



Investment & Financial Services Association Ltd

SHAREHOLDER ACTIVISM AMONG
FUND MANAGERS: POLICY AND
PRACTICE

INDUSTRY OVERVIEW
CONCLUSIONS &
RECOMMENDATIONS

Introduction

IFSA is pleased to release the report “Shareholder Activism Among Fund Managers: Policy and Practice” which has been prepared by Eureka Strategic Research. The report contains a great deal of information on the nature and levels of shareholder activism by fund managers in relation to their shareholdings in Australian companies.

The report is accompanied by information prepared by IFSA. The structure is as follows:

- Part 1 Overview of Funds Management Industry / IFSA Conclusions & Recommendations;
- Part 2 Shareholder Activism Among Fund Managers: Policy and Practice (Eureka Strategic Research).

IFSA would like to thank all of its members who participated in the various aspects of the study conducted solely by Eureka Strategic Research on a confidential basis. IFSA appreciates the time and effort provided by members to help provide a more comprehensive understanding of the nature of the shareholder activities of IFSA members.

Part 1 – Overview of Funds Management Industry

Investment & Financial Services Association

IFSA is a not for profit national peak body representing the wholesale and retail investment management, superannuation and life insurance industries. IFSA has 90 members who invest approximately \$650 billion dollars on behalf of over 9 million Australians.

IFSA's mission is to play a significant role in the development of the social, economic and regulatory framework in which our members operate, thereby assisting members to serve their customers better.

IFSA works to achieve its mission by encouraging ethical and equitable behaviour by its members through the development of industry standards; contributing to the development of simple and efficient regulatory regimes; creating competitive markets; and contributing to a strong national economy by encouraging savings.

Background to Shareholder Activism Research

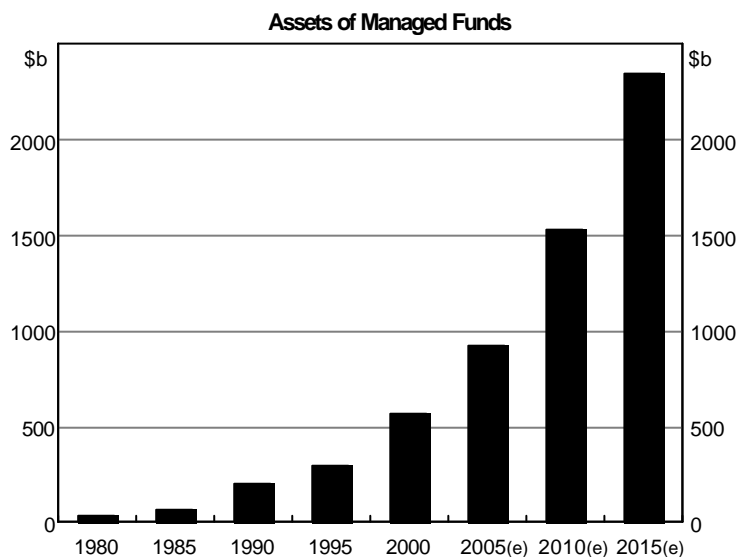
Recently, there has been some debate about the level of institutional shareholder participation in corporate governance, in particular in relation to the voting of proxies. Following calls for tenders, IFSA commissioned research by Eureka Strategic Research to survey its members on their nature and level of shareholder activism.

The objectives of the project were to:

- provide a comprehensive picture of members' corporate governance activities;
- assist IFSA to develop policies to promote good governance practices; and
- identify obstacles to member participation in corporate governance with a view to developing strategies to overcome any impediments.

The Funds Management Industry

Over the past two decades, the funds management industry has developed into a significant component of the Australian financial services sector. Continued sustained growth in the industry is expected over the next 15 years. Continued fund inflows from superannuation as a result of Government policy will remain a key driver. Further, there is a growing awareness by retail investors of some of the advantages investment management products offer over more traditional savings vehicles. The estimated growth in the assets of managed funds is depicted in the chart below.



Source: Reserve Bank of Australia, March 2000

The fund management industry comprises a diverse group of institutions offering a wide range of investment products. Professional investment managers make a full-time commitment to the management of the investment assets, something few individual investors have the time to make. This means the onerous process of selecting what financial assets to buy/sell and the day-to-day timing of transactions can be left to full-time professionals. They have greater access to the substantial resources needed to

research and analyse financial reports, to gauge economic trends and make investment decisions.

