolutions have been around for quite some time. Special resolutions require a 75 per cent plus one vote in order to be successful and they apply to all sorts of things: changing a company's constitution; company name; selective capital

reduction; winding up a company. I've never heard any industry body advocating that we do away with special resolutions for any of these things. It seems that only when it's applied to the remuneration report that it causes some sort of a problem.

We agree with the Commission that that sort of a threshold would bring remuneration issues quite rightly into a spotlight. We also agree that a two-strikes rule is quite a moderate response. I think the association in its initial recommendations only had a one strike, and then a requirement for the chairman of the remuneration committee to stand for election. So two strikes certainly does give ample room and ample time for companies to, firstly, consult with shareholders to find out what their issues are and, secondly, to amend as appropriate.

**MR FITZGERALD:** On the second strike, what is your view in relation to the right threshold of that vote?

**MR WILSON (ASA):** 25 per cent.

**MR FITZGERALD:** You have 25 per cent on the first, you're saying 25 per cent on the second?

**MR WILSON (ASA):** Yes. Even with the removal of some of the so-called conflicted or non-independent votes there would still be a relatively small amount of companies that would fall foul of the 25 per cent vote two times in a row. I think in terms of going after those that are on the worst end of the spectrum, the Commission has got it just about right.

**MR FITZGERALD:** Can you deal with the contrary views to that that we've heard today that even a 50 per cent on the second strike the Australian Institute of Company Directors opposes the strike rule, and a number of the groups have put to us that these have unintended or perverse outcomes. At two 25s, of course, their concerns grow even more strongly. Just taking the key one, they would say to us - as they have both publicly and privately said to us - it is completely inappropriate to have a threshold of 25 per cent, especially on the one that triggers the board having to stand for re-election.

Then there are many other issues that are more important in the life of a company that require at least 50 per cent. If I can start with that particular principle. Why is it that a 25 per cent threshold causing the re-election of the directors - and I avoid the word "spill" because it has been misinterpreted - is appropriate when much significant issues require at least 50 per cent?

**MR WILSON (ASA):** Shareholders are investors in companies because they want to see long-term prosperity of the company; they want to see the company performing well in terms of earnings and dividend, and paying a maintainable

income stream into the future. Therefore, they want to make sure that absolutely everything surrounding the decision-making processes, in order to make that occur, as being the primary aspect of what they should be able to influence. Executive remuneration falls directly into that. Now, is it the most important aspect of a company's reasons for existence? Perhaps, perhaps not, but I can tell you that it is the single largest issue that is raised by our members, above and beyond dividends which is what they buy their bread with. Executive remuneration is the single largest issue that shareholders complain to me about.

I suspect that the reason for having such support for a 25 per cent rule is a combination of the feedback that we receive from our members but also it's a more moderate response to what our members are suggesting in terms of caps, binding votes and the rest. It's still a non-binding vote. The end result is that you would require an election of directors with the 50 per cent plus one threshold, and that's why we simply don't have a problem with it being 25 per cent.

**MR BANKS:** In your earlier submission you mentioned that you'd seen this as a trigger for re-election of the chair of the rem committee, but that would have been after one year, I think, rather than the second year.

**MR WILSON (ASA):** Yes.

**MR BANKS:** Do you want to comment on that trade-off and whether there's any virtue in the second strike also being somewhat more targeted than the whole board?

**MR WILSON (ASA):** Sure. The original suggestion from the ASA was that if after one year the remuneration vote fails on a 25 per cent basis, the chair of the remuneration committee must stand the following year. In our view that essentially was a two-strike policy in any event because you had the first strike which failed and then the second strike which is next year's remuneration report. If it hadn't been fixed it would trigger this individual having to stand for re-election. The person would automatically be there, he would be the person who no doubt shareholders would hold accountable and that's how we arrived at it.

I think that having it extended for another year really just gives the company an extra year to get things right. Whether it's necessary or not, I'm not sure, but it certainly is a moderated response to our suggestion. We have in the past sought to remove directors from boards using the 100-member rule. We don't use that lightly. That has had mixed response. On the three occasions that I recall having done it, the director stood down on the lodgment of the request from us to the company; on another the individual received a 40 per cent against vote, and then another, only a 10 per cent against vote. These are individuals that we have targeted for specific issues that face the board. On one occasion it was the chair of the risk committee where we thought the company's risk management policies had led to a poor

outcome.

We have no problem targeting an individual even though the board's reaction is almost invariably, "But this was a considered response from the board and agreed to unanimously. Why are you picking on one individual?" We think the Commission's recommendation to have the entire board stand for re-election is an improvement on our suggestion. It takes away that argument about collegiality and it also takes away the argument that we acknowledge which is that shareholders have no idea if the person who we are targeting is actually a dissenter and on our side, rather than the person or people that we should be targeting. Therefore, without that additional information, the most practical and logical thing to do is to have all of the directors stand for re-election. We think your recommendation is an improvement on ours.

**MR BANKS:** If I can just deal with that. There have been a couple of other arguments against our proposal which I would just like to flesh out. One is - and you would have heard it put by a number of people - that a threshold of 25 per cent on the second would allow corporate raiders, particularly aggressive shareholders to manipulate this. That has been put by many directors, and I'm sure in the next few days will be put by many others. Of course it's a serious issue if you were to in fact produce, for the purposes of remuneration, a mechanism by which a corporate raider could have a deleterious effect on the stability of the company.

I was just wondering to what extent that argument has validity and, if it does, how does one circumscribe it if it's required to be contained or circumscribed?

**MR WILSON (ASA):** Firstly, I'm not sure that it does. I think that shareholders, notwithstanding being disappointed with remuneration reports, understand that directors are there for more than setting remuneration. There was a company only a few weeks ago that received an extremely high against vote at its annual general meeting - 81 per cent of the votes cast were against the remuneration report. At the same time, the chairman of the company, who also was the chairman of the remuneration committee, was standing for re-election and was returned with 96 per cent of the vote.

Despite what may be a threat of a board spill, in reality that won't occur. It may result in some directors receiving a higher against vote than others, and it may in extreme cases see the removal of one or perhaps two directors who are more involved with remuneration decisions than others. The thing that I'm most concerned about is that a corporate raider can call a meeting and seek to remove the board and replace them now. Anyone with 5 per cent of the issued capital is able to do that. If that's the case I'm not sure that what you're offering, what you're recommending is any less onerous than that. It's still a 50 per cent vote. We've heard the criticism but we can't see how it would play out in practice.

