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FESTIVE CHEER!



Dear ACSI Members

For ACSI 2005 will be best remembered as the year of the emergence of greater engagement with companies and the investment community. The escalation in engagement can be attributed to a number of factors including the –

-  weight of money superannuation funds are now investing;
-  introduction of non-binding votes on remuneration reports has meant that companies are actively engaging more on remuneration issues and resolutions and
-  media attention that the News Corporation Limited 'Poison Pill' international co-operation and litigation attracted.

It has also been a great year to consolidate our position as the representative corporate governance voice of Australian not-for-profit superannuation funds.

The re-writing of ACSI's Corporate Governance Guidelines 'A guide for Superannuation Trustees To Monitor Listed Australian Companies' has paid dividends by allowing us to deal with remuneration issues during 2005 in a more detailed and thoughtful way.

During 2005 we have significantly enhanced our Voting Alert Service. Early feedback from Subscribers to the service has been very positive.

Our success in 2005 could not have been achieved without the Committee of Managements support. In particular, I would like to express my gratitude to Michael O'Sullivan for his contribution and encouragement throughout the year.

I'd like to express my thanks to my colleagues at ACSI. Gina Preston, who has now joined AUSfund provided great support to me during her time with ACSI. I'd also like to welcome back Ros McKay. We have had to achieve quite a lot in the second half of 2005 in particular in relation to more effective engagement both in writing or in person and we also have introduced our new VAS service, for that I'd like to thank Ros for the high level of professionalism she has brought to these achievements. Many of you will receive a lot of correspondence/e-mails etc on behalf of ACSI from Chris Dardoumbas. The amount of contact that you receive from Chris is a reflection of her extraordinary work output and effectiveness. On behalf of ACSI I'd like to thank Chris for her huge contribution to ACSI's success.

2006 will see ACSI pushing the boundaries to go beyond the traditional view of corporate governance and to move slowly into the Corporate Social Responsibility space. This will pose a number of challenges not least ensuring that we and our members are comfortable with the link between activism in this area and our members overriding obligation as trustees and managers of their members retirement savings.

From all of us at ACSI we wish you all an enjoyable festive season. For those of you that celebrate Xmas we hope it is a happy one. If you are taking a break over the Christmas period we hope it is refreshing. We look forward to working with you all in the New Year!

PHIL SPATHIS
Executive Officer, ACSI

UN STUDY ON INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES

In October 2005 the United Nations Environment Programme Finance Initiative (UNEP FI) ¹ published a study 'A legal framework for the integration of environmental, social and governance issues into institutional investment' ² which was commissioned by the Asset Management Working Group (AMWG) of UNEP FI.

The study focused on the largest capital markets jurisdictions - Australia, Canada, France, Germany, Italy, Japan, Spain, the United Kingdom and the United States.

The objective of the report was to answer the following question -

Is the integration of environmental, social and governance issues into investment policy (including asset allocation, portfolio construction and stock-picking or bond-picking) voluntarily permitted, legally required or hampered by law and regulation; primarily as regards public and private pension funds, secondarily as regards insurance company reserves and mutual funds?

The findings are intended to dispel the common misunderstanding that fiduciary responsibility is restricted by law, and solely and in a narrow sense, to seeking maximisation of financial returns.

¹ The United Nations Environment Programme Finance Initiative (UNEP FI) is a global partnership between the United Nations Environment Programme and the private financial sector. UNEP FI works closely with the 170 financial institutions that are signatories to the UNEP FI Statements, and a range of partner organisations, to develop and promote linkages between the environment, sustainability and financial performance. Through regional activities, a comprehensive work programme, training programmes and research, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

² http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

Paul Watchman, Partner at Freshfields Bruckhaus Deringer and senior author of the study, said *"We are not suggesting that investors pursue a moral crusade but, in most jurisdictions, the law gives a wide discretion, encircled by general duties rather than exacting standards. A number of the perceived limitations on investment decision-making are illusory."*³

Mr. Watchman explained that those advocating a greater regard for environmental, social and governance (ESG) issues in investment decision-making often encounter resistance on the basis of a belief that institutional principals and their agents are legally prevented from taking account of such issues. *"Far from preventing the integration of ESG considerations, the law clearly permits and, in certain circumstances, requires that this be done"*, he said.

