

Dear Commissioners,

A little background information.

More than a decade ago, the Australian Shareholders' Association (ASA) adopted a policy to aim to restrict Director and Executive total remuneration packages to a fixed amount (about \$1 million p.a. from memory), with CPI adjustments. So the problem now being addressed by governments around the world is not a new one.

The ASA got nowhere with that or any of the accompanying set of sensible ASA policy proposals primarily because the federal government was deaf to its expressions of concern, and it proved impracticable for the ASA to enlist the support of the institutional (funds manager) shareholders – for reasons which have been lucidly pointed out to this enquiry by others (e.g. Mr John Green).

A more workable approach would be to limit the salary of any Executive or Director of a Publicly Listed company to, say, 50 times the average of the 100 lowest paid employees of the company. (50 x \$50,000 = \$2.5 million p.a. – enough to motivate any normal executive to do his or her best. If an executive wants to earn more, let them do so in an environment where their own savings are seriously at risk.)

Gerry Harvey (of Harvey Norman) is on record as saying that you could pay Australian executives one tenth of their current salaries and get better people. Surely he would know? Certainly, my own experience in business for 25 years, employing professionally qualified people, confirms his view. Seldom did the applicant demanding the highest salary turn out to be worth the money, or to be as good as others who were asking for less.

There is some basic logic here.

First, it needs to be remembered that human beings are hard wired to help themselves whenever the opportunity presents (with exceptions, of course). Second, it is inconceivable that a person being paid \$25 million p.a. could work any harder or smarter than one being paid \$2.5 million (the latter being a position one would not lightly give up if there were no better salaries available).

For comparison purposes, this inquiry could do worse than access or commission some research – e.g. from the Tax Office – into the salary levels of employee executives of privately owned companies. Are any of them paid more than \$2.5 million p.a.? How many?

Again in my experience as a business proprietor and management consultant, most managers of small and medium sized enterprises could manage rings around the senior executives of the typical (bureaucratic) listed public company – especially in terms of breadth of skills.

The key question (and difference) here is this: ***For whose benefit is the company being managed – the risk taking Shareholders, or the (often non-shareholder) Employee Executives?***

Most listed public companies are being managed first and foremost for the employee executives.

The Keep It Simple approach will work best.

Many years ago the federal government limited the percentage any one person or entity could own of a (major?) bank in Australia. One unintended consequence of that policy is that no single person or entity has enough influence to control the greed of the Employee Executives. They just help themselves with immunity. There is no supervising Owner.

So it is with virtually all listed public companies.

The days of light touch regulation are surely gone? Let us be prescriptive in limiting executive and director greed. It is the only approach that will work – **and let's Keep It Simple!** I sincerely hope this commission will have the courage to abandon political correctness, and to make some hard hitting, prescriptive recommendations.

Does the government have the power to control executive salaries?

Unfortunately, a referendum to give the federal government legislative power over incomes was soundly rejected in 1973. (*How, then, is it now possible for the federal government to set a minimum wage, or Award conditions affecting pay?*)

In the current state of politics in Australia, a referendum to give the federal government legislative power over executive and director remuneration would almost certainly succeed – even though it might be opposed by the conservative parties (at their cost). *If such a referendum is needed, it should be recommended as an urgent requirement.* Then let us have the “simple multiple” limitation indicated above. Even if only the CEO’s remuneration were so limited, no one else in the company would be paid more.

But would this not make Australia uncompetitive? This old line has no validity at all. \$2.5 million p.a. will buy the services *and dedicated commitment* of Australian executives well able to manage even our largest listed companies. The current multi-million dollar lot has not set the bar very high.

Let’s Make the Institutional Shareholders Vote Their Shares

John Green has submitted: “Fund managers are by far the strongest, most vociferous and most aggressive group of shareholders. Yet far too many are shareholders in name only.

‘The job they are handsomely paid to do is to represent the investors whose funds they manage, but the group far too many of them best represent is themselves. This is primarily because of serious flaws in how they insist on being paid. Generally, their incentives are misaligned both with the interests of the investors they are paid to serve as well as with a country’s best interests in having a vibrant corporate sector focused on long-term sustainable value-creation.

‘Far too many fund managers do not behave as investors at all; they are stock churners, traders and short-term speculators. They move on and off share registers as often as pop stars go in and out of rehab. They do not make long-term investment decisions, they make short-term punts.”

There are two issues here.

First, it was a big mistake to hand the almost exclusive right to manage the compulsory super contributions of Australians to free enterprise Funds Managers. Read the chapter in Professor Hugh Stretton’s excellent book: *Australia Fair* to see the sad and exorbitant cost of this decision to superannuation contributors. Absolutely disgraceful.

The institutional funds managers (which outnumber the companies available for them to invest in) take on average 2 percent of the TOTAL SUPER ASSETS of their fund members EVERY YEAR, **compounded**, in return for what has always been – and is now clearly seen to be – a very mediocre level of professionalism in long term investing. And regardless of results achieved!