**MR BANKS:** What some have said to us is that there's a difference in terms of the transparency of intent between the two routes, whereas in relation to the two strike they're kind of using the camouflage of remuneration for another purpose. What do you say to that?

**MR WILSON (ASA):** I think that's probably a valid threat. If it is used in conjunction with a motion about unrest with remuneration then there is an outside chance that that could occur. You've got to have it one way or another; either shareholders elect and remove directors using a majority vote, or they don't. That's the premise behind removing the no vacancy rule which would allow, in most circumstances, an individual with over 50 per cent of the vote to be voted in. I think particularly retail shareholders would be comfortable with the risk that some sort of camouflaged corporate raider may be sitting in the wings and being able to orchestrate a board spill.

**PROF FELS:** There is a point on the other side in respect of we're hearing all sorts of remarks about manipulation on the side of the minorities, 25 per cent, and they may use it to disguise a takeover and so on. In your experience, on the other side at least, when company chairmen and others are involved, I suppose they too can also play tactics and make it quite hard to get even up to 25 per cent, let alone 50 per cent. Do you see something in that?

**MR WILSON (ASA):** Yes, that is the case. The current mechanism where chairmen will vote undirected proxies is one aspect of that, but there are other things they can do. For instance, they can put on the proxy form in bold print, "The board recommends a 'for' vote" or an "against" vote, depending on how they would like to see the result returned. There are some issues of disclosure of when the proxies are disclosed at annual general meetings that can either keep the audience in the dark abnormally long or they can stifle debate by putting particular results up-front. There are some mechanisms that the chairman can use. That's part of owning shares.

**MR FITZGERALD:** Can I round off a couple of the arguments, so we can get it clear. The other argument that has been used against the two-strike policy - and it's been raised on several occasions - has been the fear or concern of the growing influence of proxy advisers - there's only a couple around at the moment, and no doubt that will grow - and that seems to be a pervading concern of directors specifically and it's articulated by their peak bodies. You're not a proxy adviser per se but is there a genuine concern about the rise of the proxy adviser that would in any way require us to deviate from our recommendations. In other words, yes, I understand it, I understand the influence that one or other of the two dominant players are having, but is it a genuine concern, and given that you're at the coalface of shareholders I'd be keen to get your view on that.

**MR WILSON (ASA):** Yes, there is a concern. There's a concern that the proxy

advisers are not tough enough on companies, rather than the contrary. I think proxy advisory groups are very well-intentioned. They often have their institutional shareholders' interests at heart but we think that only until very recently their public and even not so public stances on some of the remuneration excesses have been unforgivable. I think that companies have been very fortunate to have a proxy advisory industry that has so few players and that have taken on the institutional attitude towards things, such as remuneration.

It has only been that in the last few years where institutions have requested - and in particular superannuation funds have demanded - a tougher stance on remuneration, that the proxy advisory groups were actually starting to take a bit more of a tougher stance. I'm sure if you speak to the advisory groups they simply put out recommendations. Their advice is on a take it or leave it type basis and that it's the responsibility of the fund manager or the institution or that individual within there to determine whether to follow it or not. So, no, I don't see any problem, apart from them perhaps not being as tough as the Australian Shareholders' Association with the use of advisory groups.

**MR BANKS:** The no vacancy rule, you're supporting a position on the no vacancy rule. Clearly the two areas of concern to many has been the two strikes and the no vacancy rule. Are there issues to be concerned about in relation to the proposition we've put about removing this no vacancy arrangement that we should be aware of from your point of view. Perhaps if I elaborate on that. Some have argued that it wouldn't achieve the purpose that we had for it in the sense that there would be pre-emptive action of one kind or another, that we'd either see the constitutional ceiling brought down or would see pre-emptive board appointees taking all the available space so that the result would be a larger or a smaller board and there would be disadvantages in both those situations. These are the reasonable arguments that have been put to us. I'd be interested in your comments.

**MR WILSON (ASA):** Not all companies use the no vacancy rule. It's used from time to time with contested elections but not everyone subscribes to the view that if you've got someone who you don't want coming onto the board you should automatically declare no vacancy. It's a little bit curious that those who advocate for a 50 per cent threshold in recommendation 15 are arguing against a 50 per cent threshold in recommendation 1. It just seems a little bit strange to me. If shareholders want someone in position on a board and vote with 80 per cent of the vote, and vote another person with 85 per cent, it seems somewhat illogical that one of those people ought to be not included in the board because of a no vacancy rule.

On saying that though, we did find it a little bit odd that that recommendation was one of the 15 recommendations. We're not altogether sure that it will result in greater board diversity or anything else like that. We just think it simply makes sense to do away with the rule.

**MR BANKS:** Thank you. As you can appreciate, one of the themes of the submissions has been the clubbiness of boards and the extent to which you get group think which could be affecting remuneration decisions among others. We appreciate that it's a much wider issue obviously than remuneration but that was the kind of perspective that led us to think about how accessible board membership is and what the barriers to entry might be.

**MR WILSON (ASA):** I think our view would be to tackle the issue somewhat differently. The AICD puts on lots of courses. There are many graduates coming out of the AICD, the Institute of Chartered Accountants, likewise, and the Law Society. There seems to be a large number of individuals who could very easily be productive company directors. Yes, it is a wider issue and we would expect that getting these people in touch with the existing directors of major listed companies, perhaps a mentoring regime, something to close the gap between the two, we think would be one of the steps towards breaking the clubby nature of current boards.

**MR BANKS:** Good. Thank you, that has been very helpful.

**MR WILSON (ASA):** Thank you.

**MR BANKS:** We'll just break for a moment before our next participants.

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**MR BANKS:** Our next participant is Adrian Gattenhof and I would ask you tell us in what capacity you're here today.

**MR GATTENHOF:** I represent nobody but myself and I'm here as a retail shareholder. I have a couple of modest portfolios on which I, in fair substance, depend for my semi-retirement income. I've been a shareholder for about 15 years. I've tried to read a few of the remuneration reports and found them, as is commented in the draft report here, long, overly complex and I think the whole issue really does merit an examination in quite radical terms.

