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ASA VOTING POLICIES FOR ASX 200 COMPANIES

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Introduction

The policies of the Australian Shareholders' Association (ASA) have been developed as a basis for representing the interests and objectives of Australia's retail investors in the share market. The application of the ASA's policies gives a voice to millions of direct and indirect individual investors across Australia.

ASA policies and guidelines have evolved over the years since we were formed in 1960, reflecting various corporate, financial, regulatory, disclosure and governance issues as they arise. After incremental change in recent years, the ASA released a policy discussion paper in 2013 and received more than 50 submissions from companies, advisory firms, peak bodies, directors and many of our own volunteer company monitors.

This updated policy position was adopted in March 2014. Where policies have tightened, ASA monitors will take into account whether companies have enough notice of the changes before recommending voting against specific items of business at annual general meetings (AGMs).

In 2014, the ASA's policy position is most closely aligned with the Australian Council of Superannuation Investors (ACSI) governance guidelines for monitoring public companies, which was released in July 2013.

The ASA is also a member of the ASX Corporate Governance Council and generally agrees with its "Principles and Recommendations" on issues such as independent directors, responsible decision-making, safeguarding the integrity of financial reporting, managing risk, disclosing comprehensively, respecting the rights of shareholders and remunerating fairly. The latest version was updated in 2014. However, we do have particular additional areas of interest and divergent views on some issues which are outlined in this updated ASA policy position.

We are also guided by the ASX Listing Rules, common law and statute, and in particular, the Corporations Law and associated legislation which underline the common principles of accountability, transparency, fairness and responsibility.

ASA policies act as a strong and effective tool for assessing the existence of effective corporate governance, where the absence thereof, may signal the presence of increased risks. Poor corporate governance has risks for all stakeholders, including employees, customers, creditors, debt holders and equity

investors.

The ASA is primarily focused on the performance and governance of ASX 200 companies, but our policies may be interpreted for other listed companies and managed funds. We do not give financial advice but seek to maximize the payment of dividends and returns to investors over multiple years.

In terms of board governance, ASA is interested in the workload, remuneration and performance of directors. In addition, ASA acknowledges the importance of engaging, retaining and rewarding effective management, which is entrusted with safeguarding and creating shareholder value.

ASA policies are a tool for establishing a direct link between appropriate executive reward structures through remuneration, with company performance and reward to shareholders.

After the successful introduction of the innovative “two strikes” legislative reforms in 2011, the ASA has updated its remuneration and voting policies.

The ASA expects that the risk-taking capital providers in a company (including debt and equity investors) are rewarded fairly. Where a company is unable to establish a direct link between the reward to shareholders (through corporate profitability, share price and dividend performance, achieved in a socially responsible manner) and the reward to management and boards through remuneration, then ASA policies may point to weaknesses in corporate governance, causing concerns over appropriate corporate performance to benefit stakeholders.

We have also substantially updated and expanded our polices related to capital raising, in light of market experience after the GFC which saw retail investors heavily diluted through both non-participation in pro-rata offers and selective discounted placements to institutional investors.

And whilst remuneration issues will always be important, we have also substantially broadened our policies on all matters related to the vital function of director appointment and re-election on public company boards.

Shareholders provide the capital and we need good stewards of this resource who are appropriately rewarded for managing the risks and deployment of capital associated with all ASX-listed companies.

Australia is a great shareholding nation, but investors need to remain vigilant to ensure the system remains fair, transparent and accountable for the 7 million Australians who choose to invest in equity markets.

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PART A: BOARD COMPOSITION & RESPONSIBILITIES

1. Division of duties

Companies should establish the functions reserved to the board and those delegated to senior executives, and disclose those functions. Directors must be actively involved in key areas such as setting and overseeing strategy, capital management, risk management, remuneration, audit, talent development, succession management and performance evaluation.

2. Composition of Boards

A majority of the board should be genuinely independent directors, after applying strict independence criteria including on issues such as tenure, associations and related party transactions. Where there is not a clear majority of independent directors, ASA may oppose the re-election of directors classified as "not independent".

3. Chair

The chair should be an independent director. ASA does not support the appointment of an executive chairman, but recognizes the practice occasionally occurs with founders or majority shareholders, especially where there has been exceptional performance. It is preferable for boards to establish and disclose protocols concerning board tenure issues. A chairman should ideally serve on a board for at least one year before assuming the chair and should not serve for more than 10 years as chair, subject to exceptional circumstances. When a chair steps down, he/she should resign from the board completely so that the incoming chair has a clear run at any legacy issues.

