Colonial First State
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# Corporate Governance Update

February 2006

## Introduction

Colonial First State (CFS) manages money on behalf of many Australians. CFS invests in listed Australian companies, placing us in a position of influence and responsibility with respect to corporate governance issues.

As an active shareholder, CFS views corporate governance as an important tool of investment management. The voting rights that come with owning shares are a valuable asset.

CFS plays an active role in the corporate governance process with an aim to encourage management and boards to make decisions that are in line with shareholders interests.

Companies that operate under good corporate governance practices have greater potential to avoid damage to their earnings and their reputation. Shareholders are becoming more interested in companies that are operated well and those that will protect and grow their wealth.

This report aims to give an update on our corporate governance activity for the second half of 2005 and how CFS has voted on company resolutions. We also highlight several trends in voting patterns and corporate governance practices.

The introduction of non-binding shareholder votes on remuneration reports, board composition and executive remuneration packages have been given particular focus.

### Six-month summary

CFS aims to vote on all resolutions put forward at the company meetings that our funds hold shares in. During the second six months of 2005, CFS voted at 236 company meetings on 1,286 resolutions.

Each resolution is considered separately by the fund's portfolio manager, with guidance provided by our Corporate Governance Principles. In the second half of 2005, 83% of resolutions were supported, 8% were opposed and we abstained on 10%.

The bulk of abstentions were of a technical nature, dealing with approvals of share issues where CFS participated in the placement. Other abstentions resulted from the non-binding shareholder vote on remuneration reports. This is discussed more fully below.

| | Second half 2005 | Second half 2004 | Full year 2005 |
|---|---|---|---|
| # company meetings | 236 | 278 | 304 |
| # resolutions voted on | 1286 | 1526 | 1575 |
| % resolutions supported | 83% | 86% | 82% |
| % resolutions against | 8% | 9% | 7% |
| % resolutions abstained | 10% | 5% | 11% |

### Introduction of Remuneration Reports

In our last Corporate Governance Update, we mentioned the Corporate Law Economic Reform Program 9 (CLERP 9). This requires all Australian companies to submit a remuneration report to a non-binding shareholder vote at their Annual General Meeting. The report aims to increase the transparency of remuneration policies, practices and structures.

The remuneration report should include:

- Details of the remuneration of each company's five most highly paid executives and all directors.
- Principle elements of the contract of any new chief executive officer or any key executive, including remuneration details, contract period and any termination payments.
- Any termination payments agreed to by the board in connection with the departure of a director or key executive.
- The level of base (guaranteed) pay and at risk/performance based (incentive) pay for executives. Performance hurdles and outcomes should also be clearly spelt out, as well as short and long term elements.
- Details on pay for non-executive directors, including board fees, shareholder approved fee cap and when it was last approved.
- The Board's policy on share acquisition plans, retirement benefits and incentive plans for non-executive directors.

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Given that the vote on the remuneration report is non-binding, no legal effect would occur if the resolution was not supported. The board of directors would not be required to change any of its remuneration policies but the vote would show shareholder dissent and opposition to its policies.

CFS supports the increased disclosure of remuneration information as it supports our decision making process. This provides an additional method by which we can indicate our views to management and the board on remuneration policies.

Given that this was the first annual general meeting season where remuneration reports were put forward for shareholder voting, CFS took note of Corporate Governance International's (CGI) policy towards voting[1].

CGI took the approach that since 2005 is the first meeting season with such reports, a 'settling in' period was required. CGI set its benchmark for reports at transparency, looking for adequate explanation and disclosure of remuneration policies and practices.

Remuneration reports that revealed remuneration policies, procedures and practices that were clear but contentious were not necessarily opposed. Instead, either an abstention vote was cast with the matter raised with the company or a vote in favour of the report was cast with the matter still raised. The resolution was opposed if the report was not clear and/or new remuneration policies were introduced that were not best practice and against CFS's corporate governance principles.

Remuneration reports that were supported included CSR Limited, Rinker Group, CSL Limited, Qantas Airlines, Perpetual Trustees, Cochlear, Origin Energy, Billabong International, Fosters Group, Transurban Group, Pacific Brands, Suncorp Metway and Multiplex.

Remuneration reports we abstained on included Oakton Limited, Investor Group, Sirtex Medical, Baycorp Advantage, Equity Trustee, Bendigo Bank, Technology One and Kagara Zinc.