The study contends that by influencing the way investments are made, the legal factors that inform the decisions made by this relatively small group have a profound effect on the behaviour of the entities in which these assets are invested and ultimately on the environments and societies with which these investment vehicles interact.

The authors suggest that investment decision-making is also concerned with varying time horizons depending upon the investment involved. Pension fund investments in particular are intended to yield returns at some considerable distance into the future. It is therefore necessary when assessing investment decision-making against legal standards to have regard to the expected long-term performance of investments where the fund involved demands a return on investment over an extended horizon.

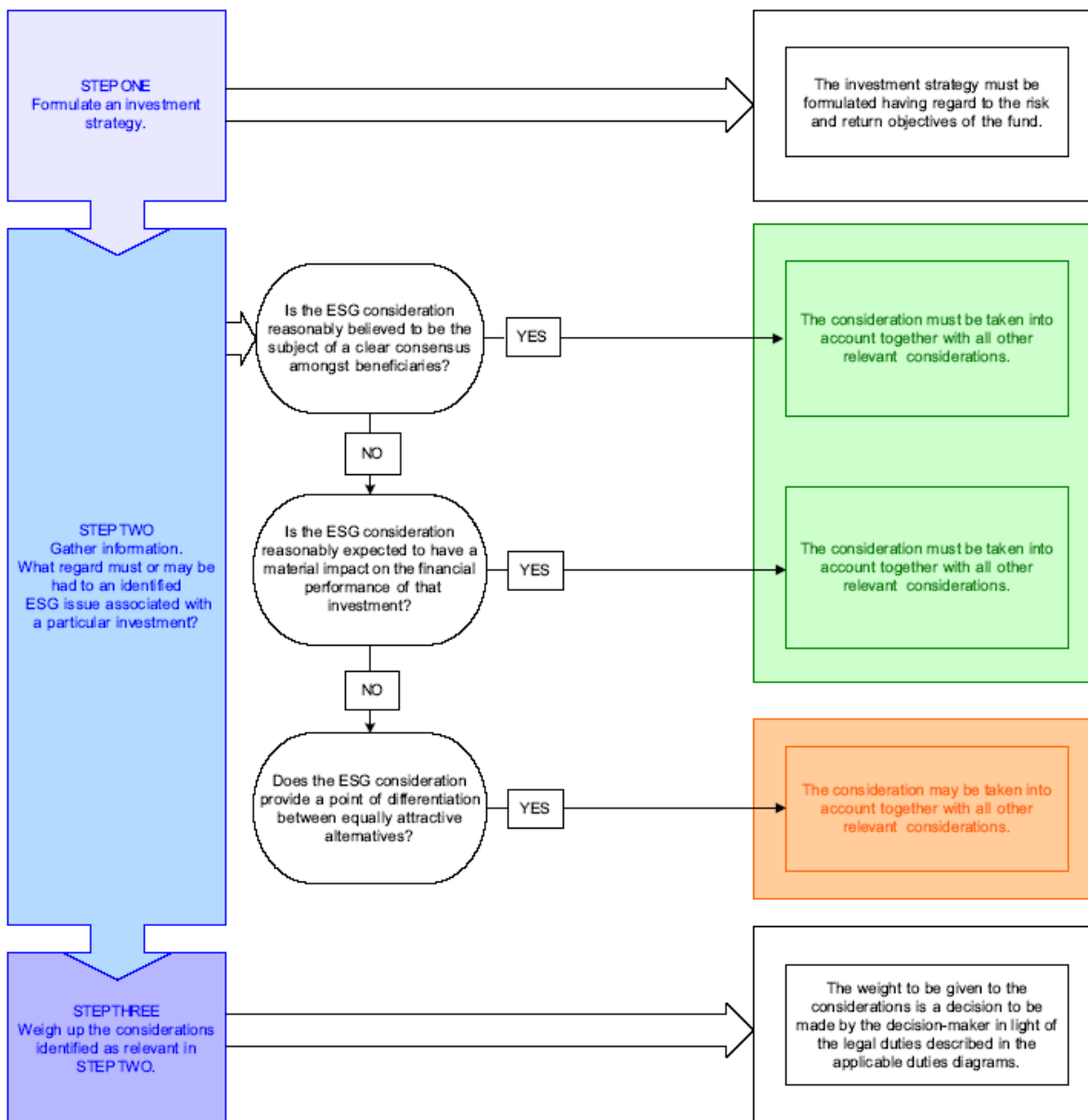
The report concludes that the links between ESG factors and financial performance are increasingly being recognised and therefore integrating ESG considerations is arguably permissible and required in all jurisdictions.