Funds managers specialise in investing in funds for individuals or institutions such as superannuation funds. Superannuation funds, including superannuation products at life offices, account for approximately 70% of the assets of all managed funds (source: ABS data). Funds managers compete for mandates from superannuation trustees to professionally manage these funds. The services provided by fund managers include developing and monitoring investment strategies appropriate to the trustees' specific needs.

Approximately \$162 billion of the assets managed by IFSA members are invested in Australian equities (source: Assirt Market Report). This represents 25% of all assets under management. The remaining assets are invested in cash, property, bonds, venture capital, private equity, international equities and fixed income.

Competition has intensified in recent years, which has led to increased pressure for lower management and other fees. Investment managers compete against each other as well as against other organisations, such as banks and direct share market investment, which offer different investment options. Investment managers differentiate themselves primarily on the basis of investment returns, investment styles, the levels of fees and charges, and the flexibility and characteristics of the products offered. Competition has also been driven by the demand for consistently superior investment performance, reflecting the greater focus on investment performance monitoring in recent years.

Share ownership in Australia

The following ABS data provides a breakdown of share ownership by type of shareholder from September 1998 to September 2000:

	Sept. 98	Sep. 99	Sep. 00
Private Investors	21.12%	22.50%	25.99%
Foreign Investors	38.05%	41.49%	37.47%
Banks and financial intermediaries n.e.c	13.80%	9.14%	10.52%
Super funds	15.55%	16.92%	15.72%
Life and other insurance corp.	7.71%	7.73%	7.38%
National, State and local general govt	1.74%	0.00%	0.91%
Private non-financial corp	2.04%	2.23%	2.00%
Total	100.00%	100.00%	100.00%

Assets invested by IFSA members in the Australian equities market would be included in the categories: Banks and Financial Intermediaries, Superannuation funds and Life & Other Insurance Corporations.

As at September 2000, Australian fund managers invested approximately \$162 billion in Australian domestic equities (source: Assirt Market Report). The market capitalisation of the ASX at September 2000 was \$687.4 billion (source: ASX data). Therefore, Australian fund managers hold approximately 23.5% of the market capitalisation of the ASX. IFSA members represent over 90% of funds under management in Australia.

According to ABS data at September 2000, other significant investors in the Australian market include private investors (approximately 26%), foreign investors (approximately 37.5%) and other institutions.

What is Corporate Governance?

Corporate governance emerged as a major issue in the investment industry largely as a reaction to the excesses in the corporate and financial sectors in the 1980s. Following the evidence of misbehaviour of a number of organisations and prominent individuals in the

US and Australia, the investment industry has argued that developing sound corporate governance is a way of ensuring a company's management practices are aligned with the interests of shareholders.

The early 1980s saw the resurgence of the hostile takeover as a means of disciplining unsatisfactory directors and company managers. This was followed by a range of amendments to the Corporations Law during the 1990s aimed at promoting disclosure as the key mechanism for ensuring accountability by companies, and in equipping shareholders, through legislation, with the practical tools they need to fulfil their monitoring and review functions. The Company Law Review Bill 1997 made a number of amendments to proxy voting procedures. These amendments were promoted by IFSA and included increasing the period of notice of meeting to 28 days, and greater disclosure of proxy voting information to the ASX.

Corporate governance is concerned with the relationship between the board of directors, managers and the company shareholders. The role of the board and company management is to manage the affairs of the company on a day-to-day basis. This principle is reflected in the OECD Principles of Corporate Governance (1999) which state that "As a practical matter ... the corporation cannot be managed by shareholder referendum ... Moreover, the corporation's management must be able to take business decisions rapidly."

Traditional corporate governance theories have viewed the right of shareholders to vote on company resolutions as the principal mechanism of making boards accountable to shareholders. However, voting is only one mechanism available to shareholders. Other mechanisms include the market for corporate control (as witnessed in the 1980s), mandatory disclosure rules and independent audit requirements.

The rise in institutional shareholdings in Australia, as well as globally, has produced a new avenue for ensuring that the views of company decision makers are aligned with

shareholders. For example, fund managers who invest on behalf of unit holders and superannuation beneficiaries, employ analysts and other investment professionals to actively monitor corporate performance. Dialogue between institutional shareholders and companies is now firmly established in our corporate culture. As well as providing useful discussion, there are a number of high profile examples of the power of institutions in forcing change within certain corporations.

