Colonial First State

We want what you want

Colonial First State

# Corporate Governance Update

August 2005

## Introduction

Colonial First State (CFS) is a significant shareholder in many listed Australian companies. This places CFS in a position of responsibility and influence on matters of corporate governance.

The voting rights that come with share ownership are valuable assets and CFS is required to act and vote in a manner that is in the best interest of our investors.

CFS plays an active role in the corporate governance process. This is achieved through the exercise of proxy votes and through direct discussion with management and boards of directors. We aim to encourage management and boards to make decisions that are in line with shareholder interests.

This report aims to give an update on our corporate governance activity for the first half of 2005 and to provide some insights into the way CFS votes on company resolutions.

Particular focus in this report has been given to executive remuneration and non-executive directors fees. These issues are highlighted due to the recent introduction of the Corporate Law Economic Reform Program 9 (CLERP 9) by the Federal Government.

CLERP 9 is a set of regulations placed upon companies from 1st July 2004 designed to strengthen the financial reporting framework. It covers changes to financial reporting, continuous disclosure, executive remuneration, shareholder participation and the function of auditors.

In particular, CLERP 9 reforms in relation to executive remuneration include:

→ All Australian companies must put their executive remuneration report to a non-binding shareholder vote at their annual general meeting.

→ The disclosure of performance hurdles and other contingent payments, duration of contracts, notice periods, termination payments, equity compensation and shareholder returns over the past five years.

→ The regulation of termination payments by requiring shareholder approval for termination payments exceeding a certain amount.

CFS supports the greater disclosure of remuneration information as it assists in our decision making processes. The improved disclosure provides a basis upon which we can indicate to a company's management and board of directors our views on remuneration practices.

## Six-month Summary

CFS aims to vote on all resolutions, at all company meetings in which our funds have investments. In the first 6 months of 2005 CFS voted at 68 meetings on 289 resolutions.

Our portfolio managers consider each resolution separately, with guidance from our Corporate Governance Principles. In the first half of 2005, 79% of resolutions were supported, 5% were opposed and we abstained on 16%.

The bulk of abstentions were of a technical nature, dealing with approvals to issue shares where we had already agreed to take part in the share placement.

## Aggregate voting history

| Colonial First State proxy voting statistics | First half 2005 | First half 2004 | Full year 2004 |
|---|---|---|---|
| # company meetings | 68 | 88 | 366 |
| # resolutions voted on | 289 | 392 | 1918 |
| % resolutions supported | 79% | 86% | 86% |
| % resolutions against | 5% | 8% | 9% |
| % resolutions abstained | 16% | 6% | 5% |

Traditionally the period January to June is a quiet time for company meetings, with only 68 meetings and 289 resolutions being voted on during this time. Around 80% of company meetings take place in the second half of the year as most annual general meetings take place between September and November.

CFS voted against 14 resolutions in the six months to June 30th 2005. The major reasons for voting against resolutions centred around three main categories; director/ executive remuneration, the issuance of options to directors and the re-election of directors.

# Colonial First State

## Executive Remuneration Resolutions

CFS lodged proxy votes on executive remuneration at 16 company meetings from 1st January to 30th June 2005. At these 16 company meetings, 22 resolutions were voted upon, with CFS voting against 5. Executive remuneration plans were not supported for Colorado Group, Adelaide Brighton, Coca Cola Amatil, Gloucester Coal and AXA Asia Pacific.

Support will be given to executive remuneration increases and plans, provided they are accompanied by appropriate performance hurdles and/or previous achievements warrant the increase.

Reasons for not supporting executive remuneration and incentive plan resolutions included:

- Inappropriate incentive plan structures.
- Lack of reasonably demanding performance targets. Reasons included:
  - Allowing the board of directors to choose between two separate performance targets making the hurdle rate easier to achieve.
  - Performance hurdle component based solely on a Net Operating Profit After Tax target.
- Lack of any performance hurdles for the issuance of options.

CFS does support long term incentive plans where there are appropriate and well defined performance hurdles. This ensures the alignment of the longer-term interests of management and shareholders. CFS seeks appropriately demanding performance hurdles and will vote against incentive plans where we feel performance hurdles will be too easily met.

Although CFS is active in opposing resolutions that we feel are not in our unit holders best interests, we recognise that executive remuneration plans are important and will support resolutions where they are appropriate.

CFS supported a long-term incentive plan for an executive at National Australia Bank. In this case, CFS felt that the incentive plan was appropriate and payment of shares, performance rights and performance options should take place.

| Colonial First State proxy voting on executive remuneration | Full half 2005 |
|---|---|
| # company meetings involving executive remuneration | 16 |
| # executive remuneration resolutions voted on | 22 |
| % executive remuneration resolutions supported | 77% |
| % executive remuneration resolutions against | 23% |
| % executive remuneration resolutions abstained | 0% |

## Non-executive director fees

In the last six months CFS has voted at 10 company meetings involving increases to non-executive director fees. At these 10 company meetings CFS voted on 10 resolutions, supporting 9 and voting against 1.

CFS is active in supporting resolutions to increase non-executive director's fees where they enable companies to pay market rates. Support will also be given to enable the retention and attraction of board members and where utilisation of the current pool of funds available to pay directors has almost been fully utilised.