³ <http://www.unepfi.org/events/2005/roundtable/press/index.html>

The flow chart below taken from the study illustrates the process involved in ESG decision making.

A helpful jurisdictional analysis of Australia can be found at pages 40-48 of the report http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

Taking ESG considerations into account



CORPORATE SOCIAL RESPONSIBILITY (CSR) V SOLE PURPOSE TEST

ACSI held a seminar on 23 November 2005 on Corporate Social Responsibility (CSR). The purpose of the seminar was to educate members based on the findings of the discussion paper ‘Corporate Social Responsibility: Guidance for Investors’ and to also seek members input regarding the way forward in relation to CSR.

Like the paper commissioned by UNEP FI one of the key questions for consideration at the seminar was whether the law allows investment decision making by trustees to give appropriate weight to financial returns and non-financial considerations, including the corporate social responsibility practices of investee companies?

Phil Spathis advised that in his view *“The review of CSR practices of investee companies, can sit comfortably with prudent investment decision making policies of superannuation funds, especially where such considerations are utilised as a risk mitigation tool”*.

The notion of mitigating risk is not a novel idea and indeed fits within the framework of investment decision making of a super trustee.

“Essentially you seek to maximise investment returns in light of an acceptable level of material risk.”, Phil explained.

What do we mean by material risks in CSR? How do we measure success in monitoring such risks and over what period?

A recent Corporation and Markets Advisory Committee (CAMAC) report ⁴ made the following point

⁴
[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/\\$file/CSR_DP.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/CSR_DP.pdf)

“The management of non-financial risks may not necessarily maximise profits or shareholder wealth in the short term. However, failure by a company to identify and properly manage these risks may cause short-term or longer term detriment to the company, such as increased direct or indirect operating costs, regulatory intervention, adverse litigation, harm to corporate reputation or brand image, or reduced employee loyalty or community support”.

Therefore the benefits of CSR monitoring may not appear immediate or even visible.

Phil then briefly touched on some of the relevant signposts that apply to trustees in context of monitoring the CSR practices of companies that may impact on investment decision-making.

1. Sole Purpose Test

The discussion paper highlighted concerns of respondents to the survey that formed part of the research project, that somehow CSR monitoring does not fit the requirements of “sole purpose” test. That is whether such monitoring activity relates to the purpose of the providing a retirement benefit to members.

The sole purpose test is couched in very broad terms and accordingly in Phil’s view *“the sole purpose test is satisfied with respect to monitoring the corporate governance and CSR practices of companies that we invest in, where this activity aims to mitigate against potential failures that may arise because of weaknesses in these areas, that could have a detrimental impact on a fund’s investment in that company.”*

Without evidence that good CSR practices by a company diminishes returns to investments for members, there are therefore sound reasons for considering CSR issues.

"In order for a contravention of the sole purpose test to arise, with regards to monitoring corporate governance or CSR practices of a company, this would have to occur where there is no retirement purpose or benefit behind this activity." explained Phil.

Monitoring the CSR practices of an investee company as part of an overall investment strategy which complies with SIS covenants and investment restrictions, is unlikely to cause the fund to fail the sole purpose test.

