March 2009

AMP capital INVESTORS

Corporate Governance Report

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Lost votes: finding a way forward

Three years have passed since AMP Capital Investors Limited ("AMP Capital") first raised concerns over the issue of 'lost votes'. At the time many market participants were unaware that votes were being 'lost' in Australia. Since then significant progress has been made – in that we now have consensus amongst the various stakeholders that a problem does exist. Positive discussion has been held and steps have been taken, yet without the implementation of a clear solution, the problem continues to exist. The obvious question now is – why? What has blocked further progress and how can we move forward to find a solution?

AMP Capital is concerned that the progress on 'lost votes' appears to have slowed. Given that a broad understanding has been reached; it is time to press forward on a solution. Should any further work be required to convince stakeholders of the true magnitude and precise nature of the problem, then now is the time to undertake that work.

The problem

In January 2006, AMP Capital highlighted concerns over 'lost votes' when it appeared a portion of the voting instructions we had submitted were not being processed, counted and/or reported correctly. A subsequent detailed audit of votes cast on all 1,400 resolutions in the main proxy season of 2005 showed that at least 4% of AMP Capital's voting instructions had been 'lost'.

While the manual nature of the vote-lodgement process, combined with the lack of a clear audit trail, makes it difficult to follow the fate of voting instructions from the point where votes are lodged to the time the company reports the results at its meeting – subsequent discussions with other fund managers have revealed that AMP Capital's experience was not unique.

Further analysis identified a parallel with the UK experience[1], with the various causes for lost votes including:

- The number of shares held in 'pooled' nominee accounts may not be reconciled to the share register and/or stock-on-loan may not be deducted. If, for these reasons, the 'pooled account' votes more shares than are owned, all the account's votes may be rejected.
- As much of the process is still in paper form, proxy forms may simply be misunderstood and hence incorrectly registered or lost in transit.
- Unsigned, unauthorised signatures, spoilt cards or otherwise 'invalid' votes may be rejected.
- Most proxy votes are lodged at the last minute for lodgement, leaving no time to resolve queries.

In a recent edition of the Australian Institute of Company Directors (AICD) Magazine, Stuart Crosby, President and CEO of Computershare Ltd, wrote an article titled, 'Making every vote count'. The article details the complexity of the voting process, stating:

> "That votes go missing is not in dispute. Institutional votes are lost during their passage through the complex chain of ownership and the bevy of different service providers that administer the affairs of institutional investors."[2]

Progress made so far

In June and September 2006, and again in June 2007, the Investment and Financial Services Association (IFSA) held useful 'roundtable discussions'. These were well attended by various representatives from a broad range of interested and affected parties including the ASX, share registries, companies / investor relations, chartered secretaries, custodians, proxy voting services, fund managers and superannuation funds.

The collective recognition by IFSA and Roundtable participants was that the current proxy voting system needed to be improved and various recommendations were considered, including:

- IFSA would request that S&P/ASX 300 companies put appropriate electronic proxy voting arrangements in place as soon as possible.
- An electronic proxy voting capability be developed to provide a meaningful audit trail from issuers and their registrars to shareholders so investors can confidently declare how they voted in any instance.
- The record cut-off date should be extended to provide sufficient time for the reconciliation process to occur.
- Greater clarity and consistency as to how unclear proxy forms are handled.
- A call for a standardised format to be used by issuers when disclosing proxy results to the ASX.

In 2007, the Parliamentary Joint Committee (PJC) on Corporations and Financial Services launched an inquiry into shareholder engagement and participation. In April 2008, the Committee

considered various aspects of the engagement and participation of shareholders in the corporate governance of their 'investee' companies, including the 'efficacy and integrity of different voting mechanisms'. The PJC discussed the findings and recommendations of the IFSA Roundtable; including those centred on permitting the receipt of electronic votes and amending the record-cut-off date.

The PJC also stated that:

> "The committee agrees that the integrity of the proxy voting system could be improved if more companies established an electronic proxy voting capability that provides a clear audit trail. Evidence suggests that the cost is not prohibitive, while processing votes via a paper-based system is outdated and prone to error. The Australian Securities and Investments Commission (ASIC) should confirm that companies are able to do this without amending their constitutions and institutional investors should pressure the companies they invest in to allow electronic proxy voting. The committee is also of the view that changing the record cut-off date might limit mistakes caused by hasty reconciliations. This suggestion should be considered by the government, subject to consultation with industry."[3]

The proposed development of an 'electronic voting capability' may well involve the adoption of the SWIFT Standards[4] that have recently been developed in consultation with issuers, proxy voting agents, regulators, tabulators, institutional investors, custodian banks and central securities depositories. The new set of MX messages automates the entire proxy voting life cycle (from the announcement, voting and result dissemination process), facilitating the 'straight through' processing of proxy instructions between custodian banks.

It does appear that the last frontier in creating a better proxy voting system is for companies to accept and acknowledge electronic proxy instructions in real time. The protocols underpinning the SWIFT proxy messages could be embraced by companies and their registrars, so that AMP Capital, along with other investors, could have confidence that our proxies have been received and processed in accordance with our instructions.

The next hurdle to overcome, as IFSA has observed, is a lack of knowledge of the precise nature of the problem[5]:

> "...we have not had any participant in the roundtable actually say to us, 'the cost of this is prohibitive.' I think what you are seeing is inertia rather than a case of somebody having actually looked into this thoroughly and worked out that this is a massive overhaul of perhaps what they have already got."

Confirmation: votes still being 'lost'

Late in 2008, AMP Capital conducted a further audit of voting outcomes and we believe that votes are still being 'lost' – albeit some for different reasons than those previously identified. We were able to identify further instances where the votes lodged by AMP Capital alone exceeded the total number of votes reported as being received by the company under those categories. This audit highlighted the ever increasing number of ways the current, largely manual, voting system can fail its stakeholders.

Of particular concern has been the handling of some votes by a sample of companies using their own, in-house share registries. In the recent proxy-season, AMP Capital identified occasions where companies provided our proxy voting agent with confirmation of receipt of voting instructions, but then, due to either an ambiguity or misunderstanding, disregarded our votes or allowed them to be voted at the discretion of the chairman.

