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STANDING UP FOR SHAREHOLDERS

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Australian Shareholders' Association Submission:

Productivity Commission Discussion Draft

The ASA welcomes this opportunity to comment on the Discussion Draft and Recommendations for the Productivity Commission (the Commission) on Executive Remuneration in Australia.

The ASA commends the considered and pragmatic approach adopted by the Commission. In general, the draft recommendations provide a moderate and intelligent response to what is a substantial shareholder concern. The ASA believes that in the current environment, the Commission has effectively identified the disparate views and provided novel solutions to shareholder concerns. Perhaps this is evidenced by the fact that some within the community are disappointed that the Commission did not recommend more radical legislative change, and at the same time industry groups are urging greater moderation. In the ASA's view, if the final recommendations represented a substantial move in either direction, this would be a retrograde step.

About the ASA

The Australian Shareholders' Association (ASA) is a not-for-profit organisation formed to represent, protect and promote the interests of investors in shares, managed investments, superannuation and other financial investments.

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ASA's Comments on the Draft Recommendations

Draft Recommendation 1

The ASA supports DR 1.

Draft Recommendations 2 and 3

Draft Recommendations (DR) 2 and 3 specify the composition of remuneration committees. DR 2 would be a Listing Rule and apply to only the ASX300, whilst DR 3 would apply to all companies and be an ASX Corporate Governance Principle. The ASA would prefer not to have different standards for companies of different market capitalisation. This makes disclosure more complex for investors and encourages a view that a lesser standard of corporate governance applies to smaller cap companies. However given that there are likely to be companies outside the ASX300, the Boards of which would not be large enough to comply with the proposed Listing Rule, this seems an appropriate compromise.

The ASA acknowledges that the requirement for ASX300 companies to follow such a Listing Rule is somewhat arbitrary. The ASA would be comfortable with a cut-off point anywhere between the ASX100, above which there is an overwhelmingly high expectation that companies must comply, and ASX500, below which companies would have difficulty attracting and retaining the required independent non-executive directors necessary to meet the rule. Setting the limit at ASX300 would be consistent with regulations relating to Audit Committees.

The ASA considers that DR 3 should be better aligned with the proposed Listing Rule under DR 2. The recommendation should specify that remuneration committees:

- have at least three members, *all of whom are non-executive directors*
- be comprised of a majority of independent directors
- be chaired by an independent director.

This would promote consistency amongst all ASX-listed companies. In our view, the proposed Listing Rule, whereby company CEOs and other executive directors would be restricted from sitting on Remuneration Committees represents best practice corporate governance. The ASA strongly believes that this is why the Council was formed and what it should be encouraging. The Principles and Recommendations, operating on an 'if not, why not' basis, provide the ideal mechanism for encouraging a high standard amongst all listed companies, whilst acknowledging that some smaller companies will not be able to reach the highest standards of governance.

There should be a further component to this recommendation that the Remuneration Committee should meet at least annually (or, alternatively, at least three times a year). There is at least one recent example of a company remuneration committee that did not meet in 2008/ 2009, despite the 2007 remuneration report failing to be approved by shareholders at the annual general meeting. The ASA believes that the Council should provide this guidance to reinforce the importance of remuneration considerations in the overall governance framework. The Council should provide this guidance as it is a good governance practice.

In the event that the ASX does not agree to implement DR 2 in its entirety, the ASA would be concerned that this is an indication that the Exchange is unable to separate the setting of the Listings Rules from the corporate aims of the business. This is a concern that the ASA has held for some time. The ASA would consider any unjustified reluctance by the ASX to act purposefully to create the proposed Listing Rule in its entirety as an indication that those within the ASX who are charged with maintenance of the Listing Rules are not sufficiently independent of or immune from the for-profit motives of the ASX.

Draft Recommendation 4

The ASA supports DR 4. As the resolution seeking approval of the remuneration report is advisory only, allowing parties who benefit directly of indirectly, to vote distorts the message which might otherwise be sent to the board about remuneration, which is the only reason for the vote.

Draft Recommendation 5

The ASA supports DR 5. Pay for performance should be at risk. To use hedging or other methods of reducing the risk related to the securities being rewarded removes the underlying reason for remunerating executives in this manner. This is an extremely important issue for shareholders. As such, the proposal to regulate this type of hedging through the Corporations Act, rather than the current situation where it forms part of the Council's Principles and Recommendations, is entirely appropriate.