IFSA considers that undue legislative prescription in corporate governance could promote inappropriate structures or a 'checklist mentality', and that the guiding principle for any regulatory intervention should be to achieve a balance between mandating certain conduct and allowing boards of directors and shareholders to adopt practices appropriate to their circumstances. To this end, IFSA has republished "Corporate Governance – A Guide for Investment Managers and Corporations" in July 1999 which is discussed further below.

Fiduciary Responsibilities

Fund managers have an overriding responsibility to their unitholders and clients to manage their investments in accordance with the stated investment objectives. These objectives may be stated in the investment mandate with superannuation trustees or in the prospectus for retail funds.

The significant increase in funds under management, in particular superannuation funds, has highlighted the importance of ensuring that the shareholder interests in the funds invested in equities on behalf of investors and superannuation beneficiaries are appropriately exercised.

For a number of years, debate has centred on the legal obligations of superannuation trustees and fund managers in relation to exercising their shareholder rights.

In the US, the Department of Labor, which regulates private sector pension schemes under the Employee Retirement Income Security Act (ERISA) has stated that voting rights attached to US pension plans must be exercised on issues that may affect the value of the plan's investments. The Department has gone so far as to delineate the responsibility in various situations. That is, the pension plan managers whose activities are governed by ERISA must exercise the voting rights attached to shares in their portfolios where trustees have delegated voting responsibility to the investment manager.

There are no statutory requirements for trustees or investment managers to vote in the UK. However there has been considerable debate on whether there should be a fiduciary responsibility to vote and various committees including the Cadbury Committee and the Hampel Committee have considered the issue. In 1998 the Blair government indicated that it would consider legislation to mandate voting by institutional investors unless the level of voting increased. The Newbold Committee was established to investigate voting levels and practices by institutional investors. The Committee highlighted the difficulties for many institutional investors and considered that the introduction of electronic voting should increase the level of voting.

In Australia, there is no obligation under the Corporations Law for funds managers or trustees to attend company meetings or vote on resolutions. Stapledon has suggested that a scheme trustee has the duty to *consider* whether or not to vote as a result of general trust law duties and statutory duties contained in the Superannuation (Industry Supervision) Act and the Managed Investments Act. If the decision is made to vote on a resolution, the trustee should consider how the votes should be cast (eg Stapledon, "The Duties of Australian Institutional Investors in Relation to Corporate Governance" 1998). That is, the emphasis is not on requiring the trustee to ensure that a vote is lodged.

Where the trustee engages an external fund manager and voting responsibility is delegated to the manager, then the responsibility to consider whether or not to vote lies with the manager.

Setting Best Practice through IFSA Guidelines

IFSA's long-standing policy on a number of relevant issues is contained in *Corporate Governance: A Guide for Investment Managers and Corporations*, which was issued 1995 and re-endorsed 1999. The publication is commonly referred to as the "IFSA Blue Book." The recommendations include that IFSA members should:

- encourage direct contact with companies, including communication with senior management and board members about performance, corporate governance and other matters affecting shareholders' interests;
- vote on all material issues at all Australian company meetings where they have the voting authority and responsibility to do so;
- have a written policy on the exercising of proxy votes; and
- report on voting activities to clients who have delegated the responsibility for exercising proxy votes to the fund manager.

IFSA's recently released *Standard Investment Management Agreement* reinforces this policy by including several clauses which aim to clarify the rights of the investment manager to exercise the votes attached to shares being held on behalf of a client.

The Blue Book also contains guidelines for corporations for the governance mechanisms companies should adopt. These include ensuring a majority of independent directors on the board, the establishment of audit, remuneration and nomination committees and the disclosure of information to investors.

Conclusions and Recommendations

The Eureka report demonstrates that IFSA members are active Australian shareholders on behalf of their investors.

This is reflected in the Eureka report which states that:

“Overall, the report paints a picture of an investment community that is, for the most part, actively involved in representing the interests of managed funds investors to the companies in which they have shareholdings. Of all shares held by the sample on behalf of investors, 96% are subject either to high levels of voting or frequent direct contact [with companies] and, often, to both these forms of shareholder activism.”
(page 3)

The Eureka report contains a wealth of information regarding the shareholder activities of IFSA members. The key conclusions and IFSA’ recommendations which follow from those conclusions are outlined below.

High levels of proxy voting by IFSA members

The Report finds that managers responsible for 96% of AEFUM (69% Routine voters and 27% Discretionary Voters) are considering whether to vote their shareholdings. This means that the vast majority of AEFUM are complying with the guidelines as set out in the IFSA Guide to Corporate Governance (the ‘Blue Book’) – see Appendix 1.