2. SIS Covenants

SIS includes a list of eight covenants, which impose duties on trustees. In the context of CSR monitoring considerations, two relevant covenants that are deemed to form part of the governing rules of the superannuation fund include:

- Ensuring that the trustee's duties and powers are performed and exercised in the best financial interests of all beneficiaries;
- To formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the fund including:
 - the risk involved in making, holding and realising and the likely return from, the fund's investments having regard to its objectives and its expected cash flow requirements;

Again this emphasises the notion of managing risks, which is relevant in the context of CSR monitoring.

3. Investment obligations

The covenants contained in section 52 (2)(f) of the SIS legislation bind trustees to ensure that the investment strategy of the fund pays due regard to:

- the risks involved in making, holding and realising an investment;

- the composition of the plan's investments as a whole including the extent to which the investments are diverse or involve the fund being exposed to risks from inadequate diversification.

Phil explained that in his considered view *"where an analysis of an overall costs, risk and return profile have been explored in an investment, that may also include a consideration of the CSR risks in a company, then the legal obligation of trustees would be properly discharged."*

4. Standard of Care

SIS requires trustees to exercise a reasonable degree of care, skill and diligence expected of an ordinary person who is dealing with the property of another person.

The general law duty provides that the trustee must act prudently with reasonable diligence expected of an ordinary prudent *business* person dealing with the property of another person.

There is a real challenge here, that a person of "business" must make informed decisions on the subject matter.

A trustee that monitors CSR issues should arguably have access to reliable and high standards of information that allows trustees to make informed decision to properly discharge this standard of care.

The discussion paper refers to this real dilemma:

"A central issue for superannuation trustees is access to information to identify material issues and to incorporate such information into investment decision-making. Most of those interviewed held the view that information on material risks is unavailable or difficult to obtain."

In the context of the standard of care that a trustee must exercise, they must have access to a high standard of information on CSR in order to exercise a proper judgement.

Phil then drew parallels between CSR and corporate governance activism in relation to exercising proxy voting rights and engagement. In terms of corporate governance ACSI had taken the view that if its members wished to exercise their proxy votes then this would need to be done on an informed basis i.e. in light of ACSI guidelines, research and credible service providers.

The Business Judgement Rule – Another Safe Harbour for Trustees

In circumstances for example, where an investment fails, the Corporations Act does provide trustees with a safe harbour, should they satisfy the Business Judgement Rule (BJR) test.

Courts will look at whether a board has properly informed themselves of all relevant issues that that impacted on the decision of a Board to pursue an investment.

Under the BJR, a defence is available where Board exercises its powers, to make or not make a decision, in the belief that this is in the best interests of the corporation, and that a reasonable person in the same position of the directors would have formed a similar judgement.

This requires a trustee to show that all appropriate relevant investment risk and return issues were considered in order to form the basis that there was an expected gain from an investment.

In the context of CSR issues, the consideration of these issues must not overwhelm or set aside the conventional investment considerations, but work in tandem with these considerations.

Conclusion - Do Trustees have a fiduciary responsibility to attend to CSR?

The research, and other relevant empirical evidence conclude that material investment risks could arise in a company that has not properly addressed the CSR impacts of their activities.

As trustees increasingly becoming aware of these risks, then having a blanket policy of not monitoring these CSR issues, may well be regarded as inconsistent with a trustees fiduciary duties.

Trustees still need to justify spending members money on in CSR screens, risk mitigation tools etc. In other words trustees will need to consider whether members regard the trustees increased efforts as good value for money.

At the same time monitoring CSR or corporate governance, is not a guarantee against failure.