AMP Capital continues to work with the companies involved and also with our voting agent to identify exactly why our directed voting instructions were instead voted at the chairman's discretion. Our findings on this matter and consequent actions will be discussed in a future edition of this report.

UK votes still 'lost'

For some time the Australian 'lost votes' experience has shown similar characteristics to the UK experience as documented by Paul Myners and the Shareholder Voting Working Group[6]. Interestingly, this group recently revisited this issue, conducting a significant 'proxy vote audit campaign' to determine whether votes are still getting 'misplaced' and if so; how many, why and finally what issuers could do to prevent the leakage of votes.

The proxy voting audit concentrated on five issuers[7], between 25 to 60 institutional shareholders and their global custodians. Despite only 6 – 18% of issued capital being subject of the Audit, significant voting errors were identified, affecting £2.2bn or between 0.1 – 2.7% of issued capital (representing 2.1 – 6.9% of shares voted).

The Audit attributed the £2.2bn voting errors to the following four categories; over-voting (roughly 45%)[8], human error (25%), split voting (12%)[9] and third party issues (19%)[10]. While 'human error' was uncovered at only one issuer in the sample, the value of shares affected was very significant. An observation of the Audit Report is that electronic voting and CREST voting[11] has alleviated some of the errors caused by manual entry; however the CREST voting is not wholly used by institutional shareholders, nominees, and voting agents – as such the report suggests further work could be done to promote CREST utilisation.

A way forward

AMP Capital is keen to work with all relevant parties to seek a solution. While recent progress appears slow, we are pleased to see it continuing, especially as the varied interests of stakeholders (including share owners, voting agents, issuers and registries) makes somewhat harder to agree upon and implement a solution.

Nevertheless that votes can be 'lost' at all is a serious issue. It is our view that the market needs to move forward quickly and work together to solve the problem.

If any major doubt remains as to the significance of this problem, then a public proxy vote audit, similar to that conducted in the UK, could be carried out. However, given the general level of agreement and also IFSA's comment that cost has not be raised as a potential stumbling block, the time has come to press forward on a practical and pervasive solution, probably with electronic-voting as its centrepiece.

AMP Capital continues to talk with industry participants, further raising awareness of the scale of the problem, and looks forward to broad industry agreement on finding a way forward.

Remuneration – Australia in perspective

Much has already been written about the current global financial crisis. Economists such as AMP Capital's Shane Oliver linked the freezing of lending and the disrupted credit flows to a combination of the following four factors – 'financial deregulation', 'the shift from high inflation to low inflation', 'financial innovation' and 'the US housing boom'[12]. On the other hand, the International Corporate Governance Network (ICGN) cited 'corporate governance failings' as another significant contributor to the current woes, claiming that problems have emerged above all because boards failed to understand and manage risk and tolerated perverse incentives"[13].

Various newspapers have opined on the role played by 'perverse incentives', for example stating that:

> "Through nearly two decades of tinkering, each new twist in executive pay has proved flawed. Incentives meant to reward good management have done just the opposite, and efforts to reform the system have in some respects made matters worse. From the bursting of the dot-com bubble to the collapse of companies like Enron and WorldCom, from the rampant backdating of stock options to the current meltdown of the global financial system, the so-called pay-for-performance movement has led to colossal windfalls, reckless risk-taking and fraud".[14]

Financial incentives determine the objectives an organisation pursues, hence impacting the way managers conduct a business. Back as far as 2002, the Berkshire Hathaway Inc Annual Report quoted Warren Buffett (Chairman and CEO) as saying: "The acid test for (corporate governance) reform will be CEO compensation". Buffett's 2006 letter to shareholders further detailed his concerns with regard to US compensation:

> "Too often, executive compensation in the U.S. is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's pay. The upshot is that a mediocre-or-worse CEO – aided by his handpicked VP of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet and Bingo – all too often receives gobs of money from an ill-designed compensation arrangement."

For many years AMP Capital has focused on, voted on, engaged on and reported on issues of executive remuneration. We see the nature of remuneration structures, along with the composition of boards, as the most important governance issue. In turn we have actively encouraged companies to structure overall remuneration to be fair and reasonable and aligned with shareholder interests.

In 2008, falling share-prices and company profits have highlighted the unintended consequences and shortfalls of many current remuneration structures.

- Increasing complexity
- Significant, and often unjustified, increases in fixed pay
- Poor alignment with shareholder interests
- Generous arrangements for termination payments
- The practice of revising or re-testing performance hurdles, when previous hurdles were not met
- Unjustified, substantial sign-on payments
- Significant increases in, or poorly structured, non-executive remuneration

While providing little comfort to Australian investors, the situation does appear to be significantly worse for investors in the US. Conflicts and perverse behaviour have been allowed to flourish in an environment where options had no performance hurdles, CEOs chaired boards, and until recently, US shareholders had no power to vote 'against' directors. Unlike Australian investors, investors in the US have generally had no mechanism by which to pass judgment on the acceptability of executive 'compensation'. It is only recently that US compensation has come under increased scrutiny and 'Say-on-Pay', the US version of Australia's non-binding votes on remuneration reports, is gaining traction.

There have been innumerable examples of excessive remuneration packages in the US, especially since the former New York Stock Exchange boss, Dick Grasso received US$190m in 2003. Over the past century the CEOs of US S&P 500 companies would have earned around 20 times as much as their average employee. In the last decade, this ratio blew out to somewhere between 350 and 400 times. Not surprisingly, US Congress is now focusing on the issue and globally the link between pay and performance is under intense scrutiny.

Wall Street bankers presiding over collapsing banks have been criticised for awarding themselves US$18bn of bonuses. These excesses triggered a backlash from the US President and his announcement that tough new restrictions would limit the executive compensation of financial institutions receiving government assistance; ensuring money that's used as part of a financial stability package doesn't go to line the pockets of a CEO[15].

It has been AMP Capital's long-held view that alignment between the interests of shareholders and management is key. As such, it is vital that appropriate performance hurdles be set. Incentives should ideally be designed to reward future superior performance with a clear link to appropriate relative benchmarks which are

> "... alignment between the interests of shareholders and management is key."