Other institutional shareholder activities

Proxy voting is only one method of shareholder activism. The Eureka report reveals a very high level of direct contact between fund managers and companies: on average, 84% of companies within a manager's portfolio are contacted nearly 3 times per year. Only a very small proportion of AEFUM is held by managers who report low levels of direct contact with companies.

The Eureka report finds that institutions rarely receive price sensitive information through direct contact with companies. It notes that the majority of fund managers have strict policies regarding immediate trading blocks in the event that price sensitive information is received. This is in compliance with the IFSA Blue Book guidelines on direct contact – see Appendix 1.

Although the figures for proxy voting are high, it is interesting to note that “there was almost unanimous agreement that direct contact is a more effective and preferred means of institutional shareholder activism compared to voting.” (Eureka pg 2). This is consistent with the CGI/University of Melbourne paper, Proxy Voting in Australia's Largest Companies,” which acknowledges that proxy voting is not the only method which may impact on corporate performance. The paper notes that “it is entirely plausible that invisible activism is more effective than visible activism: UK institutions have emphasised that their most effective interventions have occurred away from the public spotlight (Stapledon, “Institutional Shareholders and Corporate Governance,” 1996)”.

Reasons given for this view include that direct contact is more proactive, pre-emptive and informal. It is clearly more cost-effective and less damaging to shareholder value to deal with significant issues before they reach the stage of a controversial resolution at an AGM. Nevertheless, it appears that some managers consider that the voting rights

attached to their shares are useful in their dialogues with company boards and management, ie a “reserve power”.

IFSA guidelines state: “A direct dialogue gives investors a better appreciation of a company's objectives, its potential problems and the quality of its management, while also making the company aware of the expectations and concerns of shareholders. Two-way communications between companies and institutions is an important aspect of Corporate Governance because corporate managers need full information about the assessments of the institutions who hold their shares. The institutions need to be given sufficient confidence to continue to be supporting investors”.

The Eureka survey results also show that fund managers consider that the vast majority of resolutions put to shareholders are not controversial. This may be a result of the high level of direct contact between institutions and companies which ensures that controversial issues are considered and dealt with in such a way that the final result put to shareholders is no longer controversial.

Compulsory voting is not necessary

The high level of voting on company resolutions by IFSA members demonstrates that legislation that requires fund managers to vote their shareholdings is unnecessary.

IFSA has previously advocated its opposition to mandated voting on a number of bases. These have included the need to gain a clearer picture of the level of voting by fund managers as well as considering all aspects of fund managers’ participation in shareholder activism. IFSA has also noted the likelihood that compulsory voting would lead to a “tick-a-box” approach for managers who are not currently voting.

Prior to the Eureka report, the public debate has centred around the Centre for Corporate Law and Securities Regulation (The University of Melbourne) and the Corporate

Governance International joint study on “Proxy Voting in Australia’s Largest Companies.” (CCLSR/CGI report). This study reviewed the total proxy instructions lodged for director-election resolutions for 59 Australian listed companies. The study concluded proxy instructions represented an average of 41% of total voting capital in 1999. The Australian average was compared to proxy votes lodged in the UK (50%) and the US (80%).

Many commentators concluded that the CCLSR/CGI report demonstrated that Australian fund managers were not exercising the voting rights attached to the shares they manage on behalf of Australian investors and superannuation beneficiaries. These commentators considered that fund managers were therefore not discharging their corporate governance responsibilities.

There is a major difficulty in drawing these conclusions based on the CCLSR/CGI report. The CCLSR/CGI report provides an average percentage of proxy instructions lodged without taking into account the breakdown of share ownership in the Australian capital market. That is, Australian fund managers only account for 23.5% of the market capitalisation of the ASX. The report provides an average for the total market and does not provide a measure of the proxy votes lodged on behalf of Australian fund managers.

One of IFSA’s objectives in commissioning the research was to contribute to the debate on proxy voting on an informed basis. The Eureka research has revealed three important findings relevant to the debate:

- Routine and discretionary voters represent 96% of the AEFUM surveyed;
- Fund managers consider voting to be the least effective method to influence company management (although it is an important back up tool for the more effective methods); and
- Routine non-voters represent only 4% of the AEFUM surveyed.