Just by way of preamble too, I was impressed by a comment from a chap by the name of Trevor Eastwood, a former CEO of Wesfarmers, that you mention here, who said, "It's really time to simplify the whole thing." But what I'd like to really start with is to address the point that I think I made at the head of my original submission which was that I don't have confidence, to be honest, in the efficacy of the two-strikes proposal. I certainly think it's a worthwhile step but I do fear, based on some observations that were made both in the draft report but also in a series of articles, and one in particular by Ian Verrender and others in the financial pages of the Sydney Morning Herald.

I wonder if I might just read to you briefly - this was an article by Ian on 24 October in the Weekend Business section of the Herald. It's headed, Huff and Puff All You Want, Old Blow Hard is Unsackable. He's really dealing there with the issue of the likelihood - he doesn't specifically mention the proposal. I think the draft had appeared by late October. I think it came out late September.

**MR BANKS:** Late September, yes.

**MR GATTENHOF:** He doesn't make specific reference to us but basically he says because of the culture within the group of people from whom directors are drawn and from who the institutional managers are drawn, because of the confluence of interests within that general social group that it is highly unlikely that they would do anything to jeopardise their own prospects of getting onto boards and the like, and therefore the chance of board dismissal, even with the sorts of proposals that's been put forward here is unlikely to be successful.

He cites, for example, the recent Geoff Dixon case which is really one of the most egregious examples of an unwarranted payout that I think you could bring forward. The report mentions quite a few but I'm sure you're all aware that there was an extra $3 million that Geoff Dixon received to cover a tax bill that he would have had to pay on a payment that he received for the previous year. The government actually changed that legislation, accommodated the protesting CEOs and the like. The additional $3 million wasn't necessary, the board still decided to award it to him.

I don't hold Qantas shares but this was well reported in the media. There was a 43 per cent "no" vote but the board went ahead and did it.

In the face of that when such a monumental expression of shareholder disapproval over in Perth - I imagine it would have been quite difficult for a lot of people to get over there. That doesn't inspire confidence in the ability of particularly the retail shareholders in the face of essentially what Ian Verrender is pointing out. Effective collusion - collusion not by way of, say, the Visy Amcor type of collusion but rather a collusion of having an interest in common; collusion that arises out of perceiving yourself coming from the same class with a sense of entitlement, that sort of thing. I think that summarises it because I really would like - in the time I have - to go on to a few other things. If I may just read a brief paragraph here:

> The directors and senior management of that hypothetical big investment house are part of a tight-knit clique of like-minded souls around the city. Some are on boards and other major corporations, the very companies in which their own institution invests.

He goes on to say that because of this confluence of interest that the large institutional shareholders - the retail superannuation funds, the commercial superannuation funds and the like - in other words, there needs to be strong action there to try to either somehow make sure that they make clear to the unit holders how they are intending to vote their shares - and assuming that they do because this is where the large swag of institutional votes on the Geoff Dixon matter would have presumably derived from. There really needs to be constructive reform to make sure that retail shareholders who, if you were to look at the make-up of the actual mums and dads who invest in these large superannuation funds, they are the sort of people who would have voted "no" at those AGMs.

What is happening is the institutions who are holding those shareholdings in trust for people like myself who would otherwise simply be retail shareholders, they are voting against. They would have seen the massive protest vote, and despite that they are voting in favour of the board to pay an amount of money that really was not only not necessary under the contract, had ceased to be necessary under the contract, but was really outrageous to the point of being comparable with Sol Trujilo and the rest of them.

Having said that, that's essentially by way of preamble. I'd like to, if I may, just read from the sheet that I've given you here because this now gets down to the nitty-gritty of what I really want to say about this issue. I really feel that this whole issue is not fundamentally economic, it is not fundamentally about productivity, it's about morality. It really goes to the heart of the kind of society that we see ourselves building. It is about whether we have a society that is founded on equity and fairness, or whether we're prepared to allow our society to drift in the way that

America has been drifting, and there are numerous examples quoted in the draft report.

Stephen Mayne made reference to some of the outrageous amounts of money being paid to CEOs in America where you have multiples. Here I think the largest one you cited was something like 160 times the average weekly earnings, whereas in America you're looking at up to 500 average weekly earnings. All of the other subordinate executives are going to be pulled up by the CEO. You're going to have a massive accumulation of wealth in the hands of a range of corporations, but particularly so in the financial sector in the US. We have recently mention of the party of massive bonuses is carrying on business as usual with Goldman Sachs and Citicorp. Details were given of that in a recent Herald article. In other words, nothing has fundamentally changed.

One of the consequences of that has been that the Obama government - whereas the mythology that we had put to us was that it was lots and mums and dads putting in their $5 to elect President Obama. According to an American economist by the name of Michael Hudson who was interviewed on Late Night Live recently, Phillip Adams' program on Radio National, that in fact he was largely financed by Wall Street. One of the consequences of being financed by Wall Street is that the main street mums and dads who suffered because of the financial meltdown, instead of them having their mortgages paid out, instead of them being relieved of the debt, the guarantees and the loans were given to the big end of town. The mums and dads in main street are left still having their houses repossessed and so on.

That to me represents a drift towards what I will call feudal capitalism where essentially you have a highly privileged caste of people - caste in the Indian sense - a sense of Brahmins of business who are quite detached from the rest of society, who are really living in an entirely different world. That to me is something that I think we don't yet have in Australia and I see the risk of us drifting in that direction if we permit remuneration received by a relatively small number of people to get to the point where they can accumulate and concentrate such wealth that they can essentially buy a government, where government is essentially owned by those big donors who will finance their position utterly, and then they will act in the interests of those who have financed them. He who pays the piper calls the tune after all.

I'm really here to urge you to reconsider the question of capping. It was touched on in some degree of detail in the draft report but I really believe strongly that it was not given the kind of weight and the kind of moral weight that it should be. One of the things that emerged throughout the report was that productivity is not tied in any direct, tangible way to the wages, to the remuneration of senior executives and CEOs, that the amount of money paid to CEOs is largely tied to the size of the corporation. That seems to be the strongest correlative of CEO pay. It's not really tied to their productivity at all.