Phil concluded by saying that *“Without evidence that monitoring CSR diminishes returns to members and assists with the mitigation of some risks, there are sound reasons for trustees to consider CSR issues.”*

The main outcome from the seminar was that a sub-committee be formed to consider ACSI’s next steps further. The first issue that the sub-committee will consider is whether and how it should articulate a “CSR Framework”. Any paper devised along these lines would include clear statements that CSR is not illegal, CSR does not destroy value, and fiduciaries’ should approach CSR as a new frontier in risk management. The aim of the framework would be to answer the question “why are we [trustees] doing anything about CSR?” and in so doing, clarify the boundary between personal values and empowering members to be more effective trustees. In effect the paper would provide the business case for ACSI and its members to engage with CSR.

UNION SHAREHOLDER ACTIVISM STUDY

On 6 December 2005 the Centre for Corporate Law and Securities Regulation at the University of Melbourne released a study titled 'Union shareholder Activism: A New Industrial Frontier For Australian Trade Unions.'

The study found that the most common method of activism by union shareholders has been the use of the '100-member rule' to put resolutions forward at a company's annual general meeting (AGM). Other methods have included lobbying shareholders to support 'vote no' campaigns relating to resolutions proposed by directors at AGMs, posing questions at AGMs in order to highlight particular employee issues, and, less commonly, calling extraordinary general meetings.

This paper examines the development of union shareholder activism in Australia through a series of recent case studies in which Australian unions have utilised their role as shareholders to pursue employee interests. Also, the role of superannuation funds in Australian union shareholder activism is considered.

Second, the legal basis for such practices is examined. Union shareholder activism in the United States is analysed in order to highlight the effectiveness of aligning pension fund activism with union activism, which has been a significant and sustained development in the United States. Developments in the United Kingdom and Canada are also outlined. Lastly, the objectives, methods, effectiveness and desirability of union shareholder activism are examined, through an analysis of the Australian case studies presented in this paper. These case studies are:

- The Construction Forestry Mining and Energy Union (CFMEU) campaign at the Rio Tinto 2000 AGM
- The Transport Workers Union (TWU) campaign at the Boral 2003 AGM.

- The Finance Sector Union (FSU) campaign to have a member appointed to the board of ANZ in 2003.
- The Finance Sector Union (FSU) campaign at the Commonwealth Bank of Australia 2004 AGM.
- The Australian Workers Union (AWU) campaign at the 2004 BlueScope Steel 2004 AGM.
- The Australian Service Union (ASU) "vote no" campaign at the Qantas 2004 AGM.
- The Australian Council of Trade Unions (ACTU) "vote no" campaign at the James Hardie 2004 AGM.
- The Australian Manufacturing Workers Union (AMWU) campaign to call an extraordinary general meeting of NRMA members in 2004.

The paper concludes that "the ability of companies to insulate themselves from the effects of traditional union action and the erosion of unions' influence under Australian labour law has been the catalyst for the recent initiation of union shareholder activism in Australia.

Cases of union shareholder activism typically have arisen in the context of failed enterprise bargaining or other disputes between a company and union.

Whilst no union shareholder campaign has, to date, been successful in having a union sponsored resolution passed by shareholders, some campaigns have apparently exerted sufficient pressure on company boards to secure a favourable result for unions. This has usually occurred where the shareholder activism has constituted one part of a wider campaign against a company and where the union shareholder action has the support of large institutional investors, such as superannuation funds. Particularly where Australian unions are able to align their interests with these investors, as has characterized labour shareholder activism in

the United States, it is likely that union shareholder activism in Australia will gain additional prominence and influence.”

The study can be found at <http://cclsr.law.unimelb.edu.au/go/news/index.cfm>

CAMAC CSR DISCUSSION PAPER RELEASED

Early in 2005 the Federal Government asked the Corporations and Markets Advisory Committee (CAMAC) to consider a series of questions related to responsible corporate conduct, including aspects of corporate decision-making, corporate reporting and whether further measures are needed to encourage socially and environmentally responsible business practices.

In response to this request, the Advisory Committee released a discussion paper on 16 November 2005 calling for public submissions on the questions that had been posed.

The paper is a very useful resource that:

- provides information and analysis, including relevant historical background, international codes and guidelines, key concepts (such as stakeholders, sustainability and triple bottom line reporting) and the legal framework for corporate decision-making and environmental and social reporting
- raises a series of questions that respondents may wish to consider in developing their submissions.