4. Recruitment of new directors and performance assessment

The chairman, along with the nomination committee, should be able to demonstrate a transparent and independent process around the selection and appointment of new directors. Companies should also disclose the process for annually evaluating the performance of the board, its committees and individual directors, including the chair.

5. CEO transition to non-executive role

A former CEO should not return to the board as a non-executive director, although where there has been exceptional performance this may be considered after a suitable "cooling off period", preferably for at least two years, to allow the new CEO to settle in. A former executive who returns to the board will not be considered independent until after at least a three year break. If they return to the board earlier than 3 years, they will not be classified as independent.

6. Outside directorships for executives

The CEO of an ASX200 company must not chair an unrelated listed company. Executive directors of ASX200 companies should not serve on unrelated ASX200 boards, unless they are well established in the role and transitioning away from an executive career. In these circumstances, it should be limited to one outside directorship.

7. Directors transitioning back to an executive role

ASA acknowledges there are times when a professional non-executive director is recruited back into an executive role. If it is only in an acting capacity for a short period of time, multiple other directorships can be retained. If it is a permanent appointment, a maximum of one un-related non-executive directorship could be retained.

8. Workload of NEDs

ASA policy on the workloads of professional directors limits our support to one director sitting on 5 separate and un-related listed company boards. A chairmanship is assessed as the equivalent of serving on two boards. Any director who chairs two public companies should not serve on more than one other board. Additional government or not-for-profit positions will also be considered when assessing the workload of a director.

9. Board committees

The board must establish nomination, audit and remuneration committees. Where a chairman is not considered to be independent, boards should nominate a "lead independent director", who should also chair at least one committee. The chairman of the board should not chair either the remuneration committee or the audit committee and no executive director should serve as a voting member on these committees.

10. Board duty of care regarding risk management

The audit committee may also oversee risk management, or this can be delegated to a separate risk committee. The board should carefully monitor the risk register and require management to design and implement the risk management and internal control systems to manage the company's material business risks. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.

11. Director credentials

ASX-listed companies should improve and expand their disclosure about directors. For instance, the website profiles of directors should include all relevant information such as professional background, qualifications, age, date of appointment to the board, when last elected, city of residence, any committee positions, all other directorships held, past directorships of ASX listed companies and the size of any shareholding. When a director is up for election, these details should also be included in the formal notice of meeting. Directors up for election should speak to their nomination at the AGM and be prepared to engage with shareholders leading up to the AGM. The chairman should encourage director candidates to answer any relevant questions at the AGM.

12. Tenure limits and board size

Companies should voluntarily adhere to tenure limits of no more than 12 years for independent directors and this should be formalised in board protocols. Whilst ASA will not automatically vote against a long-serving director, we will not classify them as "independent" after 12 years of service and we will always encourage companies to maintain a majority of independent directors. ASA prefers companies to have a constitution prescribing a minimum and maximum number of directors within a range of four to 12. It is preferable that the actual number of directors is not at or close to any prescribed maximum, in order to accommodate the wishes of shareholders to add additional directors as circumstances may require.

13. Code of conduct

Companies should establish a code of conduct and disclose the code or a summary of the code on their websites. This should include detail about the practices necessary to maintain confidence in the company's integrity and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

14. Gender diversity

Companies should establish a policy concerning diversity and disclose the policy or a summary of that policy. The policy should include requirements for the board to establish measurable objectives for achieving gender diversity and for the board to assess annually both the objectives and progress in achieving them. ASX200 company boards should have at least one female director. Companies should disclose in each annual report the proportion of female employees, senior executives and directors. Geographic, age and ethnic diversity of boards are also important.

15. Relevant experience and competence of directors

While independence and diversity are important, ultimately the cohesion of the team and the relevant skills individual directors bring on strategic planning and risk management are the keys to success. Each director should contribute a particular skill-set to a board, but boards should also have multiple directors with direct relevant industry experience.

16. Voting against poorly performing directors

Professional directors can be supported for re-election if their past and current portfolio of board seats does not include poorly performing companies. Two such companies would lead to an against vote subject to the specific circumstances. If there are significant ongoing concerns with remuneration practices, the chair of the remuneration committee will be opposed for re-election.

