



21 December 2012

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
By email: john.kluver@camac.gov.au
Cc: camac@camac.gov.au

Dear Mr Kluver

Submission to Corporations and Markets Advisory Committee: The AGM and shareholder engagement

Thank you for the opportunity to submit our views on the AGM and shareholder engagement to the Corporations and Markets Advisory Committee.

Regnan is owned by and run for institutional investors with significant shareholdings in Australian listed markets, as well as other asset classes. Our submission reflects our experience in researching and engaging with Australian listed companies on behalf of these investors. We respond only to those parts of the discussion paper for which we are in a position to have formed a view.

Guidance for companies about shareholder engagement

Regnan has observed an increase in the quantity and quality of shareholder engagement by many S&P/ASX200 companies over the decade in which we have been undertaking such engagement.

However while we do not favour additional prescription, we recognise that smaller companies and those with less well established investor relations /shareholder engagement programs may derive benefit from descriptive guidance in this area.

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Particularly helpful for this audience would be descriptive guidance that addressed common misperceptions, by:

- Emphasising the benefits to the company of engagement that involves two-way dialogue exchange rather than a one-way flow of information from the company to its shareholders;
- Forestalling any misapprehension that shareholders necessarily desire *more* reporting, or *more polished* presentation of information;
- Explaining the varying objectives of distinct classes of institutional investors (asset owner versus asset manager, long term versus short term, active versus passive etc);
- And in light of the above points, communicating the value of having the relevant (generally non-executive) directors participate directly in engagement activity.

We note examples of such guidance that is readily available¹ and note also that consideration of further developments will be the subject of a separate review by the ASX Corporate Governance Council for its 2013 review.

Should at least some institutional investors be encouraged or required to report on the nature and level of engagement with the companies in which they invest, in the manner provided for in the UK Stewardship Code or otherwise?

Regnan believes it is beneficial for institutional investors to demonstrate accountability for their engagement with companies, and we note a number of existing frameworks that encourage both stewardship activity, (including engagement) and reporting on this activity.²

More detailed analysis is required ahead of determining whether more is needed. This should include mapping to establish whether any legitimate groups are under-served by the content or coverage of these frameworks, and analysis of formal participation and (separately) *de facto* compliance with the content by market participants.

Could greater use be made of technology to promote shareholder engagement outside the AGM and, if so, how?

Institutions, their representatives and advisers (eg asset owners, larger fund managers, proxy advisers, investor groups such as Regnan and ACSI) tend to be better served by corporate engagement programs than those representing smaller parcels of shares. In practice, this means that engagement between a company and such shareholders is characterised primarily

¹ Eg Stafford, J. (2011) *Engaging with Shareholders*. Australian Institute of Company Directors

² Eg UN Principles for Responsible Investment, Financial Services Council “Blue Book” Guidelines.

by one-way rather than two-way communication. Even those shareholders able to attend the AGM in person may not have the opportunity during proceedings to put their questions or views from the floor. Some companies solicit questions in advance of AGMs however there is currently limited formal accountability for whether these are prioritised.

Regnan views these circumstances as a lost opportunity for demonstrating accountability, furthering shareholder engagement and promoting a more informed market. This is particularly unfortunate given the availability of technology-based alternatives that would demonstrate more systematic engagement with shareholder questions and concerns – including at times other than the AGM. Examples could include web-based forums for shareholders to submit, review and vote on others' questions to the company – with companies responding to a limited number of those most highly prioritised by the shareholders as a group.

Should there be additional scope for non-binding votes?

Regnan is in favour of additional scope for shareholder resolutions and notes the effectiveness of the non-binding vote on remuneration in promoting dialogue between companies and their investors on issues of interest and concern. We also note that extraordinary general meetings have been called by shareholders in recent years to circumvent (or pre-empt) companies' refusal of ordinary shareholder resolutions. Such EGMs can be costly to the company and its wider shareholders and a distraction for all parties. Regnan believes that the availability of ordinary resolutions would have reduced the instances in which the 100 member rule was used to requisition EGMs.

