

# Australia

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Australia

#### 1.1 Background

The basic rights of shareholders and duties of directors are contained both in the *Corporations Act 2001* (Corporations Act) and in the common law. Before the enactment of this legislation there was an economy-level code system and prior to that a state-based system. Financial and non-financial reporting requirements are contained in the Corporations Act, in accounting standards and in the Australian Securities Exchange (ASX) Listing Rules.

The Australian Securities and Investments Commission (ASIC) is an independent statutory authority tasked with enforcing compliance with these laws. As corporate regulator, ASIC also sets standards, issues best practice guidelines and, together with the ASX, has a key role in delivering information to the market. The Australian Prudential Regulation Authority (APRA) maintains prudential standards concerning corporate governance arrangements for authorised deposit-taking institutions and risk management standards for general insurers.

The ASX, the largest financial market in Australia, acts as co-regulator in respect of a range of market issues. This occurs primarily through enforcement of the ASX Listing Rules, which deal with such matters as audit committees, continuous disclosure obligations, reporting requirements and rules affecting dealings in listing securities. However, the recent government decision to transfer responsibility for real-time supervision of trading activity on Australia's domestically licensed markets to ASIC will impact on ASX's role in respect of listings, particularly in respect of detection of events like insider trading.

Voluntary industry codes of corporate governance are also common.

#### 1.2 Trends

The number of publicly traded companies listed on the ASX has increased over the past five years, from 1,774 in 2005 to 2,198 in 2009. Between 2006 and 2008, the number of new listings was steady, with 222 listings in 2005, 227 in 2006, 284 in 2007 and 236 in 2008. The number of new listings declined sharply in 2009 to 45, due to volatility arising out of the Global Financial Crisis (GFC).

In 2005, total market capitalisation was A\$960 billion. Between 2006 and 2007, market capitalisation rose from A\$1.2 trillion to A\$1.5 trillion. From 2008, market capitalisation fell to A\$1.4 trillion, crashing to A\$1.098 trillion in 2009. Again, the volatility associated with the GFC was the reason.

### **1.3 Key Corporate Governance Rules and Practices**

Please see Key Corporate Governance Rules and Practices in Australia, p. 57.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

The Treasury has portfolio responsibility for the development of corporate governance policy, including any changes to the legislative structure. Under the Australia Constitution, the Governor-General is responsible for making regulations, on the advice of the relevant Minister.

In some circumstances, ASIC has discretion (both specific and general) to exempt persons or classes of persons from compliance with the law. ASIC is also active in issuing regulatory guides, which, while not legally binding, provide important guidance as to how ASIC will exercise its powers.

The ASX makes and administers operating rules for listed companies. The ASX Council publishes the *Corporate Governance Principles and Recommendations* which provide for specific corporate governance requirements. For listed entities, the principles must be reported against in annual reports on an 'If not, why not' basis.

### **2.2 Enforcement of Corporate Governance Rules**

Corporate governance rules can either be enforced through Corporations Act-based legal action or through market-based actions. ASIC can choose to take an enforcement action for breaches of the Corporations Act. A summary of recent ASIC actions is provided below in section 6.2.

In financial years 2008/2009 and 2009/2010 to date, ASIC commenced eight actions against corporations and directors alleging breach of directors' duties and dishonest conduct. One action was commenced in relation to continuous disclosure. In 2008/2009 ASIC also disqualified 49 people from managing corporations for periods of up to five years. Without needing to take enforcement action, ASIC also had various corporate documents, including notices of meeting, amended to improve the disclosure of information to shareholders.

Companies must report each year against the *ASX Corporate Governance Principles Recommendations*. Under ASX listing rule 17.12, the ASX may remove a company from the official list if, in the ASX's opinion, the entity breaks a listing rule. Since July 2008, there have been three companies delisted at ASX's discretion under listing rule 17.12. The bulk of delistings take place following a corporate transaction, at an entity's own request or for failing to pay annual listing fees (mainly due to ceasing to operate).