We opposed the remuneration reports of Valad Property Group, SMS Management & Technology, Skilled Group Limited, Consolidated Minerals, Babcock & Brown Infrastructure, Equity Trustees, Domino's Pizza, Adsteam Marine Limited and Bank of Queensland.

CFS will be looking for an improvement in the remuneration reports during the 2006 company meeting season.

During the July to December period, CFS lodged proxy votes on 164 remuneration reports. Of these, 94 were supported, 15 were opposed and we abstained on 56.

| | Second half 2005 |
|---|---|
| # company meetings involving remuneration reports | 164 |
| % of all company meetings | 70% |
| % resolutions supported | 57% |
| % resolutions against | 9% |
| % resolutions abstained | 34% |

## Director elections/re-elections

CFS believes that non-executive directors must balance their number of board appointments with their personal ability to provide a meaningful contribution to each board. Executive directors who have outside directorships also need to ensure that their contribution to their current employer is not diminished.

There is an increasing trend for board members to take on additional directorships with some directors on the boards of several large listed companies. With an increasingly complex business environment and ever growing board responsibilities, we have concern over directors being able to balance their responsibilities towards each board.

CFS will examine each directorship nomination to determine whether the individual is a good candidate for the position given their other responsibilities and their background.

CFS will also examine the candidates past corporate governance record when deciding its vote.

During the July to December period, CFS voted on 513 director election/re-election resolutions. Of these, 480 were supported, 25 were opposed and we abstained on 8.

Major reasons for opposing the election/re-election of directors were:

- Poor history on corporate governance.
- The director would represent a specific shareholder's interests.
- The director up for re-election recently sold all of his/her shares in the company.

On other occasions CFS supported the resolution, yet contacted the company directly to voice our opinion on worrying trends in board composition.

An example was where we expressed our view that the company in question required new board members rather than recycling directors who had been on the board for a long time. The company concluded that they would pursue a strategy of searching for new board members with the relevant skills required to replace long serving board members.

Director election/re-elections were not supported for Harvey Norman, Tattersall's Limited, Ramsay Health Care, John Fairfax Holdings, Computershare, Aevum Limited, Gunns Limited, Equity Trustees, Australian Value Funds Management, Fiducian Portfolio Services, Origin Energy and Macquarie Goodman Group.

| | Second half 2005 |
|---|---|
| # company meetings involving director elections/re-elections | 156 |
| % of all company meetings | 66% |
| % resolutions supported | 94% |
| % resolutions against | 5% |
| % resolutions abstained | 1% |

1 CGI AGM Monitor December 2005.

## Remuneration

Executive remuneration and non-executive director remuneration continue to dominate corporate governance discussions and concerns.

During the July to December 2005 voting period, CFS voted at 121 company meetings and 212 resolutions involving remuneration. We supported 156 of these, opposed 54 and abstained on 2.

### Executive Remuneration

Well defined executive incentive plans are in shareholders best interests. Appropriate and clear performance hurdles align the longer-term interests of management and shareholders.

CFS is active in opposing resolutions that are not in our unit holder's best interest and communicating to companies the reason why resolutions were not supported.

Reasons for not supporting executive remuneration plans over the period included:

- Lack of performance hurdles for the issuance of options.
- Inappropriate incentive plan structure and performance hurdles.
- Inclusion of inappropriate employees in the plan.
- Performance hurdle based on an accounting measure open to manipulation.

Executive remuneration plans were not supported for Salmat Limited, Kimberly Diamond Company, Southern Cross Broadcasting, Hastie Group, Sky City Entertainment, Select Managed Funds, Skilled Group and Fisher & Paykel Healthcare.

CFS will vote for long-term incentive plans that reward executives for producing good returns for shareholders. Support will also be given to executive remuneration increases if past achievements warrant an increase and they are accompanied by appropriate forward looking performance hurdles.

Executive remuneration plans were supported for Cochlear Limited, Fosters Group and Transurban Group.

### Non-executive director remuneration

Resolutions involving non-executive director remuneration relate to increases in the maximum aggregate level of fees that could be paid to each company's non-executive directors or granting of options to non-executive directors.