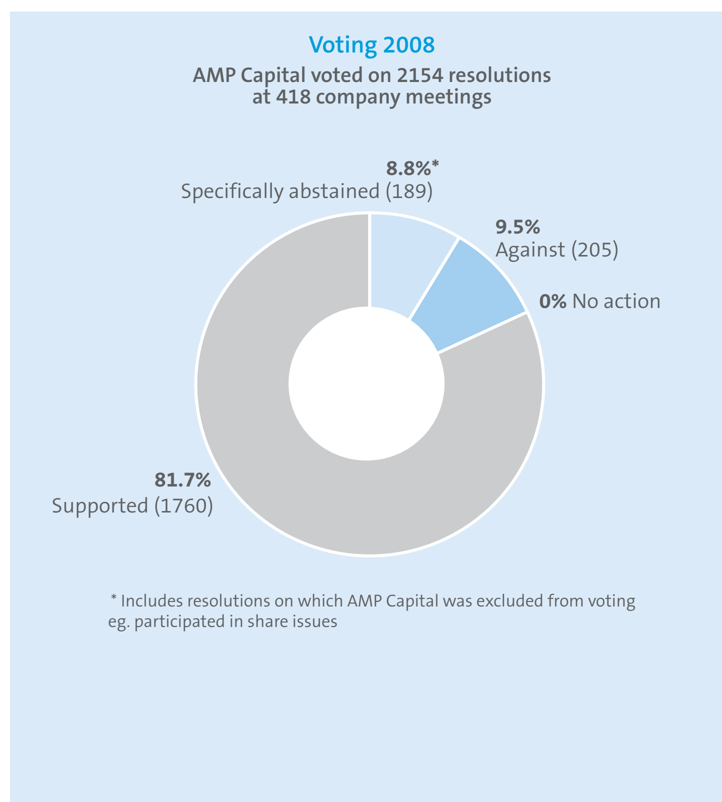
challenging and the achievement of which genuinely reflects an improved competitiveness of the company. Long-term incentive plans for senior executives should also clearly state their objectives, reflect the responsibilities of the executives, be reasonable when compared to the market and be transparent. They should also be of sufficient duration to retain key executives beyond the short-term and should not allow for automatic and full vesting on change of control where poor structure may potentially lead to conflicts of interest. Finally, to maintain their independence, non-executive directors should be ineligible to participate.

POSTSCRIPT: As we write, focus on remuneration by the many stakeholders including media and government, has certainly intensified. The increased emotion means we now face the risk that 'quantum' is given priority in discussions rather than 'principles' and/or the long-term interests of shareholders.

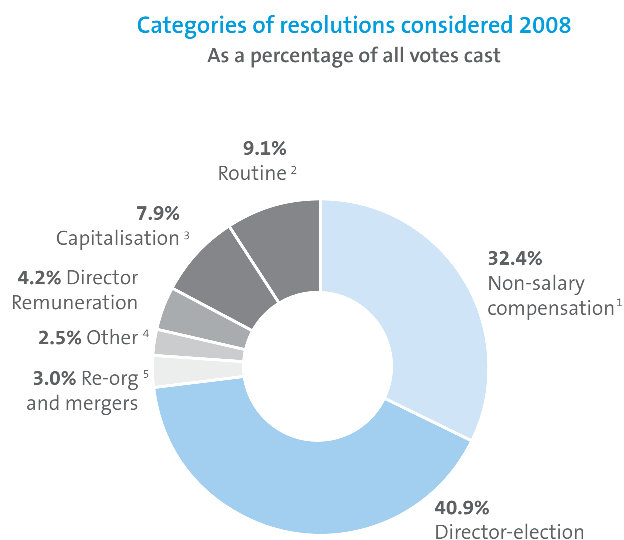
AMP Capital is keen to see the debate around the role played by incentives in the global financial crisis continue, especially in relation to the appropriateness of 'structure and principles'; however a breakdown in the application of 'sound alignment principles' could be confused with a judgement as to the appropriate level of executive remuneration. Our experience is that a failure of the former often leads to the latter and boards have a critical role to play in understanding this and getting the balance right.

Proxy voting report

In calendar 2008, AMP Capital voted on 2,154 resolutions at 418 company meetings. The bulk of resolutions related to the re-election of directors and non-salary remuneration. AMP Capital supported all resolutions at 248 (59%) meetings.



* Includes resolutions on which AMP Capital was excluded from voting eg. participated in share issues



Source: Riskmetrics – Votex Report

1. Relates to remuneration reports employees stock and option plans, various long-term Incentive plans, retirement plans etc.
2. Accepting financial statements, general amendments to constitution, appointing auditors, etc.
3. Approval and ratification for DRP, share issues, placements, etc.
4. Shareholder resolutions (self-nominated directors), board related, anti-takeover provisions etc
5. Acquistions, mergers, asset sales etc.

AMP Capital Investors (AMPCI) Proxy Voting Statistics (2001 to 2008):

	2008	2007	2006	2005	2004	2003	2002	2001
Number of company meetings where votes were submitted:	418	496	413	381	396	336	349	341
Number of resolutions voted on:	2154	2482	2,049	1,824	1,622	1,335	1,700 (est)	1,500 (est)
Meetings where all resolutions supported [by AMP Capital]:	59% (248)	58% (290)	64% (265)	63% (238)	74%	74%	78%	68%
Meetings where incentive issues considered: [*now inc Rem reports]	82% (341)	72% (357)	79% (327)	68% (261)	33% (129)	27% (91)	26% (92)	31% (105)
Meetings where incentive issues not supported [by AMP Capital]:	43% (148/341)	42% (151/357)	42% (139/327)	36% (94/261)	36% (47)	43% (39)	39% (36)	51% (53)
Meetings where remuneration reports considered:	75% (314)	68% (337)	42% (139/327)	57% (219)	n/a	n/a	n/a	n/a
Remuneration reports not supported [by AMP Capital]:	39% (122/314)	36% (120/337)	31% (97/312)	31% (68/219)	n/a	n/a	n/a	n/a

AMP Capital's shareholder activism

AMP Capital is committed to actively encouraging good corporate governance in the companies in which it invests. Whilst our lodgement of proxy votes has an impact on governance, we believe the letters we write and our meetings with company directors are a more constructive and successful form of shareholder activism.