However Regnan is also mindful of limits on the proper role of shareholders in decision-making for investee businesses. Additional scope for shareholder resolutions and voting should be framed in a manner that does not promote proliferation of resolutions on business management or operational matters.

It may be that additional scope should encompass both binding and non-binding votes to facilitate clarity about director responsibilities. For example, shareholder resolutions in other jurisdictions commonly seek a report from the board on matters of interest to the proposing shareholders. Where directors do not believe it is in the interests of the company to provide these disclosures and would consequently be conflicted if not bound to do so by the vote, it may be preferable that the vote be binding (a situation similar to the obligation on Australian-domiciled companies to report on remuneration). On the other hand, any subsequent vote on the requisitioned report might necessarily be limited to a non-binding vote (again, paralleling the non-binding vote on the remuneration report).

We see it as necessary to consult further on the mechanisms by which to a sensible balance could be achieved within Australian business context.

The Annual Report

Regnan has provided detailed comment on Annual Reporting in its recent submission to ASIC's consultation: *Effective Disclosure in an Operating and Financial Review*. This is attached as an appendix in the following pages.

Yours sincerely,



Amanda Wilson
Managing Director



APPENDIX: Regnan submission on Consultation Paper 187: Effective Disclosure in an Operating and Financial Review

22 November 2012

Ms Crystal Kwan
Executive Assistant, Financial Reporting & Audit
Australian Securities and Investments Commission
By email: policy.submission@asic.gov.au

Dear Ms Kwan

**Regnan Submission on Consultation Paper 187:
Effective Disclosure in an Operating and Financial Review**

Regnan – Governance Engagement & Research Pty Ltd was established to investigate and address environmental, social, and corporate governance (ESG) related sources of risk and value for long term shareholders in Australian companies.

Its research is used by institutional investors making investment decisions, and also used in directing the company engagement and advocacy it undertakes on behalf of long term investors with \$43 billion invested in S&P/ASX200 companies (at June 2012).

Regnan was launched in 2007 having operated previously as the BT Governance Advisory Service. It is owned by eight institutional investors: Commonwealth Superannuation Corporation (formerly ARIA); BT Investment Management; Hermes (UK); HESTA Super Fund; Local Government Super; Vanguard Australia; VicSuper; and the Victorian Funds Management Corporation.

Summary of Regnan's Response

Corporate disclosures, including the Operating and Financial Review (OFR), are critical inputs to the decisions investors make in allocating capital. We agree that there is a need to improve the quality of corporate disclosure and its relevance for investor decision-making and commend ASIC for addressing this important topic. We note that there is currently a wide gap between the best and worst disclosers, even among the large listed companies that are the focus of our work. We consider the draft guide could play an important role in closing that gap, to the benefit of investors, financial market efficiency, and the reporting entities themselves.

Overall, we consider the draft regulatory guide well adapted to this end. We consider the positions taken to be uncontroversial and the guidance and examples consistent with the current practices of companies we consider leading disclosers.

Material Environmental and Social Matters

We agree that a high-quality OFR is important in meeting the information needs of current and prospective investors, that it should be tailored to the circumstances of each entity, and provide insightful information and analysis. We also agree that this includes explaining underlying drivers of an entity's performance more generally.

In our view, the proposed guidance could be enhanced by explicitly stating that environmental and social matters should be addressed in the OFR where these are material to the company's operations, financial position, business strategies and prospects for future financial years.

We consider there is a need for explicit guidance on this point because material environmental and social matters are too often overlooked or inadequately explained in communication to investors. For example, it is accepted that over recent years skills shortages have been an important exposure for the resources sector, with implications for production costs and project timetables. Yet it remains common for resources companies to fail to address human capital management and skills in the annual review to the extent relevant for investors.

Even among companies that disclose significant amounts on environment and social matters, this disclosure is generally not adequately focussed on the aspects most material to business value, nor is the link to corporate strategy and value creation sufficiently clear to meet investor needs.