Examples of where CFS has voted to increase non-executive director fees and the total pool of funds available to directors include Timbercorp, Australand Property Group, Caltex Australia, Coca Cola Amatil and Adelaide Brighton.

CFS will support increases in directors fee's where:

- current fees are low compared to industry standards
- to allow for the attraction and retention of directors
- where a company's performance has been strong and this is linked to performance of directors or where the directors have contributed to a turnaround in a business.

Support was given to an increase in the total pool for non-executive directors at Caltex's annual general meeting in April 2005. CFS reasoned that an increase was necessary since the current pool was almost fully utilised and flexibility was required to maintain market rates.

CFS will be active in voting against resolutions involving the granting of options to non-executive directors. We do however support the notion of paying non-executive directors in the stock of the company.

| Colonial First State proxy voting on non-executive directors fees | Full half 2005 |
|---|---|
| # company meetings involving non-executive director fees | 10 |
| # non-executive director fees resolutions voted on | 10 |
| % non-executive director fees resolutions supported | 90% |
| % non-executive director fees resolutions against | 10% |
| % non-executive director fees resolutions abstained | 0% |

## Other issues of interest

CFS is active in its corporate governance practices. This results in both support for and opposition to various company resolutions. An aspect of good corporate governance involves allowing company management and the board of directors to make decisions and carry on with business.

CFS is also active in director re-election resolutions. CFS believes that there should be a formal and transparent procedure for the appointment of new directors. CFS would like to see the Chairman and a majority of members on the Nomination Committee be non-executive directors. In January 2005 CFS supported the appointment of new non-executive directors to National Australia Bank. The proposed non-executive directors had a broad range of relevant experience and we anticipate them contributing positively towards the board's future performance.

CFS is also active in voting against the appointment of certain directors to boards. Our proxy voting position on non-executive directors is that to be considered independent, they should not have been a former executive of the relevant company for a minimum of 5 years. CFS is active in opposing non-executive directors where independence is not guaranteed.

We are also active in voting against executives being appointed to the board of directors. In February 2005, CFS voted against the appointment of a Patrick Corporation executive to the board.

Use of Corporate Governance International (CGI)

Due to our size, CFS is in a position where we are able to be in regular contact with company management. This allows CFS to make educated and informed decisions regarding board re-appointments and the appropriateness of remuneration increases.

As part of our corporate governance process, CFS also uses Corporate Governance International (CGI) to assist in making voting decisions. CFS often votes in line with their recommendations, using them as a reference point. However, CFS will not hesitate to vote differently from CGI if our views differ. These views would be based on our own discussions with company management and on what is in the best interests of our unit holders.

An example of taking a position different to that of CGI occurred in relation to non-executive director remuneration. CFS believed that an increase in the total pool was necessary in order to give the company flexibility to maintain market rates and attract new directors if needed. CGI argued that the pool was sufficient and there was no reason to increase it. CFS voted for an increase in the fee pool on the grounds outlined earlier.

## Corporate governance isn't just about proxy voting

Corporate governance is not just about how we vote on resolutions. CFS can also influence corporate governance practices by advising chairmen and senior executives on corporate governance practices.

CFS is in constant contact with company chairman and senior executives. At our meetings we are able to encourage compliance with appropriate corporate governance practices and to give feedback on how we see boards of directors performing their duties. All such contact is in accordance with the Corporations Act and CFS follows the Investment and Financial Services Association (IFSA) guide on Corporate Governance.

Shareholders' ability to influence management depends on shareholders' willingness to exercise voting rights and regular dialogue with company management.

## Different portfolios within CFS may vote differently

CFS has guidelines for effective corporate governance that our equity teams follow. On the majority of occasions the teams vote in the same way. Occasionally however, interpretation of the guidelines does differ, as does the view on what is in the unit holders' best interest. In these circumstances the equity portfolio managers can vote differently, demonstrating the independence of the teams.

## Trends within the industry

The ASX conducted a report into the corporate governance disclosure by listed companies for the 2004 reporting period of 1 August to 31 December 2004. This followed on from the release in 2003 by the ASX Corporate Governance Council of 'Principles of Good Corporate Governance and Best Practice Recommendations'. The report found that 68 per cent of Australia's public companies have adopted the ASX's Corporate Governance Council guidelines. Up to 85 per cent of companies ranked in Australia's top 500 were found to be complying with the recommendations.

The report shows that corporate governance remains an important issue for Australian companies with companies focusing on areas where they can improve their disclosure. This trend is to be applauded and encouraged.

## Conclusions

CFS will continue to practice active corporate governance. We will continue to be supportive of advances in corporate governance practices that add value for investors.

The introduction of the CLERP 9 reforms is a positive step towards enhancing the disclosure of executive remuneration practices, with CFS actively assessing each resolution on this issue.

CFS recognises that corporations still need flexibility to carry out their role of making profits for shareholders. We will continue to look at areas in which corporations can improve their corporate governance practices and through our discussions with management we will continue to recommend improvements.

For a brief summary of our Corporate Governance Proxy Voting Policy, please go to **http://www.colonialfirststate.com.au/company/Corp_Gov.asp?sPageHeading=Company&Index=9 etc.**