In 2008 AMP Capital wrote around 65 governance-related letters to company chairmen. We are pleased with the companies' positive response to these letters – with many companies addressing our specific concerns and improving governance practices in subsequent years. In addition many company chairmen have accepted our invitation to discuss governance matters further, meeting with us personally to discuss issues of concern. This influence has been constructive, with visible improvements including; greater disclosure and transparency, the appointment of independent directors, improved terms for incentive plans and the abolition of termination benefits for non-executive directors in some cases.

Non-executive director (NED) remuneration

In 2008, 79 (or 3.7%) of all resolutions voted upon by AMP Capital sought approval for an increase in the maximum aggregate level of fees that could be paid to the company's NEDs. This compares to 108 such resolutions (4.5%) in 2007.

Most increases sought were considered reasonable after taking into account various factors including the size of the company, the company's complexity, performance, board composition (including the number of directors and the balance of independent directors), whether options or retirement benefits are paid to directors and the factors put forward by the company to explain the need for the increase being sought.

In line with generally accepted principles of good governance, AMP Capital is not in favour of option grants being made to non-executive directors. It is preferred that non-executive directors be aligned with shareholders they represent rather than potentially being influenced by incentive structures that may not reflect the experience of the shareholders who hold listed securities. Preferably, non-executive directors should be encouraged to invest their own capital in the company or to acquire shares from the allocation of a portion of their fees.

Companies where AMP Capital did not support the increases in NED remuneration included:

Downer EDI Ltd	Kingsgate Consolidated Ltd

In each of these cases, we have communicated our concerns to the company with regard to either the quantum and/or structure of NED remuneration. We also wrote to other companies indicating that whilst we may have supported (or in some instances abstained from voting on) the increases sought, we would have preferred the company to seek smaller, more frequent increases.

Share and option incentive plans

This year AMP Capital submitted votes on 376 incentive-related resolutions at 341 company meetings (not including votes on NED fees and remuneration reports).

Over the full year, AMP Capital voted *against* at least one incentive-related resolution at the following companies:

AJ Lucas Group Ltd	Lynas Corporation Ltd
Albidon Ltd	Marion Energy Ltd
Alchemia Ltd	Midwest Corporation Ltd
Apex Minerals NL	Mineral Resources Ltd
Arasor International Ltd	Neptune Marine Services Ltd
Asciano Group	Nexus Energy Ltd
Atlas Iron Ltd	OM Holdings Ltd
Avoca Resources Ltd	Oxiana Ltd
Boart Longyear Grp	Patrys Ltd
Carbon Energy Ltd	Peplin Inc
Challenger Group Ltd	Perseus Mining Ltd
CMA Corporation Ltd	Prosperity Resources Ltd
Cockatoo Coal Ltd	Riversdale Mining Ltd
Corporate Express Aust Ltd	Select Harvests Ltd
Flexigroup Ltd	Sino Gold Mining Ltd
Heartware Ltd	Straits Resources Ltd
Highlands Pacific Ltd	Sylvania Resources Ltd
Horizon Oil Ltd	Tower Australia Group
IMX Resources NL	Valad Property Group
Karoon Gas Australia Ltd	Virgin Blue Holdings Ltd
Lycopodium Ltd.	Western Areas NL

AMP Capital also specifically abstained from voting on incentive schemes at an additional 30 companies.

We will specifically abstain from voting where schemes contain minor 'flaws', or where it may be the first time we have raised the concern with the company. We find this 'abstention and communication' mechanism more constructive than simply voting 'for' a 'slightly flawed' resolution as it allows us to send clear signals to companies, which can often lead to useful dialogue.

In almost all cases we endeavoured to make contact with the company (usually via a letter to the chairman) to provide reasons for our position.

As investors, we seek to invest in companies that will provide the best relative share-market performance over the long term and as such we prefer that a significant portion of the CEO's remuneration is aligned with that goal.

The underlying reasons for not supporting incentive-related resolutions include:

- Poor disclosure of the terms of the incentive plans.
- Plans are shorter than the desired three-year minimum.
- Plans had no performance hurdles or hurdles that lacked sufficient alignment with the interests of shareholders.

- Plan amendments which were proposed would increase the value to employees, without any corresponding benefit to shareholders.
- Participation of NEDs in executive schemes.
- Plans showed no improvement, despite the company having received comments/input and the matter being not supported previously.

AMP Capital continues to consider how incentive grants should respond upon a change of control at the company. In 2007 we became interested in this feature after seeing instances where company executives and directors engaged in behaviour that could potentially destroy shareholder value while themselves reaping significant personal gains.

Remuneration reports

Since the introduction of the non-binding votes on remuneration reports in 2005, Australian investors now have a mechanism by which to review and comment on the approach to remuneration used by the companies in which they invest.

When reviewing the appropriateness of remuneration reports, AMP Capital generally considers a wide range of factors. Remuneration reports should be concise and facilitate a clear understanding of the company's remuneration policy, providing evidence that the policy is both fair and reasonable and is aligned with shareholder interests.

We particularly look for criteria such as the clarity of disclosure, satisfactory short and long-term incentive and termination arrangements and also appropriate non-executive director remuneration.

Over 2008, AMP Capital submitted votes on 314 remuneration reports, supporting 192 (61%) of them. The remuneration reports AMP Capital voted against (as opposed to either "supporting" or "abstaining") over this period include:

Abacus Property Group	Mesoblast Ltd
Austereo Group Ltd	Neptune Marine Services Ltd
Allco Equity Partners Ltd	Nexus Energy Ltd
Atlas Iron Ltd	OrotonGroup Ltd
Asciano Group	Panoramic Resources Ltd
Aspen Group Ltd	Port Bouvard Ltd
Apex Minerals NL	Perseus Mining Ltd
Babcock & Brown Power Ltd	Primary Health Care Ltd
Babcock & Brown Wind Partners Ltd	Ramsay Health Care Ltd
Bell Financial Group Ltd	Riversdale Mining Ltd
Cabcharge Australia Ltd	Sino Gold Mining Ltd
Challenger Group Ltd	Sunshine Gas Ltd
Cockatoo Coal Ltd	Sylvania Resources Ltd
Crane Group Ltd.	Service Stream Ltd
Energy Resources of Australia Ltd	Transurban Group
FKP Property Group	Ten Network Holdings Ltd
Gindalbie Metals Ltd	Toll Holdings Ltd
Jabiru Metals Ltd	United Group
Kingsgate Consolidated Ltd	Valad Property Group
Leighton Holdings Ltd	Village Roadshow Ltd
Marion Energy Ltd	Wesfarmers Ltd
Minemakers Ltd	Wildhorse Energy Ltd
Mesbon China	Western Areas NL
Midwest Corp Ltd	

AMP Capital voted against remuneration reports which exhibited the following criteria; poor alignment with shareholder interests, inclusion of non-executive directors in executive incentive plans, excessive quantum and poorly structured performance hurdles (eg. absolute rather than relative, not sufficiently challenging, too short-term, purely accounting-based, allow too many opportunities for re-testing etc).