The Advisory Committee has called for submissions by 24 February 2006. The Committee will then prepare its final report, taking into account these submissions. The 115 page paper can be found at –

[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/\\$file/CSR_DP.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/CSR_DP.pdf)

AWB INQUIRY

You will have noticed increasing media attention given to the establishment of a Federal Government Inquiry in relation to the United Nations Oil-for-Food program (OFF) and the alleged arrangements by AWB Limited to pay monies to Saddam Hussein’s former regime. Outlined below is some background regarding AWB’s involvement in the OFF Program from the AWB web-site.

Following Iraq’s invasion of Kuwait in August 1990, the UN Security Council adopted Resolution 661 which imposed trade sanctions on Iraq. These sanctions exempted foodstuffs such as wheat.⁵

Despite the exemption for foodstuffs international agencies reported starvation, malnutrition, and poor health among Iraqis as Saddam Hussein’s regime continued to spend its funds for purposes other than food and medicine. In response, in April 1995, the Security Council adopted Resolution 986 to create the OFF Program. This allowed Iraq to sell oil, with the proceeds going to a UN controlled escrow account to be used to purchase food, medicine and essential civilian supplies.

The UN Security Council’s 661 Committee (as it came to be called) established procedures to manage and administer the OFF Program, including approval of all contracts.

Over nearly seven years of the OFF, the Australian Wheat Board/AWB Limited supplied nearly 12 million tonnes of wheat over 41 contracts and 285 shipments that helped avert a food crisis for the Iraqi people.

⁵

<http://www.awb.com.au/AWBL/Launch/Site/Growers/AWBInvolve mentinUnitedNationsOilForFoodProgram.htm>

The UN established procedures for review and approval of all contracts. AWB contracts for wheat shipped to Iraq during the OFF Program were approved by the UN – either the 661 Committee or the UN’s Office of the Iraq Program (OIP). The OIP closed in May 2004.

In relation to transport fees in 1999 AWB became one of many contractors required by the Iraqi Grain Board (IGB), to enter new contract terms, approved by the UN, which included a price component for inland transport. The new contract terms allowed the IGB to nominate its own inland transport agent and required AWB to pay the inland transport fees set by the IGB to that agent. AWB paid the transport fees to the Jordanian based company, Alia (which it is now contended is partly owned by Saddam Hussein’s regime).

The Labor Government is now calling for the inquiry’s terms of reference to be broadened to examine whether the Federal Government effectively signed off on the arrangement. We will watch the outcome of the inquiry with much interest.

BT GOVERNANCE SYMPOSIUM

On 8 November 2005 BT held a Governance Symposium in Melbourne. A copy of Leon Davis, Chairman, Westpac Banking Corporation Limited presentation to the Symposium is provided as a supplementary attachment to this edition of the newsletter. The presentation is an informative and interesting read.

INTERNATIONAL UPDATE

ICGN Stock Lending Code of Best Practice

The International Corporate Governance Network has produced a Stock Lending Code of Best Practice. As the paper explains there are some valid reasons for stock lending such as improvement in market liquidity, reduces the risk of failed trades and

adds to incremental return of investors. But problems arise in relation to the voting rights attached to any stock loaned and as a consequence the ICGN has developed this code of best practice.

“Stock lending has grown rapidly as a market practice, more or less “below the radar,” without much consideration of its import upon stewardship of portfolio holdings. Our own studies have indicated that in fact the impact of lending upon shareholder voting and other aspects of share ownership has been of growing importance, and that an improvement in prevailing lending practices could have a profound effect upon the governance of many companies around the globe,” said Andrew Clearfield, Chair of ICGN’s Securities Lending Committee.⁶