It is noted that Section 300A (1) (da) of the Corporations Act 2001, requires the remuneration report to set out a discussion of board policy in relation to a person limiting risk in relation to securities when part of remuneration is paid by securities. This discussion of board policy is sometimes absent from the remuneration report.

The ASA remains concerned that those who provide services to facilitate the hedging of equity-based executive remuneration may seek to find loopholes in the wording of the legislation. The derivatives industry is both constantly evolving and difficult to understand, making it extremely difficult to regulate. The ASA encourages caution when drafting this amendment to the Corporations Act.

Draft Recommendation 6

The ASA supports DR 6 for the reasons set out in support of DR 4. The ASA does not support extending the recommendation to other undirected proxy holders, who have no association or relation to the recipients of the remuneration. In many cases shareholders may have specifically appointed these proxy holders on an undirected basis because they do not know how to vote on the resolution themselves and are confident that the proxy holder will know how to vote in their best interests. This is often the case with the thousands of shareholders who provide the ASA with their undirected proxies on this resolution each year.

The ASA does not agree that the restriction on voting by key management personnel and directors (and their associates) should be extended to all resolutions. The advisory vote is an special exception as it loses its desired effect – to send a message to the board about remuneration – if those who benefit from the remuneration are able to influence the vote. The restrictions should be extended to other resolutions relating to remuneration, as the recipients should not be involved in the setting or approval of that remuneration.

Draft Recommendation 7

The ASA supports DR 7. In the past there have been instances of directors failing to vote directed proxies in a poll. Shareholders who appoint a proxy holder are entitled to expect that the shares will be voted as directed, unless they withdraw the proxy.

If enacted, DR 7 would have a direct impact on the ASA's activities. The ASA is often a substantial proxy holder at major listed company general meetings, and can represent shares the equivalent of a top 20 shareholder.

Although rare, there have been occasions where the ASA representatives, as proxy holders, have not cast their votes. This has been a result of another pressing matter requiring the attention of the representative prior to a poll being called, or on one occasion, the lateness of the hour requiring the representative to leave the meeting prior to a poll being called.

However, the ASA agrees with this draft recommendation. Requiring a uniform standard for all proxy holders makes sense. If a shareholder entrusts his/her vote to a proxy holder, and that proxyholder attends the meeting, there should be some compulsion on that proxy holder to cast the votes they hold.

Draft Recommendation 8

The ASA supports DR 8 in principle. It is noted however that whilst plain English summaries of remuneration policies would greatly assist shareholders, it is difficult to see how the law in relation to this would be enforced.

The ASA supports the reporting by companies of actual remuneration. The difficulty could be in defining "actual remuneration". The ASA would propose that this could be dealt with by supplementing the reporting of remuneration on a statutory basis with reporting on a cash basis, where the cash and equivalents actually received in the hand by the executive during the year are reported separately.

Draft Recommendation 9

The ASA does not support this recommendation. The compliance burden of providing this detail is not onerous and the disclosure is of interest to shareholders.

The definition of Key Management Personnel is simply too narrow. Often a company may have an individual that may fall into the category of key personnel without being part of management, and be the highest paid individual within the company. The ASA acknowledges that an unintended consequence of the existing regime is that individuals receiving substantial payments due to their life-long employment with a company may have their emoluments disclosed. However, there may well be key individuals who are consistently the highest paid within a company, whose remuneration would never be disclosed to shareholders under DR 9. On balance, the ASA prefers the status quo.

Draft Recommendations 10 and 11

The ASA generally supports DR 10. Ensuring that advisors are appointed free of conflict is an important part of redressing the imbalance between shareholders expectations with regard to remuneration and the demands of executives. However, the proposed recommendation for a Listing Rule relating to the commissioning of expert advisers is somewhat narrow. The ASA would prefer this recommendation extended to all listed companies. For clarity, the Commission should provide guidance to the ASX on an appropriate definition of 'expert advisers'. In addition, there are aspects of DR 11 that ought to form part of the recommended Listing Rule. The Listing Rule should require that if a company's board or remuneration committee uses an expert adviser in relation to senior executive remuneration, the name of the adviser must be disclosed in the remuneration report, as well as who appointed the adviser, who the adviser reported to and both the size and nature of other work undertaken for the company by those advisers. The requirements should be extended so that the company is required to disclose the amount paid to the advisors, both for advice to the board and for any other work carried out for the company by the advisors, not simply the 'nature' of the work, which may give no indication of the level of conflict that might arise.