17. Voting against directors on integrity or character issues

A regulatory or court finding against a director related to their fiduciary standards and capabilities will be regarded as warranting opposition to their re-election, subject to the particular circumstances. Other governance issues, such as the credibility of financial statements in the event of a financial collapse, will also be taken into consideration. Any other public disclosures which question the integrity or character of a director will also be taken into consideration.

18. Chair and CEO performance

If a chairman or CEO of an ASX 200 company has been demonstrably responsible for key decisions which have led to poor performance over a sustained period, ASA will oppose their re-election at that company as well as other un-related companies into the future.

19. Related party transactions

Where a company does not have a clear majority of genuinely independent directors, ASA will consider opposing directors who have material related party transactions with the company they serve, or were recently substantial service providers. ASA requires full disclosure of related party transactions.

20. Board audit committees

The board must establish an audit committee with a formal charter. The audit committee should be structured so that it consists only of independent NEDs, has at least three members and an independent chair who is not the chairman of the company. Audit committee members should be financially literate and help facilitate any engagement between the external auditor and shareholders.

21. Auditor rotation and performance

ASA supports competitive tenders for the external audit after 10 years or sooner where audited accounts have been shown to be deficient, inaccurate or in breach of the accounting standards.

22. Continuous disclosure

Companies should establish written policies designed to ensure compliance with the continuous disclosure requirements of the ASX listing rules and to ensure accountability at a board and

senior executive level for that compliance. A summary of the policy should be publicly disclosed and the ASX announcements platform should be the priority vehicle for market disclosures. All material disclosures must appear on the company website.

23. NED Remuneration, including board and committee fees

The board must establish a remuneration committee that consists of a majority of independent directors, is chaired by an independent director and has at least three members. Companies should clearly distinguish the structure of NED remuneration from that of executive directors and senior executives. The overall fee cap for NEDs must be approved by shareholders and will include committee fees. Committee fees recognise different levels of workload. The fee cap for a company should be appropriate for the size, complexity, geographic spread, life-cycle and skill-requirements of a board. Any proposed or actual increases in individual director fees for the current year should be disclosed in the remuneration report.

24. Disclosure of non-cash benefits to directors

Where a company supplies NEDs with material non-cash benefits, such as a dedicated office facility or allocated CBD car park, these should be disclosed in the remuneration report and valued where appropriate.

25. Board responsibility for fair and equitable capital raisings

ASA was disturbed by the level of dilution of retail investors during the record capital raisings after the Global Financial Crisis. The structure of capital raisings will be an important future determinant of ASA's voting intentions with boards. We oppose dilutive and selective institutional placements, especially when these are done at a discount to market and without a follow-through share purchase plan (SPP) for retail investors. ASA's preferred method for raising capital is through a renounceable entitlement offer involving a single bookbuild for selling unaccepted and ineligible entitlements at the conclusion of the offer where institutional and retail non-participants are compensated on the same terms. **See Part D for more detail.**

26. Director equity holdings

ASA believes that NEDs should have long-term alignment with shareholders through a meaningful equity investment in the company. Directors should not receive options or performance rights, but can be paid board fees in lieu of cash with the issuance of new ordinary shares or through on-market purchases. After three years on a board, a director should own of have invested at least one year's worth of cash fees in the company's shares. A failure to establish a meaningful shareholding and alignment with investors after a full term on the board may lead to an "against" recommendation from ASA when the director is seeking re-election. There should not be an equity ownership requirement for board candidates before they are elected a director or appointed to fill a casual vacancy.

27. Board responsibility for political donations

ASA is opposed to public companies donating shareholder funds to political parties. If directors or executives are politically inclined, they should make cash donations out of their personal funds. It is acceptable for executives or directors to attend political events, but this is different from making a material cash donation. Where a donation is made, this should be disclosed in the annual report.