### **2.3 Assessment of Corporate Governance Practices**

Australia undertook a self-assessment in 1999 based on a prototype Report on the Observance of Standards and Codes (ROSC), although this pre-dated the current assessment framework (introduced in 2001). The International Monetary Fund (IMF) undertook an informal assessment on selected issues in the corporate governance framework as part of the Financial Sector Assessment Program process in 2005-06.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

The Australian Institute of Company Directors (AICD), the largest representative organisation for directors, provides links to information, educational activities, corporate governance guidance for directors and lobbying and advocacy roles. Guidance on good corporate governance is also provided by a range of industry associations. Much of the guidance provided by these bodies is publicly available and in many cases free of charge. While director training is not compulsory, a number of private sector organisations (for example, the AICD and the Chartered Secretaries of Australia) do run such programs, and continuing education for directors is strongly encouraged by the regulator and private organisations.

### **3.2 Media**

The financial press often reports on issues of corporate governance and legislative and private sector reforms in this area. However, there are no educational programs which focus specifically on corporate governance awareness for journalists. Topics which have received recent coverage include executive remuneration and the ASX's recently announced initiative to improve the number of women on boards.

### **3.3 Educational System**

Although mainly found in the Law, Commerce and Accounting areas, a number of undergraduate and postgraduate tertiary programs offer corporate governance components. The teaching of corporate governance is also a component of many of Australia's MBA courses.

### **3.4 Stock Exchange**

The ASX does not provide compulsory training for company directors. The educational programs provided by the ASX are focused foremost on retail and institutional investors. As mentioned above, the ASX is responsible for the *Corporate Governance Principles and Recommendations* and other publications promoting good corporate governance.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

At the Commonwealth level, state-owned enterprises (SOEs) are governed by the *Commonwealth Authorities and Companies Act 1997* (the CAC Act). The CAC Act sets out the financial management, accountability and audit obligations of Commonwealth statutory authorities and companies the Commonwealth controls. In particular, the CAC Act provides: the reporting and audit obligations for Commonwealth authorities; standards of conduct for officers of authorities; and requirements for ensuring that Commonwealth authorities and wholly-owned Commonwealth companies keep Ministers and Parliament informed of their activities.

The CAC Act requires reporting in addition to the enabling legislation or company constitution. For example, the CAC Act bodies must give annual, operations and auditor reports to the relevant Minister; must inform the Minister of significant events, for example the acquisition or disposal of significant property; and, for Government Business Enterprises, must provide a corporate plan at least annually.

The Commonwealth's corporate governance framework is designed to increase levels of accountability and transparency across all Commonwealth companies and authorities.

## 4.2 Family-Controlled Enterprises

There are no specific corporate governance problems regarding family-controlled enterprises in Australia. Australia's listing rules do not discourage family-controlled enterprises from becoming publicly listed for reasons of corporate governance. The majority of Australia's corporate governance obligations are imposed on all companies, whether privately held or publicly listed, through the Corporations Act. The *ASX Corporate Governance Principles and Recommendations* are not mandatory, and compliance is only required to be disclosed on an 'if not, why not' basis.

## 5. Role of Professional Service Providers in Corporate Governance

Professional service providers play a significant role in the dissemination of corporate governance information. Ratings agencies and some analysts make public their findings, however accounting, auditing and legal firms may be employed on an internal basis and therefore their work will only be made public with the approval of the employing entity. Law firms, auditors and accountants are usually employed to provide either a financial audit or a systems audit, which often include a corporate governance component. In addition, the use of proxy advisers and remuneration consultants is becoming more common.

## 6. Recent Developments in Corporate Governance

The *Corporations Amendment (No. 1) Act 2009* provides that a person is disqualified from managing corporations in Australia if the person has been disqualified from acting as a director of a foreign company by a foreign court. Currently, the regulations only recognise Court orders made in New Zealand.

The *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* strengthens the regulatory framework relating to the payment of termination benefits to company directors and executives. The Act restricts termination benefits by: reducing the threshold for shareholder approval from seven times total annual remuneration to one year's average base salary (noting that base salary is commonly only a small proportion of total remuneration); ensuring that termination benefits that exceed the threshold will require approval, regardless of whether they are made to directors or executives; and expanding the definition of termination benefits to cover all payments made at termination that are not bona fide entitlements.