Communication Between Companies and Investors

Further, the guidance could be enhanced by recognising the role of direct communication between companies and investors and their intermediaries (analysts and managers) to better understand their information needs.

Integrated Reporting

Regnan is strongly supportive of, and actively engaged in, the development of guidance for integrated reporting.

We consider that the concerns with current disclosure practices underlying the push for integrated reporting are well understood and that there is no reason that companies should not be attempting to address these concerns and adopt the principles of integrated reporting now, even before the framework is fully detailed.

We see the proposals contained within this consultation paper as consistent with integrated reporting and likely to help companies in moving toward integrated reporting.

Nonetheless, we agree that it would be premature for ASIC to explicitly include guidance on integrated reporting at this stage.

Future Orientation and Director Liability

We note that the requirement for the OFR to address prospects for future financial years (plural) is specified under the current legislation (as mentioned in the consultation paper). We consider concerns about increased director liability associated with this requirement to be excessive.

In our view, much meaningful information could be provided without going as far as providing forecasts, including (as proposed):

- disclosure of the main risks that could adversely affect the successful fulfilment of the business strategies of the entity; and
- identification of key factors relevant to an entity's prospects, but outside management's control.

We do not consider the guidance set out would often entail presenting forecasts; but information relevant to sensitivity analysis, such as ranges for key factors over which the company's view remains valid should be included, e.g., the price for the company's product over which its expansion strategy remains viable.

We do not view such disclosure as likely to increase director liability. On the contrary, fuller disclosures, including of key risks to successful fulfilment of strategy, would assist directors in fulfilling their obligations to shareholders, managing investor expectations, and thereby safeguarding against potential liability.

Compliance Costs

We do not consider the proposals will add materially to compliance costs. In our view, the proposals do not create additional obligations, but rather clarify existing ones. This clarity should reduce compliance burden.

Further, significant resources are expended by corporations in communicating with investors. Better targeting these communications to investor information needs should reduce the resources required to be expended.

Effect on Competition

We foresee that individual reporting entities and their representatives may express concerns about the potential detriment associated with making commercial information visible to competitors.

We question the basis for such concerns, given the wide-reaching applicability of the proposed guidance – it will likely apply equally to competitors. Further, we observe that the guidance is consistent with existing good practice, indicating companies that adopt higher quality disclosure have not experienced significant negative impacts from doing so. We suggest more effective communication may, in fact, be a source of competitive advantage, including for access to capital.

Moreover at the market-wide level, the availability and quality of information is a key determinant of the efficiency of a market. By reducing the cost of acquiring quality information and by ensuring it is readily available to all investors, the proposed enhancements to the OFR would support market efficiency.

Other Impacts, Costs and Benefits



We consider other benefits may also arise including for the disclosing entities reduced stock-price volatility associated with a closer match between investor expectations and company performance under a range of conditions – a relationship we have observed in practice for leading disclosers.

Our full response to each of the consultation questions is set out in Appendix 1.

Should you have any queries in relation to this submission, please contact Alison George, in the first instance, on 03 9982 6404.

Yours sincerely,

A handwritten signature in black ink, appearing to read "A. Wilson", written in a cursive style.

Amanda Wilson
Managing Director

Appendix 1: Regnan Response to Specific Consultation Questions

Feedback Question

Regnan Response

B1Q1 Do you agree with our view of what an OFR is, and broadly what it should contain?

If not, please explain why not.

We agree with the view expressed and that an OFR should:

(a) contain an analysis and narrative that explains an entity's business; and

(b) provide investors with useful and meaningful information about the entity, together with its annual financial report and other market disclosures, such as continuous disclosure.

B1Q2 Do you agree with our view that an OFR should be a major source of information about an entity's business to meet the information needs of investors?

If not, please explain why not.

We agree.

While presentations and other market disclosures are an important part of communications by companies to investors, the OFR should remain a key source where developments disclosed continuously are brought together periodically, reviewed, and contextualised.