PART B: COMMUNICATING & ENGAGING WITH RETAIL SHAREHOLDERS

1. History of financial performance

Shareholders expect annual reports to include a table showing the five year financial history that will enable them to assess the financial performance, position, financing and investing policies of the company. All figures should accord with the relevant accounting standards and include for each year key metrics such as:

1. Statutory net profit after tax;
2. Earnings before interest and tax;
3. Earnings per share;
4. Dividends per share and the extent of franking;
5. Residual franking credits held after payment of final dividend;
6. Revenue figures with relevant divisional, geographic and commodity break-downs;
7. The aggregate sum of significant unusual items affecting statutory profit;
8. Free cash flow, plus operating, investing and financing cash flows;
9. Gearing ratios including total outstanding interest bearing debt;
10. Return on equity, assets and shareholder funds;
11. End of financial year share price; and
12. Annual TSR over the previous five years

2. Communication policy and avenues

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy. This extends to recorded webcasts of AGMs and public briefings and consumer friendly publications. ASX 50 companies should live webcast AGMs (not just the formal addresses) and provide a full audio archive on their website. Whilst all company announcements since 1998 remain on the ASX website, companies should use their websites to assemble well-structured archival information going back at least five years. A standard website should include a calendar of key forward dates, including AGM details well in advance of the minimum 28 day notice period. Retail investors should be able to listen live to the half yearly or annual results presentation to analysts as well as any other “investor day” material. Such presentations should be fully archived on the company website, including transcripts where necessary. Companies should provide an email alerts service for retail investors. They should also embrace social media outlets.

3. Access to the full annual report

Companies should make it easy for shareholders to choose to receive a printed copy of the full annual report. The default position can be to send an abbreviated version of the annual report, or just the legally required notice of meeting, provided that shareholders are given a written option, complete with a reply paid envelope, to opt in for the full annual report.

4. Shareholder questions at AGMs

Companies are encouraged to invite shareholders to submit written questions to the board before the AGM in the documentation sent with the notice of meeting. The chairman should endeavour to address key issues raised in the formal addresses. In addition to the ability of shareholders and proxies physically attending the AGM to ask unscripted questions on each separate item of business, ASA encourages those companies which webcast their AGMs to allow shareholders to ask questions remotely during the AGM. Any shareholder intending to do this would need to pre-register their interest with the company.

5. Conduct of meetings

The formal addresses at the beginning of an ASX 200 AGM should be used to concisely communicate essential information about the year reported on and the future prospects of the company. These presentations should be from the Chairman and CEO and should not be released on the ASX announcements platform before the AGM has commenced unless they contain market sensitive information and the AGM commences during ASX trading hours. Chairs are encouraged to limit the time allowed to individual speakers to two questions during each visit to the microphone. Questions and discussion should not be curtailed if there are shareholders wishing to speak on the business of the meeting. All items of business should be conducted separately and a shareholder is entitled to speak on every resolution. If there is to be a media briefing following the meeting, shareholders should be entitled to attend with details outlined in the notice of meeting.

6. Polls preferred over show of hands

ASA prefers ASX 200 companies to hold a poll on all resolutions. A show of hands does indicate the voting intentions of those present but it does not usually reflect shareholder intent indicated by proxy votes. ASA will call for a poll on items where we have indicated an against vote in our voting intentions report, so as to ensure undirected proxies received by ASA are formally counted.

7. Proxy voting and notification

ASA strongly supports the retention of the existing proxy voting system, although there needs to be an improved ability to electronically audit contested voting outcomes. Given that proxy voting closes 48 hours before the AGM commences and ASA typically represents three to five times as many shareholders who attend AGMs, ASA expects to be informed of our proxy position the day before the AGM.

8. Public disclosure of aggregate proxy position

The overall proxy position on a particular item of business should be displayed on a screen at the AGM ***before*** the chairman calls for questions and comments. This is to allow debate to flow as to the reason for any material "against" votes and also to give shareholders more time to consider calling a poll. A useful additional disclosure to gauge retail shareholder sentiment would be for companies to disclose, both at the AGM and later to the ASX, how many shareholders have voted "for", "against" and "open" on a particular resolution. The undirected proxies held by the chairman should be listed separately to other "open" proxies and these should not be included in any tabulation of "for" votes unless actually voted in a poll. The special voting surrounding the remuneration report ("two strikes") should also be explained to shareholders in the notice of meeting and at the AGM.

PART C: EXECUTIVE REMUNERATION

1. Presentation of remuneration report

First and foremost, a remuneration report should be readable, transparent and understandable for investors with no material omissions. Statutory reporting requirements should be adhered to without simultaneously overwhelming shareholders with an excessively long report.