Two other features which have raised concerns are the excessive termination payments (both actual and potential) that were made to some departing senior executives and also the way in which some companies (particularly listed investment vehicles) align senior executive remuneration with the performance of the company's parent entity rather than with the experience of shareholders in that vehicle.

While the remuneration reports of some companies have improved, others did not show sufficient improvement, and so reappear on the list. In addition to those companies named above, AMP Capital also specifically abstained from voting on 76 other remuneration reports, adopting the 'abstention and communication' mechanism mentioned earlier.

Board composition

Board composition continues to be one of the most important corporate governance issue for shareholders. Despite its significance, it is often difficult for shareholders to determine whether they have the right boards governing their companies. The short biographies available in annual reports provide little detail and without being present in the boardroom, shareholders can not observe the dynamics of the board, nor its overall effectiveness. As such, we continue to note with interest the various self-assessments and peer-reviews commissioned by boards, as well as studies conducted by academics and other interested parties.

In any proxy season, most company meetings are Annual General Meetings which require shareholders to vote on the election or re-election of directors. AMP Capital supported the majority of directors seeking re-election. Instances where we voted against a director election included the nominations of directors on the following boards:

Apex Minerals NL	Macmahon Holdings Ltd
Austereo Group Ltd	Riversdale Mining Ltd
Austar United Communications Ltd	Service Stream Ltd

Carbon Energy Ltd	Sonic Healthcare Ltd
Harvey Norman Holdings Ltd	WA Newspapers Holdings Ltd
Lycopodium Ltd	Western Areas NL

In most cases the boards had too few independent directors, or planned to appoint additional executives, or otherwise affiliated directors, to boards that already had a majority of affiliated directors.

In addition AMP Capital specifically abstained from re-electing directors at a further 21 companies. In these cases there may have been a better representation of independent directors, albeit still a minority, and/or this was the first time the issue of board composition had been raised with the particular company. In almost all cases we endeavoured to communicate our specific concerns to the company involved.

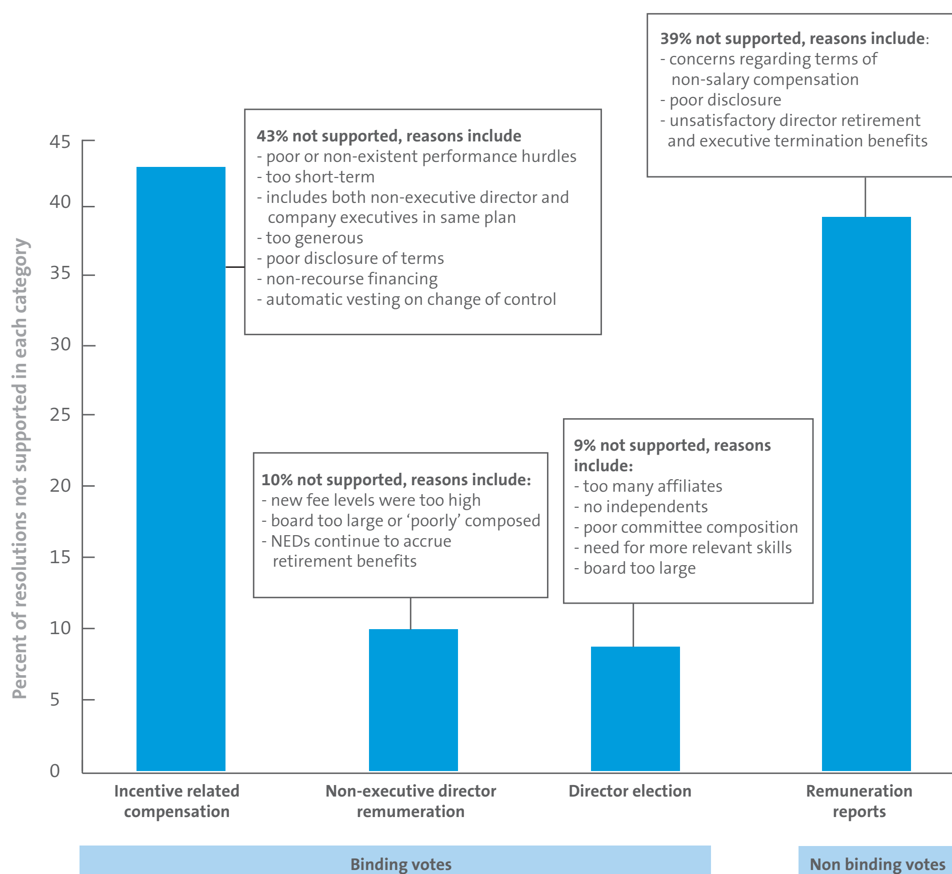
In addition there were companies where, after weighing up the merits of the nomination, AMP Capital rejected the election of self-nominated, non board-endorsed candidates.

Re-organisations, mergers and capitalisation changes

Each year shareholders are asked to vote on 're-organisations, mergers and capitalisation changes'. These resolutions seek approval for, inter alia, acquisitions, asset sales, loans and/or merger agreements, and various share issues (including those made in connection with acquisitions). Generally, the number of such resolutions put to shareholders in any particular period is not significant, typically representing less than 3% of the total number of resolutions under consideration. Interestingly, 2007 saw a favourable environment for corporate activity and the number of such resolutions increased substantially to 17% of all votes cast - in 2008 this has fallen to 11%, generally relating to the issue of shares in connection with acquisitions.