“We are also concerned that continued inattention to some of the potential problems posed by increased lending activity without regard to its possible impact upon corporate governance could pose a serious challenge to the cause of good governance in the not-too-distant future,” he said. *“We are offering this Code of Best Practice in an attempt to persuade our members and the rest of the investment industry, as well as those representing the borrowers and the issuers of shares, to improve prevailing practices, and reconcile the requirements of being good shareowners with the opportunities afforded by stock lending. We would hope that in a fairly short time the result of adoption of this Code would be visible in improved governance participation around the world.”*

A copy of the report can be found at: http://www.icgn.org/organisation/document/s/slc/code_final.pdf

UK

OFR Chopped

On 28 November 2005 the Rt. Hon. Gordon Brown MP, Chancellor of the Exchequer, at

⁶ <http://www.icgn.org/>

the Confederation of British Insurers (CBI) Annual Conference in London announced⁷ new simplification and deregulatory measures which will cut demands for information, forms and reporting requirements.

What Brown quashed was the incoming requirement on corporates to write an annual Operating and Financial Review (OFR), a forward-looking narrative akin to the US Management Discussion and Analysis, but with innovative attention to social and environmental risks.⁸

Global Proxy Watch expects investor groups to press the independent Financial Reporting Council to add the OFR to bedrock guidance in the Combined Code.

US

Internet Availability of Proxy Materials

On 29 November 2005 the US Securities and Exchange Commission (SEC) voted to propose for public comment rules that would allow companies and other persons to use the Internet to satisfy proxy material delivery requirements.

The company could satisfy its obligation to furnish proxy materials to shareholders through a "notice and access" model. The company would post its proxy materials on an Internet Web site and would send a "Notice of Electronic Proxy Materials" at least 30 days before the date of meeting.

The proposed rules potentially would have two significant benefits: (1) they could result in a substantial decrease in the expense incurred by issuers to comply with the proxy rules; and (2) they would provide persons other than the company with a more cost-

effective means to undertake their own proxy solicitations.

The proposed rules would have no impact on any state law obligation regarding soliciting proxies or holding annual meetings.

The full text of the press release can be found at:
<http://www.sec.gov/news/press/2005-166.htm>

Integrated Active Ownership by Investment Managers

Mercer Investment Consulting⁹ has started rating how active investment managers are in relation to active ownership issues such as voting and engaging on corporate governance, environmental and social issues (ESG) and integration of ESG into mainstream investment analysis.

Mercer found a mere 13% demonstrated superior ability to integrate ESG into investment analysis. On the other hand, the consultant team rated 74% of surveyed fund managers doing well when it comes to voting and engagement on corporate governance issues.¹⁰

FASB taking a narrow view on corporate disclosures

US Financial Accounting Standards Board (FASB) board has ruled that no US corporate should have to disclose to shareowners information about how well it acts as a steward of investor capital. That, FASB said, is a verdict only for the board. Instead, corporate disclosures should focus narrowly on financial data relevant for an investor's buy or sell judgments.¹¹

⁷ http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2005/press_99_05.cfm

⁸ 'Surprise U-turn frees corporates of landmark, fund-backed disclosure', Global Proxy Watch, Vol IX No 43, Dec. 2 2005

⁹ <http://www.merceric.com/ESGresearch#conclusion>

¹⁰ 'Paranoia' Global Proxy Watch, Vol IX No 40, Nov. 11 2005

¹¹ 'Fund protests over disclosure could brake global standard convergence' Global Proxy Watch, Vol IX No 40, Nov. 11 2005



Australian Council of Super Investors Inc.

CORPORATE CITIZENSHIP NEWSLETTER

December 2005 : Issue No.22

On 4 November 2005 the Investment Management Association (IMA) in the UK issued a statement "Shareholders do not want simply to value companies and assess whether they should sell or buy the shares, they want to assess management and the strategies adopted for the business for the longer term."

FASB plans to cement its stance into global accounting principles in talks with the International Accounting Standards Board (IASB).

Companies starting to address voting concerns

On 11 October 2005 the Financial Times¹² reported that leading US companies have been amending their corporate governance policies in response to growing shareholder dislike of rules that enable directors to be elected on a minority of votes cast at annual meetings.