These figures show that proxy voting by Australian fund managers is very high. It is difficult to draw international comparisons given that the figures quoted are based on studies conducted in a similar manner to the CCLSR/CGI study. That is, the studies do not provide a breakdown of voting by shareholder categories.

Drawing on these findings IFSA considers that legislation requiring fund managers to exercise their voting rights is unnecessary. Requiring managers to vote their shares will also not achieve any significant regulatory benefit.

The Eureka survey reinforces this conclusion given that “all participants interviewed were against the notion of mandatory voting, even those whose institution’s policy had a strong emphasis on voting on all resolutions.”

IFSA considers that compulsory voting may result in added costs for fund managers with little or no extra benefit to investors or company performance.

Recommendation: IFSA recommends that legislation introducing compulsory voting on fund managers is not necessary and will not result in a significant increase in the number of proxy votes lodged for Australian companies by Australian institutional investors.

Improving the voting process

The Eureka survey finds that the cost of monitoring corporate governance is a fixed figure, regardless of the size of Funds under Management. Notwithstanding the high level participation in shareholder activism by fund managers, either by voting or direct contact, a number of efficiencies could be introduced to assist managers in the voting process.

Many of these have been canvassed in earlier studies and were addressed by the Eureka report. These include:

- *Seasonality:* Many participants claimed the voting season places strain on resources – however Eureka concludes that most fund managers voted on the resolutions considered “important”
- *Client Instructions:* The Eureka survey notes that approximately 1% of all resolutions are not voted due to the instructions of a client, although this figure varies between institutions and is as high as 10% for some managers.
- *Negative press:* All institutions interviewed by Eureka claimed that possible negative press is not a deterrent as the decision is based on “what’s best for the company” rather than the impact on the share price over the short term.
- *Confidential Voting:* Some commentators have suggested that possible conflicts of interest may deter managers from voting against companies in circumstances where they may be competing for business from that company. No systemic evidence of this occurring has been recorded, which is not surprising given the number of corporate superannuation funds is declining and being replaced by growth in master funds as a result of the trends towards superannuation choice. The Eureka survey reveals that most participants did not believe that anonymous voting would facilitate the voting process.
- *Technology and the Internet:* Eureka reports that the need to develop efficient Internet-based or electronic voting was “prominent issue” which arose throughout the interviews.
- *Small Manager Bias:* the report notes that smaller institutions seem to be at a disadvantage in regard to the fixed costs associating with voting.

Reducing costs - Administrative Issues

Proxy Voting Process

The complexities involved in lodging proxy votes for fund managers have been well documented before by IFSA, particularly for superannuation funds invested in Australian domestic equities. Custodians commonly hold legal title to the equities and as such, they are the registered owner of the shares. The custodian therefore receives all company notices of meeting and proxy forms which must, in turn, be lodged with the company via the custodian. Custodians send the notices of meeting to the fund manager and lodge proxy forms with the company as instructed by the manager.

The complexities relating to voting could be reduced if companies were able to deal directly with the fund manager in relation to voting. This would reduce some of the time pressure associated with the voting season as well as the administrative complexities between custodians and fund managers. The practical issues surrounding this proposal would need to be examined with companies and share registries.

Recommendation: IFSA and relevant stakeholders should consider whether the Corporations Law could be amended to permit companies to send notices and receive proxy instructions directly from fund managers without the need to pass through custodians.

Electronic Voting

Electronic voting would also reduce costs and increase administrative efficiencies in the voting process for fund managers. The OECD Principles of Corporate Governance (1999) state that shareholders should have the opportunity to participate effectively and vote in shareholder general meetings through the use of modern technology. CASAC's report, "Shareholder Participation in the Modern Listed Public Company, June 2000" recommended that the Corporations Law should be amended to permit the directors of a

listed public company to provide for direct absentee voting, subject to any restriction in the company's constitution.

Some companies have recently successfully introduced electronic voting. However, the electronic voting has been limited to the persons who hold the legal title to the shares. To further streamline the process it would be useful to explore whether the concept could be extended to permit fund managers to lodge electronic votes without the need to involve custodians.

Recommendation: IFSA should explore with relevant stakeholders the possibility of developing electronic voting processes which would permit fund managers to directly lodge electronic proxies with companies.