CFS will support resolutions to increase the aggregate level of non-executive director fees where:

- The increase will be in line with market rates and current fees are below industry standards.
- The increase will enable the attraction and retention of board members.
- The increase is required due to an addition to the number of board members.
- The current fee pool has been almost fully utilised.
- Company performance has been strong and directors have played a key role in this.

Support was given to an increase in the total pool for non-executive director fees at Bank of Queensland's annual general meeting. CFS reasoned that an increase was required to compensate for inflation, the addition of two more directors, and to pay market rates.

Other aggregate non-executive director fee increases supported included Lion Nathan, Tabcorp Holdings, and Worley Parsons.

Common reasons for seeking increases included to adequately compensate directors for the increasing demands placed upon them, due to the growing complexity and size of their companies.

CFS will actively oppose fee increases where we believe the increase is excessive and is not warranted. Examples where we voted against increases included Adsteam Marine Limited, Centennial Coal and Aquarius Platinum.

CFS is of the view that options should not be granted to non-executive directors and will actively oppose resolutions for this. We are of the opinion that non-executive directors should not be compensated in the same way as executives of the company.

Executives are granted options to align their interests with that of shareholders. Non-executive directors exert less control over the future performance of the company than executives, and should not be remunerated in the same way.

During the July to December period there were a number of resolutions seeking approval for granting of options to non-executive directors as part of their overall remuneration package.

CFS did not support the granting of options to non-executive directors for Consolidated Minerals, Jubilee Mines, Mineral Deposits, Hardman Resources, Amadeus Energy and Epitan.

Despite the position taken by CFS, all resolutions were passed by the majority of shareholders at each of the above company meetings. In the case of Hardman Resources and Jubliee Mines significant votes against the resolution were registered.

The large number of votes opposed to the resolution should send a message to the board of directors that shareholders are not in favour of this policy. In the case of Consolidated Minerals, the resolution was withdrawn prior to votes being cast.

| | Second half 2005 |
|---|---|
| # company meetings involving remuneration | 121 |
| % of all company meetings | 51% |
| % resolutions supported | 75% |
| % resolutions against | 25% |
| % resolutions abstained | 1% |

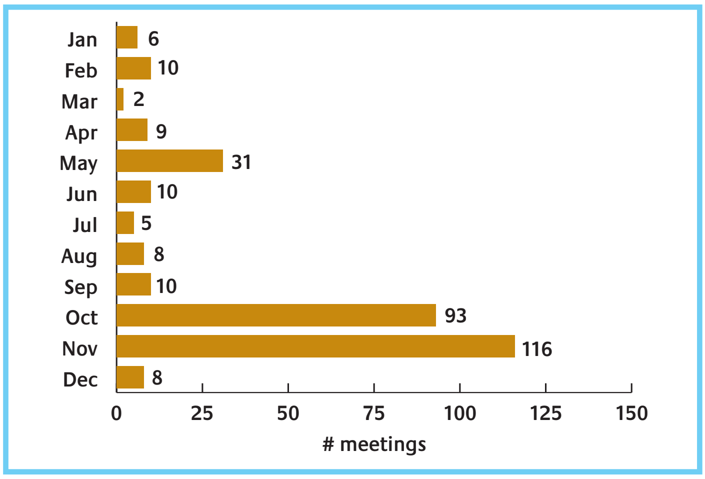
## Other issues

### Busy meetings season

Two-thirds of all company meetings in which CFS held investments occurred during October and November 2005. This put a great deal of pressure on fund managers and other investors to give sufficient attention to each individual resolution to vote in the best interests of shareholders, and give feedback to the company on concerns.

The advantage that CFS has is its size. CFS employs a large team of investment professionals enabling us to give each resolution attention. This facilitates discussions with management over issues relating to corporate governance matters.

The busy meeting season and tight deadlines have the potential to impact on corporate governance with poor decisions on resolutions and minimal feedback to companies likely to result.




**Different portfolios within CFS**

CFS is Australia's largest fund manager. We operate multiple investment portfolios covering different sectors. Our two Australian Equity teams, GDP-plus and Core, as well our Listed Property and Global Resources all vote at company meetings.

CFS has guidelines for effective corporate governance that all teams follow. On the majority of resolutions our teams vote in the same way.

Occasionally interpretation of the guidelines does differ, as does what is in the interests of unit holders'. In these cases, the fund managers can vote differently, demonstrating the independence of all the teams.



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