Each resolution that relates to re-organisation, mergers and capitalisation changes requires stringent analysis against both "governance" and "investment" criteria. Analysis is undertaken to establish whether transactions are conducted appropriately, in the best interests of shareholders and with full and clear disclosure.

Resolutions not supported by AMP Capital Investors in 2008



Source: AMP Capital estimates (based on number of meetings)

Governance snippets

Independent boards: what have we learnt?

It appears the issue of 'separating the role of CEO and Chair' will have a vocal advocate in the US when Telstra's former public policy chief, Phil Burgess, champions Australia's corporate governance standards on his return to the US.

In mid-2008 a press article[16] quoted Dr Burgess as saying that while his opinions on regulatory matters might have differed, he had been swayed in favour of the non-executive chairman model by which most Australian listed companies abide. He said he would promote the model on his return to the US.

> "I think it's good that the CEO has to be accountable to somebody. I think it's good that the chairman is there to give attention to governance issues on a regular basis," he told BusinessDaily. "I think if we'd had a separation between chairman and CEO in the US we'd probably not have had Enron and some of the other problems we've had there."

In every edition of this Governance Report, AMP Capital has focussed on the key issues of board composition and board effectiveness.

Whilst few forecasters foresaw the difficulties of 2008, our December 2007 edition discussed the imperative of good boards to steer companies through tough times, focusing particularly on the need for skilled independent directors who could act, without any conflict of interest, in the best interest of the company and shareholders.

Despite an understanding that 'real and rigorous independent board leadership is consistent with the role of the board of directors to exercise meaningful guidance and oversight[17]', in the US has yet to fully embrace the separation of the roles of Chief Executive Officer and board chair and the appointment of an independent chair.

The following comments are a brief summary of Ira Millstein's address to the 2008 ICGN Mid-Year Event: In Times of Financial Crisis – What Now for Corporate Governance? (July 2008):

> "The board is where the buck stops, and this self-imposed crisis reflects a lack of oversight on the part of corporate boards. Strengthening board independence and fixing board oversight, particularly of risk management, is the essential starting point for corporate governance reform.
>
> The board oversees and monitors management discretion. Or so theory goes. In reality, despite the board's prominent standing in the books, in practice for years directors were no more than decorative figures beholden to the imperial CEO. Historically, in the U.S., lack of board oversight was blamed for the corporate corruption scandals of the 1970s, for the falling performance and competitiveness of U.S. corporations in the 1980s, and for the accounting scandals of the early 2000s. And here we are once more witnessing still another, this time major, consequence of the lack of board independence and oversight."

While some changes have been made in U.S governance, such as only independent directors now being allowed to serve as members of audit committees and non-executive directors are required to meet without the presence of management, today only around 36% of S&P 500 companies have separate chairs and CEOs, up from 22% in 2002.[18] According to RiskMetrics data, just 17% of S&P 1500 firms have chairs which can be qualified as independent.[19]

This is in sharp contrast to the landscape in other countries. In Australia, most companies have separated these roles as have the UK and Canada. In the U.K., for instance, approximately 95% of all FTSE 350 companies adhere to the principle that different people should hold each of these roles.[20]

Judge grants settlement on options backdating: UnitedHealth Group

On 19 December, 2008 a federal judge in the U.S. state of Minnesota granted preliminary approval to a $900 million-plus settlement of a securities class-action lawsuit brought against UnitedHealth by the California Public Employees' Retirement System, the largest public pension fund in the United States, concerning past stock-options practices by company executives.

Various media reports[21] provided background into the interesting scandal which dates to the tenure of former CEO William McGuire, who was forced to relinquish US$400 million (of his US$1.6 billion fortune) when it was revealed that he had allegedly engaged in back-dating of stock options to seek the best possible entry price.

Starting in 2006, the U.S. Securities and Exchange Commission and the U.S. Justice Department probed hundreds of public companies over the timing of their stock-option grants. At issue was whether company executives illegally backdated the grants, boosting the value of the options by timing them at low points, thereby increasing executives' payouts. Under securities laws, companies must properly disclose the practice of backdating to their shareholders.

The agreement settles charges brought by the SEC against McGuire under the Sarbanes-Oxley Act, legislation enacted in the wake of the Enron scandal which prohibits various types of questionable financial conduct by officers of public companies. That includes a prohibition on profiting from stock sales made while executives misled investors. An internal UnitedHealth investigation had found that he had backdated shares for himself and other executives.

US fund manager and vocal advocate of good governance, CalPERS[22], was pleased with the judge's order and has said the settlement with the former CEO may be the biggest cash recovery received from an individual defendant in a securities class-action suit. A spokesman for UnitedHealth officials has said the settlement is considered "fair, adequate and reasonable."[23]

In a letter to UnitedHealth[24], Rob Feckner CalPERS' President Board of Administration stated that:

> "These stock option grants are an insult and add injury in a market of skyrocketing health care costs in America, and as the third largest health care purchaser we find this intolerable and unsustainable.... These practices are extremely troubling for all shareowners and it is critically important that the Board fully explain its actions."

CalPERS pushed UnitedHealth to make changes to its corporate governance policies[25], in addition to those it had made previously. Peter Mixon, general counsel of CalPERS said this will protect CalPERS and all shareowners in the future. "The corporate governance reforms achieved in the settlement are a major step forward in our broader effort to ensure that directors are responsible to shareowners," he said.

U.S. District Court Judge James M. Rosenbaum will hold a hearing in March 2009 for a final approval of the settlement.

While there have been no similar cases in Australia, the case provides important lessons in relation to the unfettered power of a combined CEO/Chair, the responsibility of directors, the importance of good governance standards and the role of shareholders in monitoring company behaviour or mis-behaviour.