In fact if you read - as I'm sure you would have - the research done by David Peetz, whose submission I went through in detail, he even reached the conclusion that beyond a certain level of CEO pay, and way below the levels that are now prevailing in the larger companies in Australia, something like I suppose the law of diminishing returns operates and in fact you get an inverse correlation between increasing CEO pay and performance in the company. He cites quite a few examples of that where it's simply no longer the case that you keep on paying more and more to the CEO and the executives immediately below him almost invariably, and that you get improved productivity as a result of that.

I think the argument that these people need to be paid so grossly out of proportion to the rest of the workforce who make an equally valuable contribution I think has no substance to it. The thing that I would like to see happening is that the Australian government - where we have substantial social reform, somebody has to take the lead. Take, for example, women's suffrage, it was New Zealand took the lead. New Zealand was the first country to introduce the vote for women in about 1897; Australia was the second; America, considerably further down the track; European countries, roughly in between. Somebody had to take the lead on that. What I would like to say - and I've written it here on my handwritten notes at the bottom of this and I'd just like to quickly read it:

> Some societies, some government needs to take the lead on progressive social reform. Australia could push for consistent internationally based capping of executive pay. The executive pay issue would then cease to be the distracting distortion that I believe that it has become in our corporate life. Boards would then be able better to focus on the actual business of the enterprise.

I mention there at page 223 of the draft report where Charles Macek commented - and he has served on boards - that because we're dealing with a cast of essentially prima donnas, who are highly overpriced prima donnas - and I would cite Sol Trujilo as a very obvious recent example of that - that the whole remuneration issue becomes blown out of proportion to the weight that it should have in the life of the corporation. It should be a much smaller issue in the life of a corporation.

One of the arguments advanced towards the end of the report on page 299 - going to my final handwritten dot point there - was that capping would not be desirable because it would lead to - supposing we had a cap in Australia, as advanced by the ACTU, a maximum of 10 times average weekly earnings, or whether it be 15 or 20, at some level very much below what we have now, that that would set Australian corporations at a disadvantage.

The first point I'd like to make to that is that if Australia actually took a lead on

this issue internationally - and you might recall that even Stephen Mayne, who is certainly not the leftie end of the spectrum as I might be - I think he came from a background of working for Jeff Kennett - he said in his submission, the very first point, Bringing Down the Roof Globally, Stephen Mayne:

> Lobby the Obama administration to curb the outrageous system of executive pay in the US which has caused blowouts and distortions all over the world.

If Stephen Mayne can make a point as strongly as that, I think the moral argument for this position is very strong.

**MR BANKS:** If you could pause there, I'm not sure Stephen Mayne advocated caps in Australia.

**MR GATTENHOF:** No, he didn't, I know. But it's interesting to see that where he sees the distortion going even further to the levels that you have in America 500 times - you have executives being paid 500 times average weekly earnings but yet you have Puerto Rican immigrants being paid three or five dollars an hour. There was again a program on our beloved Radio National - and where would Australia be without Radio National - there was an American investigative reporter who looked into the pay and conditions of some of the people, who are at the bottom of what I call the feudal capitalist pile, being paid something like three to five dollars an hour. Gross distortions there.

The point I wanted to make is something that I think has not been picked up here and that is that if we only look - society is much, much more than its commercial activities, than its corporate activities. It made mention on page 299 that, "Capping really would set Australian corporations at a disadvantage," but I think the key point that has been missed is that the exponential increases that we've had - and if you look at the graphs in David Peetz's submission, he plots a number of graphs there. You can see the departure, the curve is starting to trend upwards very, very steeply on executive pay, compared with average weekly earnings and compared with the productivity of the economy as a whole.

I want to invite you to think about what are the distortions and the disadvantages that that massive departure within the corporate sector is creating in the rest of the economy. I summarise that by saying here, the exponential increases in executive pay creates a damaging, competitive disadvantage for government, the public service and all those sectors of society where talent, skills, experience and commitment of a high order are needed for a properly functioning civil society. I also read through the submission put in by the Remuneration Tribunal which sets out the pay levels that senior Australian public servants, such as your good selves, would be earning. The disproportion there - - -

**MR FITZGERALD:** Miserable sums that we earn, I might say, miserable, but that's - - -

**MR GATTENHOF:** Pardon? They're so miserable? I would feel myself quite well remunerated on $600,000, but nevertheless - - -

**MR BANKS:** So would we.

**MR GATTENHOF:** Jolly well said. We need good, talented, committed people to fulfil a wide range of people. The best people needed are schoolteachers and doctors and nurses and all of this. These people are far more essential, to my way of thinking, than a society that is ballooning itself out, that is becoming bulimic on wealth anyway. That's a personal point of view.

A distortion where you have corporate excess without any real effective restraint, that must have a very damaging effect on the rest of society, even by way of the promotion of greed and envy. We have again mentioned in the report the ratcheting effect, the leapfrogging effect. So the senior executives are all glancing over each other's shoulders to see what they're getting, to see what their bargaining power is.

Sol Trujilo: I don't know whether he needs now - after having scalped a number of corporations, both American and now Telstra - to bother working any more. But certainly that kind of mentality - and it's mentioned again in the report there - a lot of the American executives who came out here with these extraordinary expectations have had, what I would say, a poisoning effect on the Australian corporate sector, whether it's desirable for government to stand by and allow that sort of thing to continue.

One of the things I'd like to draw your attention to is the comment made by - now I consider myself a very amateur investor in the scheme of things. I'm certainly no match for Warren Buffett. Here in the CFMEU submission was a very nice little quote from Warren Buffett that I'd like to read to you:

> Renowned US investor Warren Buffett had the following to say about remuneration consultants, "Too often, executive compensation" -

and I'll make comment on that word "compensation" in a moment -

> "in the US is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's" -

remuneration.

> "The upshot is that a mediocre-or-worse CEO - aided by a handpicked VP" -

vice president -

> "of human relations and a consultant from the ever accommodating firm of Ratchet, Ratchet and Bingo - all too often gobs money from an ill-designed compensation agreement."

Now, Warren Buffett I think would generally be regarded as one of the best analysts of corporate performance over something like 50 years or greater on the planet today. Those are his comments about executive compensation. I want to comment on the word "compensation". Don Watson makes the comment about the way in which the erosion of language erodes thought. When we destroy language, when we use language that is depleted of meaning, we ultimately rob ourselves of the ability to think clearly. It's interesting to note how even in the report here that the term "compensation" is starting to seep into our language.