IFSA Standard Investment Management Agreement Review

The role of funds managers in corporate governance monitoring can be clarified in the mandate negotiated between trustees and fund managers. Most mandates are based on IFSA's Standard Investment Management Agreement (SIMA) which currently provides the fund manager with the authority to the vote in the absence of any other directions (Clause 12.1). The SIMA also requires a fund manager to provide a copy of its proxy voting policy to the client upon request (12.3).

There are a number of possible ways in which the SIMA could be amended to increase the transparency of fund managers corporate governance related activities.

Currently, the SIMA only focuses on proxy voting. It does not acknowledge the alternative mechanisms available to managers to attempt to influence the corporate governance of Australian companies, ie direct contact with the board or management. The Eureka survey indicates that managers consider this to be a far more effective means of influencing corporate governance.

Interestingly, the Eureka report notes that, “almost all were in agreement that responsibility for voting decisions should still lie with the fund manager, as opposed to a related body.... This suggests that institutions do see voting as an important part of the overall service that they provide ...”

The SIMA clauses could be reviewed to consider ways to promote more thorough considerations and clarification of the managers’ responsibilities regarding shareholder activism for individual mandates. For example, where a mandate relates to indexed funds, it may be explicitly agreed between the trustee and the manager that shareholder activism is not a part of the investment mandate.

Recommendation: IFSA should implement a review of the SIMA to consider more fully recognising the role of fund managers in relation to shareholder activities and corporate governance.

Development of standard instructions to processing of votes

Some of IFSA’s members have reported that there are a large number of different instructions that clients may give to fund managers in relation to voting. For example, one member reports that it has up to 14 different scenarios regarding requirements to consult, not to consult, consult on some issues and so on. This obviously makes the administrative task of voting more complicated, and it is compounded given that a manager is likely to have different instructions from different clients in relation to the same company.

IFSA would like to explore with trustees, their advisers, and other clients the possibility of achieving some form of standardised instructions that reduces the administrative complexities in voting. For example, the Standard Investment Management Agreement could contain a number of standardised clauses that will have the effect of rationalising the types of instructions a manager is likely to receive from clients.

Recommendation: IFSA will consult with trustees and their advisers to explore the feasibility of promoting standardised client instructions to reduce the administrative complexity in voting.

Attendance at Annual General Meetings

Some commentators have suggested that institutional investors should attend and take a prominent role at annual general meetings. To assess the worthiness of this suggestion, one must consider the role the Annual General Meeting plays in a modern economy.

“Shareholder meetings, particularly the annual general meeting, also serve to give shareholders direct and public access to the board. They provide an opportunity to receive information about the board’s past performance and future plans and otherwise to hold the board accountable through questioning.” (CASAC Report on Shareholder participation, June 2000).

The purpose of attending the AGM for institutional investors and for individual shareholders must be acknowledged as being different.

The institutional investor is primarily concerned with two things:

- ◆ assessing the Company’s financial results (which are announced and analysed well before the AGM), and
- ◆ holding the board accountable and communicating with the company’s management and Board on matters materially affecting shareholder value. This is done prior to the meeting through the exercise of proxy votes and, on an ongoing basis during the year, through direct contact with management.

CASAC also noted that “The nature of meetings has changed considerably from that originally envisaged, given the continuing growth in the number of shareholders, their geographical dispersion and technological developments in communications....Even so, as a practical matter, the number of shareholders for whom it is convenient to attend a general meeting is usually relatively very small”.

Given the small number of shareholders in attendance, (and in many cases the impossibility for shareholders to attend the AGM), the ultimate democratic mechanism for shareholders in a modern economy must be the lodgement of proxy votes, the ability to place resolutions on the agenda, and the ability to call meetings. One must conclude that, on this basis, it would be only in the most extreme circumstances that a substantive outcome would be achieved by institutional investors simply attending the meeting itself. Rather, as the Eureka study shows, it is through the lodgement of proxies and direct contact, that institutional investors can be most effective in ensuring proper governance of the companies in which they invest.

It should also be noted that in many cases, the fund manager does not actually have the right to be present at the meeting, as the shares are usually held in the name of the custodian. Only members (shareholders) or their validly appointed proxy are entitled to attend and vote at company meetings. For a fund manager to attend and vote at a meeting, it would be necessary for the custodian to appoint the manager as a proxy.

It is acknowledged that some small shareholders hold the opinion that institutions should attend AGMs, but we must conclude that this desire is more perception driven, as opposed to being based on a thorough analysis of the cost/benefits, and the more efficient means for investors to exercise their rights. In effect the institutions are already present through the lodgement of their proxies.