The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* received royal assent on 28 June 2007. Prior to this amendment, the Corporations Act provided that shareholder approval was not needed for a transaction involving giving a benefit to a director or spouse where the benefit did not exceed A\$2,000. The amended section now: (a) applies to any related party (not just a director or spouse); and (b) provides that member approval is not required where the amount or value of the financial benefit is less than or equal to the amount prescribed by the regulations—currently A\$5,000.

The *ASX Corporate Governance Principles and Recommendations* that provide guidance to companies in implementing good corporate governance are currently being revised. The ASX is consulting on a recommendation requiring boards to implement board diversity goals, particularly in reference to gender, and then to report against them in their annual report. It is expected to be instituted from 1 January 2011.

## 6.1 Corporate Governance Developments

During 2008-09, 72 corporate takeovers and mergers were announced in Australia, down from 109 in 2007-08. One quarter of the deals required government approval of a foreign investment. All of the seven transactions with values over A\$1 billion involved foreign parties. The Takeovers Panel was involved in 20% of transactions. More than two-thirds of transactions involved takeovers, with the average delay for a scheme of arrangement compared with a takeover being one month.

In 2009, the Productivity Commission (PC), at the request of the Australian government, conducted a broad-ranging inquiry into the regulation of executive remuneration. The PC reported on 4 January 2010. The government supports the majority of the PC's recommendations, including the "two strikes" proposal, which will strengthen the non-binding shareholder vote on remuneration and sets out consequences where companies do not adequately respond to shareholder concerns on remuneration issues. The proposed changes will also, amongst other things: require a board to obtain shareholder approval before declaring that there is "no vacancy" on a company's board; reduce conflicts of interest by preventing key management personnel from hedging the incentive components of their remuneration or voting on their own remuneration arrangements; and require proxy holders to vote all directed proxies as designated. Legislation giving effect to the reforms will be introduced this year, following public consultation. The proposed changes follow reforms to Australia's system of termination benefits passed in 2009 (see Section 6 above).

The Australian government has provided funding to the St. James Ethics Centre over the past three years to assist in the Centre's efforts to expand the number of Australian companies that are actively engaged in identifying and adopting more responsible business practices. An Australian Global Compact Focal Point and an Australian Global Reporting Initiative Focal Point are now established in Australia. In February 2009, the Australian government also agreed to provide funding to the Responsible Investment Association of Australasia (RIAA) to assist it in its efforts to create a centre for responsible investment education and training.

## 6.2 Enforcement of Corporate Governance Rules

In 2009, ASIC unsuccessfully took action against Fortescue Metals Group and its Chief Executive Officer alleging breaches of the corporate governance law as a result of announcements to the ASX in 2004. This case raised important issues as to the proper interpretation and application of provisions of the Corporations Act that govern company announcements such as the misleading and deceptive conduct provisions, the continuous disclosure provisions and directors' duties. ASIC has announced its intention to appeal.

In January 2010, ASIC launched criminal proceedings against three former directors of Opes Prime, each of whom was charged with breaching their duties under the Corporations Act. ASIC alleges that the directors signed documents agreeing to a loan with ANZ bank shortly before Opes Prime collapsed, pledging the company's assets as security to meet the obligations of a third party. As a result, ASIC alleges that the directors were intentionally dishonest in signing this contract and failed to discharge their duties in the best interests of the company; and that the directors dishonestly used their positions to directly or indirectly gain a personal advantage. A committal mention will be held in late May 2010.

In April 2009, the former non-executive directors and executives and James Hardie Industries were found to have breached the Corporations Act when making statements about the adequacy of asbestos compensation funding. James Hardie Industries NV was also found to have breached

its continuous disclosure obligation in 2003. In August 2009, the New South Wales Supreme Court imposed pecuniary penalties and disqualification orders against the company officers.

ASIC commenced civil penalty proceedings in 2007 against the former chief executive of the Australian Wheat Board (AWB) and five other former AWB directors and officers, alleging they had breached their fiduciary duties under the Corporations Act concerning AWB's involvement in the UN Oil-For-Food Programme. ASIC alleges that the defendants contravened sections of the Corporations Act which require company officers to act with care and diligence, and which require company officers to discharge their duties in good faith and for a proper purpose. ASIC is seeking declarations that each defendant has breached the law, the imposition of pecuniary penalties and disqualification of each defendant from managing a corporation.