If I think about the term "compensation", I think of the victims of James Hardie and I think of Bernie Banton and their deserving compensation. But this term "compensation" has now been appropriated by CEOs. I'm an old bloke, I've just hit 60 so I'm, as it were, getting towards past my best, I suppose, but when I grew up compensation meant payment made to somebody who had suffered injury or loss in some material and tangible way. Executives are now appropriating the term "compensation" to be used for the money that they get, as though by giving of their services they're suffering some injury or loss. I think this has a remarkably corrosive effect on how they are viewed and helps to promulgate the notion that we are dealing here with a privileged caste - in the Indian sense - that must be somehow treated with kid gloves and must be treated differently from the rest of society. Ordinary workers don't get compensated by way - you know, your weekly wage is not compensation. It's what you get paid for doing your job.

I'm arguing, I suppose, I'm pleading for a lost cause, that the Commission would reconsider the issue of capping of executive pay on the basis of the moral dimensions that I'm trying to introduce into the discussion that permitting greed and envy to seep like a poison through our society is something immensely unhealthy, it has happened across the world, largely led by the example of America. Australia could take a lead on it and I would plead that a good Australian government would take a lead on doing it.

Now, it might mean perhaps a temporary disadvantage, though I don't think so. I would argue, for example, that somebody like Lindsay Tanner would run rings

around any CEO that I've heard speak publicly. The Prime Minister, for example, earns one-third the pay level of Sue Morphet, the CEO of socks and jocks, otherwise known as Pacific Brands, who is still paid over $1 million. I think most Australians simply cannot see that a job like running - and I'm a shareholder of socks and jocks, I might say, much to my disappointment. That company basically makes socks, jocks and T-shirts in Asia, puts them on the shelves of Kmart, Big W and Target, that's it. That's essentially what that company does. I cannot understand how anybody could possibly argue that that job carries with it three times the complexity of the position of Prime Minister of this country.

When you consider that everything the Prime Minister does is under public scrutiny, it's under constant attack from the Opposition. Not only that, he or she who might be Prime Minister of Australia needs to have their head around every single portfolio. They need to be able to come forward and speak intelligently, sensibly on absolutely every issue. A person running a fairly narrowly focused company, whether it be Pacific Brands or whether it be Telstra or for that matter whether it be one of our very protected large banks - which I'm lucky also to have a few shares in, but not many - they're dealing with nothing like the complexity; they're dealing with nothing like the array of competing voices, the competing interests, around which they have to have their position thought through and to which they have to respond on a daily basis.

To put up the CEOs of these corporations as somehow meriting, deserving these astronomic levels of pay I consider utterly preposterous and, again, a social distortion, one that detracts from the ability of our public service, of government and of other areas of our society then to be able to remunerate and to fairly remunerate people that we vitally need for a balanced, healthy, civil society. I think I've just about run out of steam, and I thank you for listening.

**MR BANKS:** Thank you. That's obviously a contrasting perspective and I'm sure that's why you came.

**MR GATTENHOF:** That's why I wanted to come. I'm sorry, Gary, if I may just make one little comment. I did note and mention to Nick that it was noted in the draft here that you hadn't received that many submissions from, shall we say, ordinary people like me. One of the things that I think has happened increasingly is that people become disillusioned with our institutions and disillusionment with our institutions and cynicism about the capacity of our institutions to manage the country, not just the economy but to manage our society in a way that is fair for all is really something that we need to be alert to. A loss of confidence and a hardening of people's attitudes into cynicism, "Oh, they won't listen to me. Nobody will take any notice. What's the point?" which I not infrequently feel, as my good lady wife would attest, who is a very active and volunteer worker in many things.

We need to be engaged and I feel that - perhaps one reason why more people like me aren't actively engaged is that they don't feel that their voices will be heard or that their voices will be given weight in these sorts of issues and that would be a sad thing.

**MR BANKS:** That may well be the case, although partly our comment was a comparative one. We have been involved in other inquiries where there has been quite a strong participation from individuals and households and so on. But certainly we welcome your contribution and thank you for that.

**MR FITZGERALD:** Just a comment, we acknowledge absolutely that - and I think Gary has made this comment in many speeches - you don't need to pay somebody $10 million to get them up in the morning to do a good job. We acknowledge that.

**MR GATTENHOF:** Precisely.

**MR FITZGERALD:** Nevertheless, you would also have to acknowledge that in a marketplace - and there's no doubt that labour is a marketplace, including for executives. The one thing we were able to point out in the report was that as companies grow, and that's a proxy for complexity, they get paid more and more. So in a sense whilst you might think that caps deal with the moral dimension, in effect it's as inequitable an instrument as you can probably get. We looked at the caps issue and they may have some benefits, but they also have huge disadvantages as well. So I suppose what we're trying to say is that we recognise that people are going to be differentially paid.

**MR GATTENHOF:** Of course.

**MR FITZGERALD:** You can argue about the base from which that difference is started and we've acknowledged that some of that was the importation of USA executives and the packages that came with them.

**MR GATTENHOF:** Yes.

**MR FITZGERALD:** But the danger that you have with your proposition is that if you place government as the sole arbiter of moral value and then give it practical implication through the imposition of caps and other measures, that's an equally dangerous course. So in one sense I just put it to you that even if you believe there was a moral dimension to this argument, and there undoubtedly is, your proposition of capping seems to me to have as many flaws as it has strengths. So even if you believed your proposition that there is a moral dimension, that response is not necessarily the way that's going to achieve your objective.

**MR GATTENHOF:** Commissioner Fitzgerald, I'd certainly agree with you that it's one of those issues that does need to be argued out very thoroughly. The point I'd make in response to that, I suppose, indirectly answers it in my mind, which is that in a civil society we understand the necessity of putting a floor under poverty. In Australia we have a minimum wage and that's considered something, I think, something that is a measure of being a civil and civilised society, that we understand the concept of a living a wage, what a person needs. It's been tradition in Australia for a very long time. It's part of what we call this unwritten thing of the social contract. But I think also for the equally important measure to prevent the concentration of wealth that we need to have limits to wealth because we need to have limits to power. One of the things that makes for a civil society is the dispersal of power - not quite dissipation, but the dispersal of power throughout society. We no longer have an absolute monarch; we no longer have barons and feudal lords. We have power distributed widely.