Simplifying Company Resolutions

A number of IFSA members have expressed concern regarding the complexity of company resolutions. Generally, resolutions are highly technical and drafted by legal advisors. One manager has noted that the person in the organisation responsible for reviewing all company resolutions often has to ring the company to discuss the reasoning behind the resolution.

If professional fund managers consider the resolutions difficult to understand, the problem must be compounded for retail investors.

Simplifying company resolutions would benefit all shareholders. Resolutions should be drafted in plain English in a manner that permits all shareholders to clearly understand the issues they are asked to consider. Meaningful information must be presented to enable shareholders to make informed decisions.

IFSA would like to discuss this issue with relevant stakeholders including the Australian Institute of Company Directors, the Australian Shareholders Association and the Chartered Secretaries of Australia. There are a number of guidelines in IFSA's Blue Book relating to company meetings. For example, the Blue Book recommends that separate issues should not be combined and presented as a single motion. The Blue Book may be the appropriate place for further guidance including the use of plain English resolutions.

Recommendation: IFSA should liaise with relevant stakeholders to explore ways in which company resolutions can be simplified so that shareholders are able to make more informed decisions.

Where to next?

Strong and effective corporate governance must be a dynamic code of standards, which are measured by corporate performance and the quality of the relationships between company directors and management and their shareholders. Arthur Levitt, retiring chairman of the United States Securities Exchange Commission recently said, “the discussion of corporate governance is more a cultural one, than a programmatic one.....A corporate governance ethic must emerge.....In an increasingly dynamic marketplace, judgement and integrity are indispensable.....But we must avoid risk aversity. Whilst risk taking can lead to mistakes, good corporate governance can reduce the likelihood and impact. But when making risky decisions, judgement is critical, not just process adherence.”

Over the past two decades, the practice of corporate governance has gone through several phases: from focussing on takeovers & control, to shareholder legislative protections, to disclosure and accountability.

In an increasingly global environment, where Australian companies must attract global capital, the focus and challenge is to ensure we continue to build a culture of integrity and transparency, focussing on corporate performance and building shareholder value.

Institutional investors in Australia do and will continue to play a key role in these developments.

Appendix 1

Corporate Governance – A Guide for Investment Managers and Corporations

“IFSA Blue Book” July 1999

Relevant Excerpts

1.1 *Guideline 1 – Communication*

Investment Managers should encourage direct contact with companies including constructive communication with both senior management and board members about performance, Corporate Governance and other matters affecting shareholders' interests.

Shareholders receive reports and accounts and other explanatory circulars from companies which are required by statute or, for example, by the stock exchange. They also have the right to attend company meetings where they can raise questions about the affairs of the company. In addition, some companies have a practice of making presentations to institutional or other shareholders. While these communications are necessary, they may not be sufficient to allow companies and shareholders to gain a full understanding of each other's aims and requirements.

A direct dialogue gives Investors a better appreciation of a company's objectives, its potential problems and the quality of its management, while also making the company aware of the expectations and concerns of shareholders. Two-way communications between companies and institutions is an important aspect of Corporate Governance because corporate managers need full information about the assessments of the institutions who hold their shares. The institutions need to be given sufficient confidence to continue to be supporting Investors. Some Guidelines for improving this communications process follow: -

1.1.1 **Value of institutional feedback**

Institutions represent an informed professional Investor constituency and are more able to provide direct feedback to companies. Mechanisms to take advantage of institutions' viewpoints can benefit other Investors, as institutions often serve as a channel for the interests and concerns of more dispersed Investors.

Communication channels should not, of course, preclude communication with other Investors. Instead, the goal should be to add a new avenue for effective information gathering from the larger Investors.

1.1.2 Use by companies of institutional information

Information from institutions on the company's overall market standing, such as valuation, stock performance, performance relative to peers and analysts' reports, can be a useful part of the information regularly provided to directors and to senior managers. Such data can create a critical performance benchmark, revealing the overall judgement of capital markets about a company's past and present policies. This information can also be helpful to companies formulating and debating future plans and projects.

1.1.3 Communication should be at senior level

As it is the chief executive officer, the board and senior managers who set long term policy, it is at this level of the company that broad Investor and market opinion should be made available. Consequently, communication on Corporate Governance matters should generally be held between senior members of institutions and a company's board members or senior management.

Direct communications are, however, only credible when those engaged in them, both institutional Investors and corporate representatives, understand the company's strategy and have clear decision making responsibility in their organisations. Communications should signal a serious commitment to high level feedback that can directly affect policy.