This is also important for the many investors who do not have access to the briefings and other market disclosures more readily accessed by institutions.

The proposed enhancements to the OFR reduce the cost to acquire quality information and reduce information asymmetries supporting market efficiency.

Feedback Question

B2Q1 See draft RG 000.21–RG 000.26.

Is there other additional guidance that would be useful about the relationship between disclosures in other documents and the disclosures made in the OFR?

B3Q1 Do you agree with our view on the level of disclosure required?

If not, please explain why not and suggest alternatives.

C1Q1 Do you consider that the proposed guidelines on the specified contents of an OFR (as set out in the draft regulatory guide) are appropriate?

If not, please explain why not and suggest alternatives.

Regnan Response

The guidance could be enhanced by recognising the role of direct communication between companies and investors and their intermediaries (analysts and managers) to better understand their information needs.

We agree that the full depth and detail of a prospectus would rarely be required in the OFR.

However, in our view, there is scope for companies to restate key information included in a prospectus and maintain its currency with little additional effort or expense.

For example, the discussion of risks included within a prospectus is typically highly valuable to investors and rarely available from other disclosures. This information could be summarised in the OFR (consistent with the example set out in the draft regulatory guide) and a full version appended to the risk policy on the company's website and reviewed and updated along with the policy.

We consider the guidance (in sections C and D) to be appropriate.

Feedback Question

C1Q2 Do you agree with the examples of disclosure set out in Tables 1 and 2 of the draft guide?

If not, please explain why not.

If you think that there is a preferable way of illustrating our guidance, please suggest alternatives.

C1Q3 Do you think that there is any other key information that should be included in an OFR that has not been referred to in our draft guidance?

Regnan Response

We agree the examples are appropriate.

In our view, the proposed guidance could be enhanced by explicitly stating that environmental and social matters should be addressed in the OFR where these are material to the company's operations, financial position, or business strategies and prospects for future financial years.

We consider there is a need for explicit guidance on this point because material environmental and social matters are too often overlooked or inadequately explained in communication to investors. For example, it is accepted that over recent years skills shortages have been an important exposure for the resources sector, with implications for production costs and project timetables. Yet it remains common for resources companies to fail to address human capital management and skills in the annual review to the extent relevant for investors.

Even among companies that disclose significant amounts on environment and social matters, this disclosure is generally not adequately focussed on the aspects most material to business value, nor is the link to corporate strategy and value creation sufficiently clear to meet investor needs.

Feedback Question

C2Q1 Do you consider that our proposed guidance on disclosure about an entity's operations (as set out in the draft regulatory guide) is appropriate?

If not, please explain why not and suggest alternatives.

See draft RG 000.41–RG 000.42.

C3Q1 Do you agree that the reference to RG 228 in relation to business models is useful?

See RG 000.43–RG 000.45.

If not, please explain why not and suggest alternatives.

Regnan Response

We agree the OFR should disclose the underlying drivers of an entity's performance that are relevant to understanding its performance and the factors underlying its results; and that this may include significant factors affecting:

(a) the total income and income for major operating segments; and

(b) the significant components of overall expenses and expenses for major operating segments.

We consider the proposed guidance appropriate.

We agree that the reference is useful.

We consider business model to be a critical matter that should be central to investor communications.

Further, once initially produced, whether for a prospectus or otherwise, there is scope to restate and maintain the currency of this information with little additional effort or expense.

A summary in the OFR with additional information online can assist where length is a concern.

Feedback Question

C4Q1 Do you consider that our proposed guidance on disclosure about an entity's financial position (as set out in the draft regulatory guide) is appropriate?

If not, please explain why not and suggest alternatives.

See draft RG 000.46–RG 000.47.

C5Q1 Do you consider that our proposed guidance on disclosure about an entity's business strategies and prospects (as set out in the draft regulatory guide) is appropriate?

If not, please explain why not and suggest alternatives.