One of the points that Michael Hudson, the economist that I briefly mentioned on Late Night Live, pointed to the changes over the last 20 years in the concentration of wealth in America. In the last 25 years I think the figures were that it's gone from the top 1 per cent, the richest 1 per cent earning roughly 40 per cent of the nation's wealth to now 66 per cent of the nation's wealth. That has consequences and that has consequences for everybody in the society. It is the part of the reason, I would think, as to why America essentially doesn't have what we would consider proper public health care. It doesn't have a proper minimum wage system because the more powerful the wealthy are, the more they are going to be persuaded by the argument that market forces should control the wages of the least well paid.

**MR FITZGERALD:** When we get a wealth inquiry, we can explore this in greater detail. Can I ask a question of you as a shareholder. We have tried in this report to expand the influence of shareholders, some might say modestly, others seem to think it's a more radical approach. Do the measures we put forward give you any confidence that the shareholder voice can be more effectively heard going forward. It's always a matter of seeing how it actually plays out. But through various mechanisms, would you agree or otherwise that we've at least made some inroads, some attempts to put the shareholder in a slightly stronger position than they are today and a much stronger position that any American shareholder has ever been in.

**MR GATTENHOF:** Yes, I certainly agree with that. I have a concern about the two-strikes proposition on the basis that, say, for example they're going to - initial proposal in the remuneration report is to increase Ralph Norris's pay from six million to 12 million in one hit, shareholder revolt. So for the next one they bring it down, so instead of going from six million to 12 million - I think I've got it wrong, it's Marius Kloppers, isn't it? Kloppers going from six million to 12 million in one hit. They will tweak it down. So in other words, instead of going for 12 million they will bring it down to 10. That would be sufficient, I think, in the minds of a lot of people

because most Australian don't like to rock the boat. There's the sense of going along with things we are not the rabble rousers and rebellious type of people. We are a docile and compliant bunch generally.

I suspect that boards will then simply pull back a little bit on the second vote so as to not trigger essentially the vote for the entire board. I certainly think that it is well intended, I have no doubt about that, your intentions in proposing that and I think it has probably put the wind up a few people, but I would go back to a point that I made and I overheard Stuart Wilson that boards essentially come from a class and they are highly resistant to outsiders. Stephen Mayne has tried. I've voted for Stephen Mayne on numerous boards and he has never got anywhere near being elected. I mentioned in my initial submission the case of what I thought was an excellent candidate for the ANZ board some years ago that I voted for, the FSU were supporting her, she had 20-odd years of branch and customer service experience. The board closed ranks and ganged up against her and she failed to get elected.

Interestingly too I heard Gail Kelly just before I came down from Mullumbimby. Gail Kelly, CEO of Westpac now, was on the radio saying the sorts of things this lady would have been saying, say, five years ago when she ran for election, "We need to get back to having direct contact with our customers. We need to think about customer service again," and yet when the ANZ had the opportunity five years ago to bring in – the ANZ board is about eight or 10 people, I forget exactly – even just one voice from somebody who had been a 20-year long employee at customer service level, they didn't want her. They actively campaigned against her election. If that doesn't indicate a measure of the resistance of existing boards to somebody who is from outside their caste getting elected, I don't know what does. So therefore the measures that you are proposing, the no vacancy, the abolition of the no-vacancy rule and all of that, I wish it every success.

**MR BANKS:** We will wait and see. That sounds like an excellent note to end on.

**MR GATTENHOF:** I'm happy to leave it there and I thank you for giving probably more time than was originally allocated to me.

**MR BANKS:** No. We will just break for a moment before our final participant today. Thanks.

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**MR BANKS:** Our final participant today here in Sydney is Malcolm Fraser. Welcome to the hearings. Perhaps you could just indicate the capacity in which you are here today, clearly not as the former Prime Minister, but in another capacity.

**MR FRASER:** No, that's right, Mr Banks. Thank you very much for the opportunity of coming. I am speaking as a private individual. I've had 39 years of experience in industry with a major Australian company. I worked as a professional engineer in that company and I left in March 2007 and my age is 64.

**MR BANKS:** We appreciate you participating as an individual and we just had a conversation earlier about the difficulty of getting individuals to come along and so on to these hearings. So you're very welcome and we will give you the opportunity to make the points you want to make.

**MR FRASER:** I said I would only take seven minutes, but I've got a bit more to say if that's permissible.

**MR BANKS:** Absolutely. Take the time you need.

**MR FRASER:** I just feel a sense of pride and gratitude actually to be a citizen of a country where ordinary people are just given a chance of speaking like this. I also appreciate Mr Nick Hague because when I contacted him last week it was like meeting an old friend and he pretty well put me at ease straightaway. I also just wanted to say that I had been listening out the door to Mr Gattenhof and I just found what he was saying was nothing short of statesmanship. I think it's global statesmanship that he is exhibiting. I think his views would resound around this country and I think they'd resound around every western democracy and indeed, I think we wouldn't have the enormous stuff-up going on at the moment in Russia where capitalism is being introduced in a sort of cowboy capitalism manner if Mr Gattenhof's concepts were actually practised.

So I regard his perspective as a question of global survival. It's just as important as global warming in my view and just as important as climate change issues. We do want to have an economy where we're not driven to just a mob of terrorists all trying to take each other down. I think that what you have done is spoken extremely - I just can't speak highly enough.

I would like to just bring a little bit of my own work and shareholder activist experience to the Commission, if I may, please. I'd like to speak of three aspects. One is the benefits that would accrue from a reduction in the gap between executives and ordinary workers in a company. Second is to talk about my 1998 request to the company to have a pay freeze and thirdly, is to suggest possible amendments to align the interests of board and executives better with shareholders. So the first thing is, is

it possible that actually deep down many executives are really motivated by a desire, somewhere hidden - it may be even when they went to university or just left - just to leave the world a tiny little bit better than when they first found it? If that is so - or even if it is not so - should this sort of motivation be more deeply embedded into the Corporations Act?