### **6.3 Current Issues and Challenges for Corporate Governance**

#### **6.3.1 Challenges**

A question remains as to how to deal with the interests of multi-stakeholder corporations. For example, should the ultimate aim of the board be to maximise and distribute shareholder profits or to safeguard assets for the benefit of creditors. In addition, how important should the role of the community be in understanding and organising stakeholder priority. Another challenge facing Australia's corporate governance system is whether shareholders participate to a sufficient level to assist good corporate governance practices. The inclusion of an engaged shareholder group will encourage good corporate governance and hold directors to a high standard.

#### **6.3.2 Priorities for Reform**

Priorities for reform include the implementation of the new supervisory role for ASIC over Australia's domestically licensed financial markets. Legislation was passed in early 2010 to give effect to this change. Draft regulations are currently out for consultation. The transfer of supervisory responsibility to ASIC is expected by the end of 2010.

As noted above, the Australian government intends to introduce legislation in 2010 to address issues identified in Australia's remuneration framework. In particular, the reforms will improve board capacities; reduce conflicts of interest; encourage stakeholder engagement; and improve relevant disclosure.

#### **6.3.3 Financial Crisis**

Australia's corporate governance framework stood up well during the GFC, and as such wholesale changes to the framework are not considered necessary.

The Federal government introduced new legislative requirements to regulate the use of short selling in Australia. The requirements included a ban on naked short selling, subject to some minor exceptions, and the imposition of specific reporting obligations in relation to covered short sales. In September 2008, ASIC also took emergency action to temporarily ban short selling in Australia, including naked short sales and covered short sales. The ban on covered short selling of non-financial securities was lifted on 19 November 2008, while the ban on covered short selling of financial securities was lifted on 25 May 2009.

The GFC also highlighted the importance of ensuring that remuneration packages are appropriately structured and do not reward excessive risk taking or promote corporate greed. Australia has taken action to address those concerns (see Section 6).

## Key Corporate Governance Rules and Practices in Australia

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for meetings?	X		CL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL	
3. Must company transactions with its insiders be on a non-preferential basis?		X		There are a number of rules relating to when a related party transaction can be approved, including shareholder approval, but there is no requirement that the transactions be on a non-preferential basis.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	If there is no provision in the company constitution then at least 75% of the members of the class whose shares are being altered need to agree to the change. However, the company constitution may outline a different procedure.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?		X		SLR: A board is not required to have a certain percentage of independent directors, however the ASX Principles suggest that a majority of directors are independent. As described above these principles require listed entities to report on an <i>If not, why not</i> basis.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		GP	A number of listed entities have independent remuneration committees which oversee these issues. Whilst this is not mandatory and is not undertaken by all companies it is a feature of general practice. Under the Listing Rules, ASX 300 companies must have an audit committee which is comprised of a majority of independent directors.
7. Do independent directors decide what information the board receives from management?		X		
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		GP	
9. Are all board members elected annually?		X		
10. Does the board oversee enforcement of a company code of conduct?			GP	A director appointed between annual general meetings (AGMs), to fill a vacancy, must stand for election at the next AGM. All directors of listed companies (excluding the managing director) must stand for re-election every three years.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X			Australian Accounting Standards Board requirement.
12. Are the identities of the five largest shareholders disclosed?	X		SLR	Under Listing Rule 4.10 a listed entity needs to provide the names of the 20 largest holders of each class of shares and the number and percentage of capital held by each of them.

Element	Yes	No	Source(s) of Rule	Comments
13. Is compensation of company executive officers disclosed?	X		CL	The Corporations Act provides for particular executive remuneration reporting in annual reports. As outlined above this process is currently under review.
14. Are extraordinary corporate events disclosed?	X		CL	The annual report must give details of any significant changes in the entity's state of affairs during the year, including any significant changes in the nature of the entity's activities. In addition listed companies are subject to continuous disclosure requirements relating to certain significant events.
15. Are risk factors disclosed in securities offering materials?	X			There are a number of different requirements for disclosure statements, including forecasting risk factors.
16. Are transactions of a company with its insiders disclosed?		X		These types of transactions must be disclosed as part of the entity's financial statements in compliance with the accounting standards. They will often be disclosed in other ways, for example through the requirement that shareholders vote on the related party transaction.

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*