2. Long-term alignment with shareholders

The most important objective of any remuneration structure is to attract and retain superior executive talent which operates in an environment with long-term financial alignment with shareholders. ASA will expect financial performance, shareholder reward and executive remuneration to have a logical relationship.

ASA requires that at least 50% of a CEO's total potential pay should be genuinely at risk. Equity bonuses should only accrue and vest if the company has financially out-performed an appropriately selected peer group over a period of at least four years, but preferably five years.

3. CEO remuneration

The CEO should have the largest component of at risk pay amongst the key management personnel (KMP). Salaries may rise with market capitalisation, but the financial performance, size, competitiveness and complexity of a company's operations should be a key determinant.

ASA is opposed to short-term incentive (STI) payments for CEOs. Where they do feature in a three-tiered pay structure, the STI opportunity should not usually exceed base pay.

ASA policy is that maximum annual total pay for any Australian-based CEO should be related to performance. As a general rule the adequacy of performance is assessed by comparative analysis relative to prior years, industry, the type of business environment and exogenous macroeconomic factors.

The overall balance of an executive package will differ from company to company and ASA monitors take into account company specific arrangements when making recommendations in a Voting Intentions report ahead of an AGM.

Whilst many companies opt for a one third equal split between fixed, STI and long-term incentives (LTI), ASA policy is for companies to minimise or even eliminate the STI for the CEO where the split should be up to 50% fixed, with a majority at risk, primarily through the LTI.

4. STI payments

ASA is broadly opposed to STIs, but we acknowledge they are widely used by ASX 200 companies. If there are to be STIs, a majority of the award should be based on verifiable financial performance metrics. If non-financial measures are included, (safety, staff turnover, reputational, customer satisfaction, market share and risk management issues) these must be disclosed, even if retrospectively. For the CEO and other KMP, at least 50% of any STI award, if available, should be paid in equity with a minimum two-year holding lock. Up to 50% can be paid as cash.

5. LTI payments – performance periods

From the shareholder's point of view the LTI is the most important component of any remuneration package, even though international research has shown that executives prefer to receive fixed cash payments and value these more highly than the various accounting treatments of LTI schemes.

Since 2004, ASA has opposed many remuneration reports citing, usually amongst other factors, the lack of an LTI performance period which extends to at least four years, but preferably five years. We continue to hold to this position and note the market is moving to longer term incentive schemes.

ASA will continue to take into account performance periods together with actual performance hurdles. ASA also requires deferral of some part of any LTI award for two years after the shares have vested.

6. Retesting of incentives

The ASA is generally opposed to "re-testing" of at risk executive incentive schemes which fall short of performance hurdles over the initial performance period, which should be at least 4 years. Where there is retesting, it should only be for one year and require all performance hurdles over the extended period to be met, including making up any shortfall in previous years. However, this is discouraged where an executive is receiving an LTI grant every year as there should be no more than 5 different annual grants in play for an executive at any point in time. Where an executive receives a single LTI grant at the commencement of their contract, retesting can be extended beyond the 5th year, provided all performance hurdles are met.

7. Relative TSR, negative TSR and absolute TSR

ASA requires companies to have at least two hurdles for an LTI scheme and one of them should always be based on Total Shareholder Return (TSR) which reflects share price performance plus dividends paid. However, where relative TSR is the measure, there should be no out-performance bonuses paid if shareholders experience negative TSR in nominal terms over the performance period, which should be at least four years. If companies eliminate bonuses for negative TSR, ASA will support LTI schemes with a straight absolute TSR requirement, provided there are appropriate hurdles. As an example, vesting could commence with 10% compounding annual TSR over a four or five year performance period and provide 100% vesting if annual compounding TSR exceeds 20%. However, any absolute TSR measure should only apply to a maximum of 50% of the LTI award.

8. Comparator groups and benchmarks for relative TSR measurement

When measuring relative TSR, any comparator group should not be the ASX 200 index where a rising market can benefit all companies. For determining out-performance bonuses, ASA requires comparator companies from similar industries or a specific index such as Financial Services or Resources. Any comparator group should include key competitors and preferably at least five companies, including relevant companies listed on foreign exchanges. The performance of the comparator group should be graphically presented in the annual report.