For example, I think the Corporations Act has a preamble, with what it says what the general idea is and I feel the idea that as an executive you're contributing to the evolution of human society is the sort of thing that we're really on about. It's not just an executive showing up to work, making a lot of money for the shareholders, getting heaps of money for himself, then quitting and that's it. I was at an annual general meeting last year where an executive had just come to the end of his executiveship and it was so sad because I felt people were having a go at him and yet he had given his heart and sole for years and years but this remuneration issue was something that biased people against him.

Anyway, I feel that staff at all levels in a company, if they are highly motivated to work together, they'll face the challenges that the company is faced with, particularly in Australia as we have to fit into the global context where, at the moment, especially our people costs are somewhat out of adjustment with our neighbours in Asia, especially China. I think the GFC, global financial crisis, is something which again, as employees are motivated together, these sorts of challenges will be faced adequately. I think if there was a reduction in the gap between the executives and typically in companies I think executives doesn't just mean the top five people that appear on the annual general report. The executive pay scheme, as I understand it, in some companies, extends downward, maybe to the top 3 per cent of all the staff in the company. So it's not an inconsiderable number of people that are affected.

I feel that with a reduction between that group and the ordinary working person in an organisation you would improve your chances of having a profitable organisation, you would get solid share performance, the company would be seen as more socially responsible, there would be less need to shed jobs and there would be more money for equipment and training. One anecdote if I may share from my working life, is that I came across a fellow who was very disgruntled because he'd just been taken off shift along with a whole lot of other colleagues because the work he was doing was affected by outsourcing and other issues so there was no longer a need for two shift operations and they all went down to one shift whereas they had been working two shifts for years and years and years and he said, "If they want me to come in on weekends, they can get stuffed." Then a few months later he'd actually been promoted to a slightly higher position. He was a bloke with 19 years' experience.

He said to me a few months later, "I got a call from an overseas outsourcing" - an organisation where some of the work that he was dealing with was outsourced to

and he said, "They wanted my technical assistance," so I said, "The answer's in the manual and hung up." That is not good for the productivity of an organisation. You want this commitment where the guy at the bottom - I acknowledge that if there is no work to do you've got to cut out shifts and stuff. But if the people at the top are just swanning around on maybe 10 times as much as Mr Rudd gets and they're all saying, "Gee, we're so sorry to see" - I've actually seen a senior executive just regretting how much trouble was going to be caused by people being dismissed because there wasn't any work for them. But I think it would mean something to these guys if they saw this leadership at the top.

The second point I wanted to say is - and I've been banging on about this for years and years and years - way back in 1998 I went and talked to a friend of mine who actually is quite a high official in a major union now and I was talking about all this business about executive pay reduction and he said, "What you need is a pilot scheme." So I thought about this and I thought, "I'll be the pilot scheme," and I discussed it with my wife and we decided that we would be in touch with the company and actually ask that at the commencement of the next three-year pay agreement that I wouldn't be given a pay increase. Funnily enough the union supported me in this. They had been dealing with me for years and years before that and they knew I was as mad as a cut snake so I think they thought, "We'd better support him or else he's going to cause us a lot of trouble." They said, "If you have trouble, get in touch with us," and I wrote to the company and the company wrote back to me and said, "Yes, we agree with your request."

But it all went horribly pear shaped because my wife said, "Look, it's all very well for us to be on a frozen salary" - which lasted, by the way, from 1 July 1998 to 30 June 2006, so that was eight years altogether. My wife said, "It's all very well for us to be on this campaign to save the company and save the world, what about getting some of the executives to join?" That was my big mistake, I suppose, because I went and talked to them and one of them discovered that it's illegal for an award-paid employee, such as I was, to be on less than the award wages and the thing that I had been told that I could do was in fact illegal, even though I had it in writing. So they had to figure out how to readjust the whole thing.

So what happened was that I was repaid all the money that I had foregone and my wife again thought, "Well, you can't make a public statement and then say this is a bit of a windfall for us, we'll buy this and we'll buy that," so we've put it into a socially useful purposes fund and I feel really satisfied that some of the money that we were able to access is actually now able to be used for socially useful purposes. I feel this is where executives are missing out on some psychological - how would you say? It's a bit like if you don't go power walking like Mr Howard used to do, you may not make very good decisions in the office when it comes to making decisions. I'm sure Mr Rudd does the same thing. I think they need to power-walk their emotions and they need to power-walk their moral fortitude so that they will say,

"Aha, let me try reducing and see if it makes me happier." I really want to see happy executives, not just happy staff.

The final thing that I wanted to mention was being a shareholder activist I've had a go at section 249P of the Corporations Act which, as no doubt you know, provides for 100 or more shareholders of the company to put forward a statement of no more than a thousand words on some matter that's going to be raised at a general meeting or which is relevant to a general meeting. So, of course, at the AGM of every company by law, by the Corporations Act, you've got to put forward, as you know, this advisory resolution on executive remuneration. Basically it provides for a vote of everybody on whether the executives for the previous 12 months, I think it is, will be paid or not which I think is a terrible way of writing it because who would want to deny the pay of another human being? They'd be kicked out of their house for a start.

Anyway, we nevertheless did campaign in a particular company's case against this advisory resolution and we raised the section 249P statement and we nearly got it through, we nearly did. But technicalities and stuff, time and deadlines resulted in the whole thing coming crashing down. Rather than getting depressed and despondent I remembered what the lady in the print room of our company had up on her wall 40 years ago when I first joined and it said, "When one door closes, most of us stand looking at the closed door instead of noticing all the open doors around about us." So I thought, "Well, there's lots of other things we can do," and this is one of the things we're having a shot at.

What I would like to see is four changes, in fact more than four changes now. But the first is that section 249P be amended in some way along the following lines, "That company annual reports prominently state that the board is shareholder friendly." In other words, somewhere in the report where it's very prominent, not right at the back in some tiny print at the bottom of the page, but somewhere saying, "We value shareholder input," something like that. The second point is for the annual report to be required to say what provisions the board has of being contacted by shareholders. I only found out about section 249P through the Australian Shareholders' Association and as a shareholder in a couple of companies, I had no idea that this provision existed.

The third thing I would like to see is a statement in the annual general report saying, "Get your 249P statements in and the deadline is," because if you look at the Act itself, 249P says something like "it's got to be got in in good time". Also it left me a little bit unclear as to whether all 100 signatures needed to be lodged at one time or if we could lodge them in instalments and we lodged ours in instalments and that definitely didn't work. Also a summary of what conditions have to be met by section 249P petitioners.