Australia slips slightly in global governance ratings:

Each year GovernanceMetrics International®, an independent corporate governance research and rating agency, publishes global ratings.[26] The most recent global rankings, published as of 23 September, 2008, show that while Australia remains high in the rankings, it has fallen to fourth place as compared to first place last year.[27]

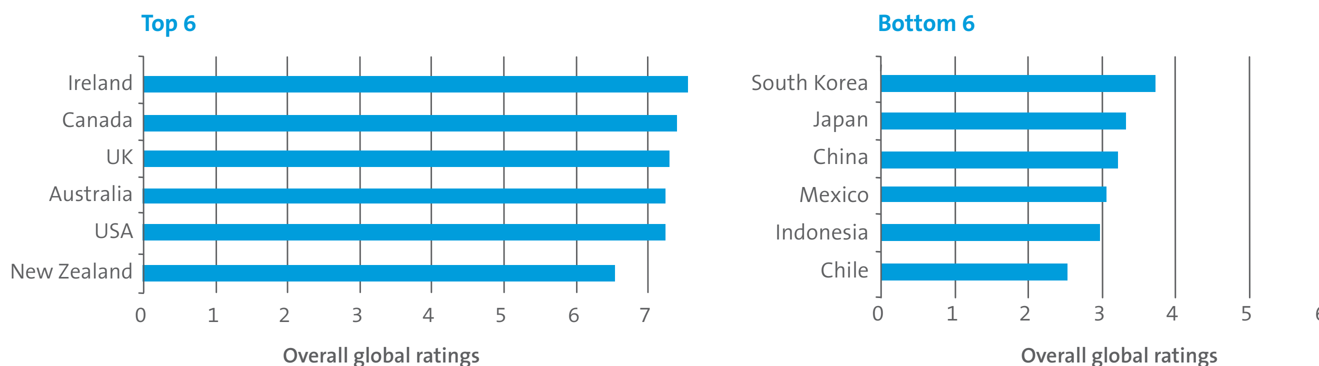
When asked why Australia's ranking had slipped, John Jarrett of GMI offered the following explanation:

> "GMI country rankings tend to fluctuate from year to year, some markets may have improvements whilst other markets don't have as much improvement and thus the rankings change around. The country rankings are an average of all companies rated by GMI in each market. As each company rating is relative, a company ranking can sometimes slip due to other companies making positive changes, whilst that company has made none. Alternatively, ratings can go down when negative changes occur compared to the other companies rated by GMI. The fall in Australia's ranking most likely reflects the number of companies rated by GMI which have run into serious problems in 2008, particularly ABC Learning Centres, Allco Finance and Babcock and Brown."

The same countries comprise the 'Top 6' as last year, while the biggest improvement in rankings was made by Greece.

The following extract highlights countries rated by GMI in the 'Top 6' and 'Bottom 6' respectively.

GMI country rankings as at 23 September, 2008: overall rating by country



Source: GovernanceMetrics International www.gmiratings.com

ICGN statement on the global financial crisis: an excerpt

In November 2008 the International Corporate Governance Network (ICGN) released a statement on the current financial crisis, detailing both the role played by corporate governance failings but also the role corporate governance should now play in restoring trust to the market.

The statement, which encourages markets to take a longer term perspective, also points to the failure of regulators:

> "They (regulators) did not respond decisively when they realised that markets were mispricing risk. They allowed banks to operate with too little capital, with excessive leverage and too little attention to liquidity risk. They failed to pick up on poor risk management by boards and on poor lending practices in the mortgage market.
>
> There will therefore need to be a regulatory response with heightened international coordination and one which encourages markets to take a longer term perspective. A leading priority should be to maximise the supporting contribution of governance. This will help avoid a knee-jerk reaction that impairs the ability of markets to innovate and allocate capital efficiently, adds unduly to the burden of red tape or is protectionist in motivation. It is vital that regulatory reform enhances corporate governance solutions and does not aggravate existing weaknesses.
>
> Empowering shareholders is an important part of this, but they also have to be willing to make the necessary effort. The ICGN's detailed thinking on shareholder responsibility is set out in the ICGN's 'Statement of Principles on Institutional Shareholder Responsibilities'. This stresses the importance of institutional investors putting proper resources into governance and recognising their own accountability to their end-beneficiaries who are individual savers and pensioners. It is the job of institutional shareholders to preserve and add value for these beneficiaries over the long term."

Shareholder responsibilities

The crisis has highlighted a number of issues which are relevant to shareholders and where the ICGN will seek to engage actively in policy debate. These include strengthening shareholder rights, strengthening boards, and increasing market transparency, along with increasing focus on appropriate remuneration strategies.

When looking at what needs to happen next, the ICGN statement focuses on how shareholders can be served by regulations that strengthen shareholder rights, but acknowledges shareholders must also take their responsibilities seriously, for example:

> "Institutional shareholders must recognise their responsibility to generate long term value on behalf of their beneficiaries, the savers and pensioners for whom they are ultimately working.
>
> Pension funds and those in a similar position of hiring fund managers should insist that fund managers put sufficient resource into governance that delivers long term value.
>
> Shareholders should take governance factors into account and consider the riskiness of a company's business model as part of their investment decision-making.
>
> Shareholders should pay attention to developments in other markets, including the credit market, where these may have an impact on their investments.
>
> They should recognise that they lose their voting rights when they lend stock. Where it is important to vote, the stock should be recalled."

The statement concludes that:

> "Corporate governance has an important role to play in overcoming the present crisis, restoring confidence for the future and preventing regulatory overkill that would damage the entrepreneurialism needed to secure economic growth. The global authorities should work with market participants to develop enhanced governance practices that will underpin other actions being taken to address the current problems.
>
> Most importantly this involves securing and maintaining the rights of shareholders and developing the transparency needed for them to exercise these rights in a responsible, informed and considered way. Properly equipped, shareholders can play an important role in holding companies to account for the way they manage risk and incentivise board directors.
>
> However shareholders must also recognise that they should use their share-ownership rights responsibly in the interest of creating long-term value for their beneficiaries. If they do not act responsibly their rights will be at risk."

The challenge of how to restore trust will be one of the major themes discussed at the ICGN's annual conference (Sydney: 13-15 July, 2009) see further details across.

The ICGN annual conference comes to Sydney, July 09

'The route map to reform and recovery' – Hilton Hotel Sydney, 13-15 July, 2009

The International Corporate Governance Network ("ICGN") is a not-for-profit company that provides an investor-led network for the exchange of views and information about corporate governance issues internationally. Membership of ICGN is open to those who are committed to the development of good corporate governance.