9. Vesting of equity grants when out-performance

ASA has long maintained that LTI awards should not commence unless performance is ***above*** the 50th percentile of the peer group over a minimum four year period. Our preferred position is 30% vesting at the 50.1 percentile, rising with a sliding scale of 2% vesting for each additional percentile such that only CEOs who exceed the 85th percentile will receive 100% of the potential award.

10. Dividends on performance rights

Dividends must not accrue on unvested shares for either an STI or an LTI. Dividends can accrue on fully vested, but deferred, equity from an STI award. Similarly, once an LTI has irrevocably vested, the executive can accrue the benefit of any dividends paid even if there is a holding lock. ASA requires the cash payment of any dividend benefit to be deferred or locked up until the vested share is also unconditionally available to the executive.

11. On-market purchases vs newly issued equity

Companies have not proved to be very effective purchasers of their own shares on the market for the purposes of executive incentive schemes. The required disclosure of such purchases is also poor, as opposed to the daily disclosures of shares purchased in a buyback. Therefore, ASA prefers that companies issue new shares at the time incentive schemes vest, as this also makes the question of dividends on un-vested shares easier to manage. These new shares will be included in the 15% cap on selective placements in any 12 month period and ASA prefers that they are not pre-approved for this purpose.

12. Opposition to underlying earnings as a performance metric

Where earnings per share is a performance metric for a CEO, ASA requires this to be based on statutory profit, rather than any form of “underlying” or “normalised” profit measure. Shareholders lose real money with write-downs, restructuring costs and other one-off items, so these should not be excluded from any bonus calculation.

13. Other LTI performance hurdles

Return on assets (ROA) is a measure which may be suitable for some companies, such as banks. However it needs to be assessed by consideration of other risk ratios, such as those for credit, interest rate margins, liquidity, foreign exchange and off balance sheet exposures.

Return on capital employed (ROCE) is a measure which is suitable for some sectors such as real estate trusts or for divisional executives in conglomerate structures, but the composition of the return if it includes revaluations from equity accounted investments should be adjusted to reflect that such revaluations may not be realised

A return on equity (ROE) target can be appropriate where it can be demonstrated that the target hasn’t been achieved by excessive gearing, or by a capital restructuring (ie share buyback). If this measure is chosen it should be absolute, not relative, in view of the many different capital structures across companies.

Cash generation is often the best sign of business success so an appropriate cash flow metric may also be used.

Non-financial metrics in an LTI scheme should be limited to a small minority of the award. The ASA requires these to be focused on the STI. However, if companies do not have an STI scheme it is acceptable for some non-financial measures such as defined market share, customer satisfaction, safety, diversity, production numbers, unit costs, minerals reserves, succession planning and the like to be included in the LTI metrics.

14. Executive sign-on benefits

ASA opposes the payment of sign-on benefits for newly hired executives. Where negotiations unavoidably require compensation to be paid for foregone incentive payments, these should be fully disclosed when the executive is hired. These should never be paid in cash, but should instead be structured as deferred equity-based payments with payments for good performance over the longer term.

15. Termination payments

ASA supports the move to rolling contracts for CEOs. We oppose termination benefits which exceed the 12 months fixed pay Corporations Law requirement which, in any event, requires shareholder approval. After an initial period of appointment (ie two to three years) for a senior executive, notice periods should not exceed six months. If departing executives receive any pro-rata payments for unvested LTI schemes, these should be clearly disclosed as termination benefits. ASA opposes any ex-gratia payments to departing executives over and above their contractual entitlements.

16. Treatment of incentive schemes in takeovers

ASA has been concerned by past practice which has seen CEOs greatly enriched through the full vesting of incentive schemes in a takeover or “change of control” event. ASA is opposed to automatic full vesting in these circumstances as it can distort the decision-making process. In relation to non-financial metrics, we prefer pro-rata vesting based on past rewards.

Any early vesting arrangements for KMP in takeover or merger situations must be comprehensively disclosed when the scheme is approved and in the annual remuneration report. The premature conclusion of a CEO contract should not see automatic full vesting, but rather a pro-rata approach taken based on the time remaining, whilst also considering the performance impact of the control transaction.

ASA recognises that some board discretion is appropriate in determining the outcome of executive pay arrangements in change of control transactions.

15. Calculation and valuation of share grants

The shift away from LTI schemes involving traditional option grants to free shares, performance rights or so-called zero exercise price options (ZEPOs) has created additional complexity for both the valuation of any equity grant in the accounts and the determination of the number of free shares to be issued.