Furthermore, I would want to see some other stuff in that instead of this advisory resolution I would want to see a mandatory resolution two years hence so that the shareholders have a lot more say over what's going to happen, but it doesn't deny executives their rightful money for the year that they've just had, because I think that's immoral to say you can't have any money for the work you've done for the last year. But we have very little choice in expressing an objection at the moment. Then the other thing is that some people said to me, who were shareholders and employees of the particular company, said, "What would it mean for me if I sign this document? What does it mean for my job security?" and I said, "Well, I can't tell you because I'm not privy to what management's policies are."

I feel it needs to be very clear that employees who happen to be shareholders ought to be not second-class shareholders, they ought to be given the same rights and protected as every other shareholder in a particular company. There is some very perverse thing about the current thinking in business for paying executives and that is that you have to look at the share performance. If the shares go up, the executives, "Oh, yes, this is great, we need to pay more." If the shares go down, "Oh, well, do they really deserve it?" But I would say often times shares go down because of adverse market conditions and the executives are having to actually work harder and, if anything, should be paid more, not less. So it's a bit of a perverse system that just because you work really hard - I mean, if a doctor has a really difficult operation to perform - I don't know whether you pay him any more for that particular operation, but you certainly don't pay him less. Finally, may I read three brief quotes?

**MR BANKS:** You may.

**MR FRASER:** These are in relation to the alignment of staff with executive and board aspirations which in turn leads to their alignment with shareholder aspirations. The first quote is from Dr Tanveer Ahmed, a Sydney psychiatrist and writer and he said in the Sydney Morning Herald on 5 October 2004 that:

> Large discrepancies between directors and ordinary staff remuneration increases leave staff demoralised and angry which is unlikely to translate into productivity gains. In fact the opposite may be true."

Then the second quote from Dr Matt Bloom, associate professor of management, Notre Dame University in the USA, he was interviewed on ABC Radio National Background Briefing, 6 February 2000, and he said that:

> If an organisation is rewarding individual performance too much, then people are simply not going to participate as a team."

He had research to back that up. The third one is from an address quoted in the Sydney Morning Herald, 15 February 1999, by Sir Gerard Brennan, he's the former

chief justice of the High Court, of course, and he states that:

> Egalitarianism is the pre-eminent Australian value and that great disparity in wealth erodes and ultimately undermines our society.

**MR BANKS:** Okay, thank you ver much. You reflected on your own experience, taking a personal stand, I guess, in this area.

**MR FRASER:** Yes.

**MR BANKS:** Would you talk a little bit about what motivated that and in particular whether, within the company that you're most familiar with, whether the disparities in remuneration from the top to the bottom had had a demotivating effect on others. I suppose the last thing is whether anyone else in the company shared your view. It was obviously difficult to get people above you to share the view, but whether you encouraged any peers to follow your example.

**MR FRASER:** Of taking a pay pause, for example?

**MR BANKS:** Yes, which turned out to be illegal, I guess, so it would have been hard for them to do that.

**MR FRASER:** No, nobody in my union was keen to do that.

**MR BANKS:** Just the question then about what motivated you to do that and indeed, whether the relativities - you saw that as being a corrosive thing within your particular company or not.

**MR FRASER:** What motivated me was concern for the gap between the rich and the poor worldwide. That was back in the middle of 1998 and I still have that concern, even more so now. So in a sense that's nothing to do with Australia or perhaps nothing to do with what your talking about. But the other half of what I wrote to the company was that I felt that if people who are in a position to do so could take a pause, it would put the company into a stronger position when the inevitable downturn came, because in all business there's a cycle and while things are going well, that's fine. But we also, I think, need to be guarding against jobs having to be shared and business curtailed because of too much expense with the workforce, so that was my motivation.

**MR FITZGERALD:** Can I ask a question. You were generous to say we would know about 249P - - -

**MR FRASER:** Yes.

**MR FITZGERALD:** - - - in fact I don't. Can you just explain this to me, we seem to have two concepts of play: one was the non-binding and you're indicating that should become a binding vote but two years hence.

**MR FRASER:** Yes, suggesting two years hence.

**MR FITZGERALD:** 249P, is this simply a statement that you can in fact put into the record of the AGM? I don't want any technicality, I just want in very broad terms.

**MR FRASER:** I've got a copy of it here and it's very short.

**MR FITZGERALD:** I was not sure as to whether or not you needed a resolution to pass the statement or whether you only need 100 shareholders to put the statement or - - -

**MR FRASER:** Yes, 100 shareholders to put the statement.

**MR FITZGERALD:** Then you need a resolution to pass it?

**MR FRASER:** No, what it says here - this is downloaded and the year is chopped off.

**MR FITZGERALD:** Don't worry.

**MR FRASER:** What it says is, Corporations Act, section 249P, "Members statements to be distributed. (1) Members may request a company to give to all its members a statement provided by the members making the request about: (a) a resolution that is proposed to be moved at a general meeting; or (b) any other matter that may be properly considered at a general meeting.

**MR FITZGERALD:** So it's the ability just to put the statement.

**MR FRASER:** That's right.

**MR FITZGERALD:** If you've got 100 members, you can put it.

**MR FRASER:** Yes, if you have 100 actual shareholders then you can put it, yes.

**MR FITZGERALD:** Thank you for that.

**MR BANKS:** Thank you very much for your contribution and for participating in the hearings.

**MR FRASER:** Can I make one further statement?

**MR BANKS:** Yes, certainly you may.

**MR FRASER:** I forgot to mention this. One of the people who I met in this particular company was a leading hand and he said, "We need to educate the shareholders." He said, "If we're going to have" - the particular company he was interested in - "succeed, we need to have shareholders feel that they're not just there to get the maximum possible return, but they're there to see a sustainable, well-managed business that will give them reasonable returns," and I think that's a very important point. I just want to make that point.

**MR BANKS:** That is well put.

**MR FITZGERALD:** Thank you very much.

**MR FRASER:** Thank you very much.

**MR BANKS:** So we thank participants who have appeared here in Sydney today. Our next hearings will be in Melbourne on Friday morning and we adjourn these hearings until then. Thank you.

AT 4.21 PM THE INQUIRY WAS ADJOURNED UNTIL
FRIDAY, 13 NOVEMBER 2009