Regnan Response

We strongly agree that relevant information to understanding an entity's financial position includes:

- disclosing the underlying drivers of the financial position of the entity;
- disclosing exposures that are not reflected in the financial report (e.g. off-balance sheet arrangements); and
- explaining the accounting information and other detail contained in the financial report (rather than simply repeating it).

We consider the guidance is appropriate.

We approve the proposal that the OFR include:

- an outline of the entity's key business strategies, and its plans that are a significant part of those strategies; and
- disclosure of the main risks that could adversely affect the successful fulfilment of the business strategies of the entity.

This information is reasonably required by investors and their agents to understand an entity's financial position and prospects.

We agree that it would assist investors 'if key factors relevant to an entity's prospects outside management's control were appropriately identified'.

We do not consider the guidance set out would often entail presenting forecasts; but information relevant to sensitivity analysis, such as ranges for key factors over which the company's view remains valid should be included, e.g., the price for the company's product over which its expansion strategy remains viable.

Feedback Question

Regnan Response

We do not view such disclosure as likely to increase director liability. On the contrary, fuller disclosures, including of key risks to successful fulfilment of strategy, would assist directors in fulfilling their obligations to shareholders, managing investor expectations, and thereby safeguarding against potential liability.

C7Q1 Do you agree with our interpretation of the exemption requirement? If not, please explain why not.

We agree with this interpretation.

C7Q2 Do you agree that, when information has been omitted in reliance on the exemption, a summary of the type of information omitted and the reasons for the omission should be disclosed, where possible?
If not, please explain why not.

We agree that this information is necessary for investors and that this should generally be possible.

C7Q3 Do you agree with the final example of disclosure (relating to the use of the unreasonable prejudice exemption), which is set out in Table 2 of the draft regulatory guide? If not, please explain why not.

We agree the final example is appropriate.

Feedback Question

C7Q4 Are there other matters of practical guidance that should be included? If so, please describe these matters and explain why you think they should be included.

C7Q5 Do you agree with our suggestion for internal record keeping?
If not, please explain why not.

Regnan Response

The guidance could be enhanced by giving greater emphasis to the need (when determining whether any prejudice is unreasonable) to judge potential detriment to the disclosing entity against the value of withheld information to investors, particularly when this relates to risk.

We see this greater emphasis as necessary in order to communicate more assertively about investors' entitlement to relevant information, particularly given the lack of clarity about this exemption reported within the consultation paper and also to counteract the reticence entities may feel in the early stages of providing fuller disclosures.

We agree that directors should ensure adequate internal records are maintained including information 'which:

(i) identifies the information that has not been disclosed; and

(ii) explains how disclosure of the excluded information would be likely to result in unreasonable prejudice'.

In our view, this is consistent with well-established obligations on company directors.

Feedback Question

C8Q1 Do you consider that the proposed good disclosure practices in Table 3 of the draft regulatory guide are appropriate?

If not, please explain why not and suggest alternatives.

Regnan Response

We agree the good disclosure practices are appropriate.

We note the guidance that ‘there is no provision that allows the OFR to incorporate information by reference to other documents that do not form part of the annual report, such as briefings to analysts.’ We agree this guidance is appropriate but should not prevent companies from providing links to **additional** information (supplementary to the OFR) by reference.

We strongly agree that disclosure can and should be concise and that excessive length may impede the effective communication of key, material information.

We consider management and directors are well positioned to strike a balance between disclosing all material information and excessive length.

Feedback Question

C9Q1 Do you agree that it is not appropriate to include guidance on integrated reporting at this stage? If you think guidance should be included, please explain why.

Regnan Response

Regnan is strongly supportive of, and actively engaged in, the development of guidance for integrated reporting.

We consider that the concerns with current disclosure practices underlying the push for integrated reporting are well understood and that there is no reason that companies should not be attempting to address these concerns and adopt the principles of integrated reporting now, even before the framework is fully detailed.

We see the proposals contained within this consultation paper as consistent with integrated reporting and likely to help companies in moving toward integrated reporting.

Nonetheless, we agree that it would be premature for ASIC to explicitly include guidance on integrated reporting at this stage.