The systems employed to calculate the number of ZEPOs to be issued needs to be clear and equitable. ASA policy is for a less opaque approach such as the number of ZEPOs to be issued being derived from a simple public formula which references the current market value. In the case of existing contracts, ASA requires additional disclosure which measures the number of shares to be issued based on market value, in addition to other measures such as “fair value”, where the risks of not achieving the targets are discounted.

For new contracts, ASA requires companies to solely reference any annual award of performance rights against the prevailing market price. For example, an ASX 50 CEO could be contracted to receive $1 million worth of performance rights each year on a rolling four year LTI plan. The number of rights issued would simply be $1 million divided by the average price of the shares in the two month period up until the issue of the notice of meeting. The formal accounting valuation of the incentives will be driven by the prevailing accounting standards, but ASA requires the actual number of performance rights issued to be referenced against the prevailing market value.

16. Loans to executives

Whilst the move to free equity in bonus schemes has seen a reduction in company-funded loans to allow executives to buy shares, some companies still have such arrangements. ASA will regard any such scheme where the loans are non-recourse, interest free and can be forgiven in the case of poor performance as a negative in considering how to vote on remuneration reports and the issue of shares or rights.

17. Disclosure of material margin loans

If a company has lent funds to one if its directors or KMP, then this must be disclosed in the annual report. Similarly, if an executive or director is a substantial shareholder with more than 5% of the company's shares, any margin loan against this should be disclosed to the board and/or the broader market in accordance with ASX Listing Rule 3.1.

18. Voting policy in relation to the "two strikes" regime

If a company receives a first strike with 25% of the voted shares against the remuneration report, ASA will undertake engagement with the company to secure improvements the following year. ASA supports the "two strikes" regime, but regards the decision to vote in favour of a board spill after a second strike to be a substantial step only to be taken in extreme circumstances. Calling an EGM to spill an entire board can be a highly disruptive event for a company. ASA acknowledges that the threat of this happening has led to substantial pay reform in Australia. ASA policy regarding a vote on a board spill will be determined by the willingness of a board to accept the need for review and change to remuneration structures.

PART D: CAPITAL MANAGEMENT

1. Treating all shareholders equitably

When raising capital, devising dividend policy or considering other capital management issues such as buybacks, directors must always strive to treat shareholders as equitably as possible, including minority shareholders, retail investors, institutions, directors, executives, staff and foreign investors.

2. Dividend policy

ASA dividend policy is for a majority of distributable earnings to be paid to shareholders as dividends. Boards should have a clear and consistent policy in this regard. Where franking credits have been generated, ASA believes public companies should strive to distribute as many of these as possible to Australian resident shareholders within the constraints of the company's balance sheet and cash requirements for investment. Residual franking credits held after the final dividend has been paid should also be routinely disclosed in the five year summary contained in the annual report. Dividend reinvestment plans (DRPs) are appropriate when companies need to retain some earnings and can come with an appropriately modest discount to VWAP formula in order to encourage participation.

3. Respecting the property rights of shareholders

All shareholders are entitled to be able to retain their percentage holding in an ASX-listed company without being diluted or squeezed out through a capital raising. This is a fundamental property right too often ignored under Australia's highly flexible capital raising rules. When raising capital, companies should do so on a pro-rata basis to all shareholders with the ability for non-participants to be compensated through a single bookbuild if they renounce their entitlement.

4. Selective placements

ASA is opposed to selective institutional placements as these do not respect the property rights of existing shareholders to retain their proportionate stake in the company. The reason for any placement should be clearly explained to retail investors. The introduction of a new strategic cornerstone investor can be secured through a placement, but only if there is a compelling commercial argument. Such issues should be priced above the prevailing market price and should not surrender the ability of shareholders to receive a subsequent change of control premium.

5. SPPs

Boards must offer retail investors a SPP after any selective placement, on the same or better terms than the institutional offer. Individual shareholders should be offered the maximum $15,000 investment. Participation will always be stronger and applications will arrive earlier if there is discount to volume weighted average price (VWAP) formula in addition to any fixed price component. If the size of the SPP is to be capped, it should reflect the percentage of the register owned by retail investors (ie, if a company is seeking to raise $100 million and retail investors collectively own 40%, it should be a $60 million placement and a $40 million SPP) to minimise the prospect of retail investors being diluted as a class.