1.1.4 Companies' expectations

Companies agreeing to enhance communications with their major investors can expect positive undertakings from major investors in response. These might include a commitment to continuing informed, expert discourse, agreements or understandings about the process governing the dialogue and a commitment to play a constructive role. Once companies have made the commitment to open up their process and seek new kinds of input, the onus is on the Investors to respond responsibly and positively.

1.1.5 Institutions' expectations

At the same time, institutions should feel entitled to have their questions or concerns on Corporate Governance issues, including performance, answered or addressed in a business like manner.

1.1.6 Compliance with the law

This Guideline should not be taken to advocate any conduct inconsistent with the insider trading, continuous disclosure and other corporate laws.

In particular, communications should be managed by both companies and institutions so that no Investor or potential Investor obtains material or price sensitive information which is not publicly available. Where, exceptionally, there are compelling reasons for a board to consult institutional shareholders on issues which may be price sensitive, those shareholders will have to accept that consultation would involve the receipt of confidences which will have to be strictly safeguarded and insulated from their other activities. In these circumstances, shareholders will not be able to trade in the company's shares unless they have constructed appropriate 'Chinese Walls'.

If information is in a proper form to disclose to an Investor, the company should consider whether it has a duty to disclose the information to the market as a whole, under Australian listing rules and continuous disclosure laws. This has become an area of increased focus in the market since the second edition was issued in 1997.

1.2 *Guideline 2 – Voting Scope & Mandate*

Investment Managers should vote on all material issues at all Australian company meetings where they have the voting authority and responsibility to do so.

IFSA strongly supports the principle of "one share one vote". Voting rights are a valuable asset of the Investor which should be managed with the same care and diligence as any other. Ultimately, shareholders' ability to influence management depends on shareholders' willingness to exercise those rights.

Institutions should support boards by positive use of their voting power unless they have good reasons for doing otherwise. Where a board has received steady support over a period of time, it should become a matter of concern for the board if that support is withdrawn.

If an institution intends to vote against a proposal, it may be appropriate for the institution to contact the company in time for the problem to be considered with a view to achieving a satisfactory solution. The company also has a responsibility to provide enough time for this to occur. Where a satisfactory outcome cannot be achieved on an important issue, it may be desirable for a spokesperson to attend the relevant meeting of the company and to explain why the proposal is being opposed. In such cases a poll should be demanded to ensure that the vote is duly recorded.

1.3 *Guideline 3 - Proxy Voting Policy and Procedures*

Investment Managers should have a written policy on the exercising of proxy votes that is approved by their board and formal internal procedures to ensure that that policy is applied consistently.

To ensure that voting rights are managed with due care and diligence, it is important that there is a documented policy on proxy voting which is approved at board level and that procedures are in place to ensure it is consistently applied. The benefits to both the company and the investment community of a consistently applied policy are self-evident and can do much to avoid conflict and uncertainty. Where Investment Managers have written policies on Corporate Governance which will affect the exercise of their proxy votes, these should also be communicated to clients.

1.4 *Guideline 4 - Reporting to Clients*

Wherever a client delegates responsibility for exercising proxy votes, the Investment Manager should report back to the client when votes are cast (including abstentions) on investments owned by the client. Reporting on voting should be a part of the regular reporting process to each client. The Manager should report back to clients whether or not the votes are cast. The report should include a positive statement that the Investment Manager has complied with its obligation to exercise voting rights in the client's interest only. If an Investment Manager is unable to make the statement without qualification, the report should include an explanation.

The responsibility for exercising proxy votes should be clarified between the Investment Manager and the client and incorporated in the contract between them. The Investment Manager will, however, still be subject to the client's instructions on voting issues.

Where that authority is delegated to the Investment Manager, reporting to the client on the exercise of proxy votes by the Investment Manager will both enhance this performance of the Manager's duty to the client and provide evidence that both Manager and client have satisfied their fiduciary duties. The Manager should report whether or not votes are cast. Information about abstentions is just as relevant to clients, as abstentions are another form of dealing with proxy votes.

Reporting, with the client's approval, should at least be annual and at least be detailed enough to deal with:

- material Corporate Governance issues resolved by discussion before an AGM;
- resolutions where the Investment Manager voted against the board's recommendation; and
- issues voted in favour of a board's recommendation where there is a significant opposition view known to the Manager.