Second, because “Far too many fund managers do not behave as investors at all”, the institutions often do not vote, or do not vote as a well informed individual shareholder would do.

To at least partially overcome this problem they should be required by law to:

- a. Always vote all of their shareholdings; and
- b. Always promptly advise their investors (even if only by email and on their web sites) **how they voted** on every resolution. At least then the media could name and shame those funds managers who did not properly represent the interests of their investors.

A National Infrastructure Fund for Super Funds to Invest In

A better solution, and an alternative that should form part of the recommendations of this inquiry, would be for the federal government to offer a fee free alternative investment fund for super fund

trustees to invest in. That fund could then be managed by a killed independent Board, and ideally the government should guarantee a **fixed** long term rate of return of, say, 7 percent p.a., to insulate super funds from the cycles (and worse – such as now) of the markets. The guaranteed rate should require a reasonable minimum period of investment.

Skilled investment managers could achieve 7 percent p.a. compound on such a fund over the long term – *A National Infrastructure Fund?* - plus cover their management expenses. (Most institutional funds managers claim to do at least that well, and their typical MER is a high 2 percent.)

One distinct benefit of having such a government guaranteed fund would be that Australia's big infrastructure projects could be funded out of savings rather than borrowings.

Another would be avoidance of the “Weight of Money” effect on the prices of Australia’s limited availability of listed companies and A-REITs for the institutions to invest in. With too much money now chasing too few investment opportunities in a “relative performance comparison” environment for funds managers (which mitigates against investment in start-up long term infrastructure funds), this weight of money effect causes unjustified increases in stock prices (until a bubble market develops, and eventually deflates, as has recently occurred).

Finally, Don't Miss The Funds Managers' Remuneration Packages

John Green makes the case for including the funds managers' executives in the remuneration control net. It is critical that they be included, as they are a big part of the problem. He writes:

“Let's examine some of the misalignments.

‘First, many funds managers get rated and pay themselves based on quarterly performance. If a fund manager is paid a percentage of what the funds they manage are worth on the last day of each quarter, it would only be human if they tried to maximise that quarterly value. Almost their entire focus will be on quarters and halves. They will churn stocks. If a company makes a good long-term acquisition but it is earnings-per-share decreative for a couple of years, they will dump the stock. They may even sell it short. To them, the share is a commodity, not an investment. Too bad it may represent the daily lives of thousands of employees, suppliers and customers, all essential components of a vibrant economy.

‘Secondly, funds management is a relative game. Fund managers are rated and compared against each other. Even if they lose money, as long as they lose less than other fund managers, they can beat their chests. This is what we get from a system which pays based on the value of assets under management, not based on absolute returns or on beating, for example, the risk-free cash rate.

‘Some of these fund managers are the same wealth destroyers who seem happy to lend other people's assets to short-sellers. They don't mind because they earn a few basis points from the stock loan which helps their relative performance, even though it helps trash the underlying stock price. The incentive for index funds to do this is especially high.

‘Thirdly, the standard percentage fee should be subject to claw-backs and deferrals in the same way corporate boards are sensibly considering deferrals and claw-backs for senior executives' short-term bonuses, to ensure that short-term performance is sustainable, not illusory.

‘If a fund manager performs well one year and takes large fees, investors won't mind. But if the fund manager delivers a shocker the following year, why shouldn't the investor get to claw back the fees? If we want to encourage fund managers to think and act longer-term, investors should set their fee structures with deferrals and claw-backs that operate over a multiple-year period.

‘Fourthly, many fund managers report their funds' returns on a pre-tax basis and charge their fees based on those pre-tax returns. These are, by definition, inflated returns since in normal years most investors pay tax.

‘One problem with that practice is that these fund managers are overpaying themselves by stealth.

‘An even more poisonous aspect of this practice is it encourages these fund managers to churn investments. That costs their investors dearly in costs and, in some cases, can mean companies are taken over for bid prices that are lower than they should be, especially if the bid comes near the end of a quarter. If a fund manager’s fees were based on post-tax returns, they would worry as deeply about the taxes associated with the transaction as (they would) if they were dealing with their own money, which is what their investors would like them to do.

‘Corporate boards are being encouraged to redesign the structure of senior executive pay so it has a closer shareholder alignment. But which group of shareholders should they try to align to?

‘If communities, governments, regulators and even boards think the current spotlight on restructuring executive pay will make a material difference to how senior executives and CEOs behave, they may be disappointed unless we shine that same light on the elephant in the room, the funds management industry.

‘That light needs to shine brightly and strongly, and for long enough that we achieve the same changes in behaviour in the funds management industry that we are seeking from corporate CEOs and senior management teams around the world.’

I endorse these comments.

Concluding Remark

I would welcome the opportunity to be heard in person by the Commission’s Inquiry panel.

Kind Personal Regards,

Ray Bricknell