6. Renounceable pro-rata entitlement offers

ASA policy for raising capital is to use pro-rata renounceable entitlement offers as this method treats all shareholders equally and avoids any dilution for investors who choose to participate. The form of renounceability is important. On-market "rights" trading is in decline but still should be offered where practicable. In order to maximise compensation for non-participants, a single bookbuild combining the institutional and retail shortfall should be conducted at the conclusion of the offer. Market practice has shown that earlier institutional bookbuilds where the offer is accelerated, tends to deliver higher returns than retail investors receive in any later offer. Therefore, ASA does not support separate bookbuilds.

7. ASA response to unfair capital raising structures

ASA notes that retail investors were diluted out of more than $10 billion worth of value during the raft of capital raisings which occurred in the immediate aftermath of the global financial crisis. The primary causes were discounted institutional placements with no follow-up SPP, unfairly restricted SPPs, a lack of renounceability in entitlement offers, separate bookbuilds to deal with institutional and retail shortfalls, poorly marketed retail offers and limits on the ability of shareholders to apply for additional shares in entitlement offers. Having learnt all these lessons and with corporate balance sheets now rebuilt, ASA is concerned about ongoing unfair treatment of retail investors in capital raisings. When this occurs, ASA will consider opposing incumbent directors seeking re-election at the next AGM. In particularly egregious cases, ASA will consider supporting alternative candidates for the board if they are committed to the fair treatment of retail investors in capital raisings.

8. Non-renounceable entitlement offers

Non-renounceable offers have declined in recent years but they are still preferable to institutional placements. However, if an offer is to be non-renounceable, retail investors should be able to make unlimited applications for "overs" or "additional shares" to take up any lapsed entitlements from other retail investors. This facility minimises the dilution of retail shareholders as a class.

9. Disclosure of allocation and scale-back policy

When raising capital through an SPP or entitlement offer with “overs”, the documentation should clearly enunciate any scale back policy which will apply in the event of applications exceeding the new shares which are available. And when disclosing the outcome of such offers, boards should clearly explain the scale back formula including disclosures such as the number of shareholders who participated and the amounts allocated to “overs”. ASA requires a scale back formula which reflects the size of a shareholder’s existing holding, rather than the size of any application for new shares. Therefore, larger retail investors should receive larger numbers of additional shares than someone with an unmarketable parcel. However, there is also merit in allowing the smallest investors to lift their holding to the marketable parcel threshold of $500 as a base case where “overs” or SPP applications are being scaled back.

10. Disclosure of fees paid when raising capital

ASX listed companies have paid excessive fees when raising capital in recent years, often with poor disclosure. Any agreements with investment banks or under-writers should be fully disclosed to the market at the time of the capital raising announcement. This disclosure should include the total dollar figure in costs, the percentage or fixed fees to be paid for each component of the capital raising and the total costs as a percentage of the funds raised.

11. ASX Onmarket Bookbuilds

ASA is a public supporter of the new ASX Onmarket Bookbuilds service as it uses technology to potentially lower the cost of raising capital and make the capital raising process fairer and more transparent. Companies which use this service should be able to save on fees to intermediaries and also offer new shares to a wider pool of investors, including eligible retail investors, once the system is better understood and more established. There is merit in exploring legislative reform which facilitates direct retail participation in bookbuilds associated with capital raisings

12. Communicating with shareholders when raising capital

Retail investors often don’t act in their best interests when presented with an attractive in-the-money capital raising opportunity. Therefore, companies are encouraged to actively market such offers to small investors. A good example is the sending of a reminder email shortly before the offer closes. Similarly, boards should consider taking out newspaper advertisements, issuing press releases or engaging with prominent private client retail brokers if there are early signs that an in-the-money retail offer won’t be fully subscribed.

13. Managing un-marketable parcels

Companies are quite within their rights to manage down the size of their share register, especially after demergers or takeovers which create large numbers of holders with unmarketable parcels. It is also acceptable for the default position to be that those who do nothing have their shares sold. However, the document advising of this which is sent to holders with parcels worth less than $500 should always include a reply paid envelope to make it easier for small investors to retain their shares. This is especially the case with poorly performing companies which have created unmarketable parcels through value destruction and may have shareholders who wish to take tax losses at a time of their choosing.