Unless no other work is undertaken for the company by the adviser, this adviser should not be considered 'independent'.

It is important that the disclosure of expert remuneration advisers is made in a consistent manner. The ASA advocates that it form part of the Remuneration Report and be required annually. This may mean that the requirement form part of section 300A of the Corporations Act rather than a Listing Rule. In the event that the ASX does not introduce a suitably encompassing Listing Rule, ASA advocates an amendment to section 300A.

The primary concern for the ASA is driving accountability to those responsible for widespread inappropriate executive remuneration practices – the board of directors. All too often, listed company boards of all sizes shield themselves by stating that they took advice from 'independent expert remuneration advisers', without shareholders having any way to ascertain who the adviser was, who appointed them, who they reported to and whether they were truly independent.

Moreover, shareholders will be interested to see if a remuneration expert is retained by the board following a substantial 'against' vote based on their advice. Alternatively, if the expert's independence remains compromised after a substantial 'against' vote, this is useful information for shareholders. These disclosures may have a direct impact on shareholder opinion of directors' suitability to continue in their role at a company with continuing remuneration issues.

In addition, other companies will benefit from the increased disclosure. Where a company's remuneration report receives a substantial 'against' vote, and the company acted on advice from a publicly disclosed expert, this will provide other companies that have engaged that expert with an early warning that the remuneration reports risk a similar fate.

The recommendation should specify that the Rule relates to the use of experts for board and/or senior executive remuneration advice, as opposed to remuneration advice of a more general nature.

The ASA acknowledges that under the proposed regime, there is little or no disclosure obligation on companies that do not engage with remuneration advisers. If a board or remuneration committee is not influenced by expert advice, shareholders would not require additional disclosure.

In the ASA's view, requiring independent board appointment and disclosure of information in relation to advisors should be mandatory rather than optional. However, should DRs 10 and 11 stand, the ensuing two or more years may see a dramatic improvement in disclosure practices and remuneration adviser appointment processes. In that case, providing the ASX and ASX Corporate Governance Council an opportunity to address shareholder concerns may be an option worth considering.

In the event that the ASX does not agree to implement DR 10 in its entirety (at the very least), the ASA would be concerned that this is an indication that the Exchange is unable to separate the setting of the Listings Rules from the corporate aims of the business.

In the event that such a situation exists in relation to both DR 2 and 10, the ASA would recommend a review the by the Australian Securities and Investments Commission of the ASX Listing Rules, who maintains the Rules and whether a body completely independent of the ASX would be more independently minded in the maintenance and development of the Rules.

Draft Recommendation 12

The ASA supports this recommendation.

Draft Recommendation 13

The ASA supports this recommendation.

Draft Recommendation 14

The ASA supports this recommendation.

Draft Recommendation 15

The ASA supports this recommendation and makes the following comments:

- The recommendation is likely to be criticised because of the risk that it will be abused to remove a board. This is unlikely, as any shareholder with the requisite number of shares to remove the board in this manner could much more efficiently requisition a meeting to remove the directors
- The recommendation is likely to be criticised because of the risk that a company could be left without a board. This is unlikely to occur, as shareholders are unlikely to risk the stewardship of their investment in this way
- The directors should only be required to submit for election at the next Annual General Meeting, to provide the maximum amount of time to address shareholders concerns
- It is appropriate that on each occasion the threshold for an 'against' vote be 25 percent
- Directors appointed after the first vote and the Managing Directors should not be subject to removal.

The ASA is concerned that this recommendation could be considered extreme and for that reason not adopted. The ASA would urge the Commission to consider providing an alternative recommendation in addition to DR15. In our initial submission to the enquiry we made a similar, but less onerous proposal:

- That the remuneration report be attract the higher standard of a special resolution and be required to achieve a 75 percent vote in favour before it can be said to be passed
- That in the event the Report is not passed, then in the following year the Chair of the Remuneration Committee is automatically required to stand for re-election.