The ICGN mission is to develop and encourage adherence to corporate governance standards and guidelines, and to promote good corporate governance worldwide. In seeking to achieve this mission, the ICGN can draw on three unique strengths: the breadth of its membership base, the weight of funds represented by its international institutional investor members (currently $10 trillion) and the geographic diversity of its membership, with members drawn from over 25 countries.

These strengths add weight and credibility to the Network's representation activities. This means the ICGN voice is heard and its opinions are respected by governments as well as international and national organisations such as the OECD, the European Commission, the SEC and the World Bank.

The ICGN convenes the world's premier international event on corporate governance each year in a different host country. In 2009, this event will be held in Sydney.

The Australian Minister for Corporate Law has welcomed the holding of the conference in Sydney reflecting Australia's commitment to high standards of corporate governance.

This year's Annual Conference takes place at a critical moment in global financial markets reform. ICGN is partnering with the World Economic Forum and the UN PRI to bring together leaders in corporate governance from around the world to consider how to rebuild sustainability and trust for the long term.

The three-day conference is hosted by the Australian Council of Superannuation Investors and the Australian Institute of Superannuation Trustees and will bring together shareholders, directors, policy-makers, regulators and stakeholders in a global dialogue with a focus on practical action for corporate governance reform in times of financial crisis.

The event usually attracts around 500 delegates from over 45 countries. The event will be held in the heart of Sydney, Australia at the Hilton Hotel.

To reserve your place for the 2009 ICGN Annual conference in Sydney and find out more about the conference, travel and accommodation, please visit: www.icgn.org/conferences/2009/

ENDNOTES:

1 Myners, P. Report to the Shareholders Voting Working Group (January 2004) Retrieved from: www.manifest.co.uk/myners/04-02-04%20Final%20SVWG%20 Report.pdf

2 Crosby, S. 'Making every vote count': *Company Director* December 08/January 09

3 Parliamentary Joint Committee on Shareholder Engagement Inquiry (PJC): Improving corporate accountability mechanisms. Chapter Four - Section 4.13: *Committee comment with regard to Recommendation* 13. Retrieved from: www.aph.gov.au/senate/committee/corporations_ctte/sharehold/report/c04.htm

4 *SWIFT Solutions - Business transactions*. Retrieved from: www.swift.com/ solutions/standards/business_transactions/proxy_voting.page

5 PJC Shareholder Engagement Inquiry (as above): Section 4.9.

6 Myners, P. Report to the Shareholders Voting Working Group (January 2004)

7 The five issuer participants in the Audit Project were: British Airways plc, HSBC plc, Land Securities plc, Marks and Spencer plc and Prudential plc.

8 'Over-voting' may be a result of a sale or lending activity. Shares sold after the submission of votes could still be voted by the buyer, if they are acquired before the meeting date.

9 'Split-voting'; votes for certain resolutions did not get cast, because the institutions were specific to an actual number of shares as opposed to all shares in the account.

10 'Third-party Issue': voting agent failed to execute nominee instructions.

11 CREST is an electronic system for settling the sale and purchase of shares i.e. the system for paperless settlement of share transfers and the holding of shares in uncertificated form. A CREST proxy instruction is a properly authenticated CREST message appointing and instructing a proxy to attend and vote in the place of the shareholder at the company meeting.

12 Oliver, S. 'Lessons learned from the global financial crisis' *Oliver's Insights*: (December 12, 2008)

13 International Corporate Governance Network (ICGN): *Statement on the Global Financial Crisis* (November 10, 2008)

14 Hilzenrath, D.S. 'Executive Pay' *Washington Post* (December 21, 2008)

15 U.S. Government Office of the Press Secretary THE WHITE HOUSE: '*Treasury Announces New Restrictions on Executive Compensation*' (February 4, 2009) Retrieved from: www.ustreas.gov/press/releases/tg15.htm

16 Leyden, F. 'Combining the role of CEO & Chair: Final word from Burgess'. *Herald Sun* (August 19, 2008)

17 Millstein, I. 'In Times of Financial Crisis – What Now for Corporate Governance?' *Address to the 2008 ICGN Mid-Year Event: Wilmington, Delaware* (December 9, 2008)

18 Lublin, J.S. 'When Chairman And CEO Roles Get a Divorce', *The Wall St. Journal*. (January 14, 2008) (citing Corporate Library data)

19 Allen, T. 'Wachovia Appoints an Independent Chair', *RiskMetrics Group Risk & Governance Weekly* (May 16, 2008)

20 Coombes, P & Chiu-Yin Wong, S 'Chairman and CEO – one job or two?', The *McKinsey Quarterly* n. 2 (2004).

21 FierceHealthcare: Retrieved from: www.fiercehealthcare.com/story/ unitedhealth-reveals-details-option-back-dating-settlement/2008-12-01

22 'Calpers': The California Public Employees' Retirement System which manages pension and health benefits for more than 1.6 million California public employees, retirees, and their families. Information on the Calpers' governance focus can be found on www.calpers.ca.gov/eip-docs/about/facts/corpgov.pdf

23 FierceHealthcare: Retrieved from: www.fiercehealthcare.com/story/ unitedhealth-gets-initial-ok-settle-options-suit-895m/2008-12-19

24 CalPERS '*Letter to UnitedHealth*' Retrived from www.calpers.ca.gov/eip-docs/ about/press/news/invest-corp/unh-letter-to-cc-chair.pdf

25 CalPERS *Welcomes ISS Support on UnitedHealth Proxy Access Proposal*: (May 18, 2007) Retrieved from: www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2007/ may/iss-support-unitedhealth.xml

26 GovernanceMetrics International Retrieved from www.gmiratings.com

27 GMI rating criteria are based on securities regulations, stock exchange listing requirements and various corporate governance codes and principles. Among the latter are principles promulgated by the OECD, the Commonwealth Association for Corporate Governance, the International Corporate Governance Network and the Business Roundtable. In addition, GMI have sought the views of various corporate governance and legal advisors, institutional investors, corporate officers and company directors, and utilised the combined experience of the founding partners. Retrieved from www.gmiratings.com

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