Pfizer, the pharmaceuticals group, was the first public company to say it was amending governance principles so that a director must submit his resignation if a majority of votes cast were marked "withhold". The board then considers how to respond.

Companies that have made similar changes to Pfizer's include Altria, United Technologies, Microsoft, Walt Disney, Prudential Financial, Aetna, Gap, Avnet and Pitney Bowes.

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This newsletter is correct to the best of our knowledge and belief at the time of going to press. It is, however, written as a general guide so it is recommended that specific professional advice is sought before any action is taken.

¹² 'Companies move to quell voting concerns' By Andrew Parker in New York FT



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BT Governance Symposium recognising the interests of stakeholders

BT Offices, Level 24, 367 Collins St, Melbourne
9.00am 8 November 2005

Speech

I'd like to thank the Governance Advisory Service for the opportunity to talk about a subject - the interests of stakeholders - I feel quite passionate about; one that has well and truly moved centre stage for all directors, public companies, and I hope, investors.

But, before I do this I would just like to talk about the pressure that directors have as a normal part of their job. While it is proper and right to debate and improve laws governing the function of Boards and Corporations, we are seeing much more than that happening today. Increasingly we see Government bodies, Semi-Government bodies, NGO's and community groups going further than just the law in telling Boards how they should operate and what they should do. The obvious question here is shouldn't it be shareholders who do this, and if so how do they have their say? How do shareholders impact and influence Boards? In my view there is a disconnect between shareholders and Boards and increasingly other organisations and institutions are filling the vacuum. I think that today we need to think seriously how we restore shareholders pre-eminent position and try to come up with something more than just an AGM as a means of embedding their position.

Also, it is my view that the debate on whether Boards need to consider more than just financial matters is over. Of course Boards have to do that and have always had to do that. Businesses are an integral part of society. As such, of course they need to concern themselves with such matters as global warming, energy use, water conservation, disadvantaged groups in our community and our ageing population - to name just a few. On the question of our ageing population this means that business must get involved with and understand a whole range of interconnected issues, such as the impact of lower participation rates in the workforce, declining fertility rates, worker productivity, immigration, women in the workforce, the impediments that presently abound preventing women to achieve their full potential and the fact that presently there is one million of our highly educated youth working outside of the country. All this is not the concern of Boards? Of course it is and shareholders would be poorly served if directors failed to address these issues because surely they are the ones that will affect profitability in the future.

I'm also delighted to be talking to investors about this because what sometimes gets lost in a complex debate is the business imperative as well as what the shareholders really want - and this is difficult at times to discern.

But this is my essential position: recognising the interests of all stakeholders and in so doing, successfully managing reputational, social, environmental and other non-financial drivers of value is simply fundamental to corporate resilience and the creation of sustainable shareholder value.

And I see no conflict in this with the primary obligation of companies - namely, to maximise returns for shareholders over the long term.



Australian Council of Super Investors Inc.

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Put simply, a company needs employees who want to work for it; customers who want to buy from it; suppliers who want to supply to it; and of course investors who want to invest in it.

There is no question that the primary obligation of business is to maximise returns for shareholders. The reality is you can't have business without profit, and it certainly can't be sustainable if medium to longer-term profitability is compromised.

But equally there can be little question that maximising long-term returns for shareholders is put at risk if a company ignores any material reputational, social and environmental risk that is present in its business.

At Westpac, we were forced to recognise this in the late 1990s. Like it or not, along with others in our industry, we faced apparently intractable reputation problems and perhaps unprecedented levels of public criticism.

This finally forced the Board and executive management to set aside the rhetoric and take stock of the performance of the business in the light of stakeholder expectations which were clearly extending well beyond the financial.

It seems obvious in hindsight that it was not sufficient to be delivering short-term financial gains while at the same time alienating the community on which we depended for our business. It became clear to us that our reputation, our community licence to operate if you like, was fundamental to our business prospects. Now, of course in this there is nothing new. Perhaps operating overseas in the 90's as I was, it was a little clearer there. Working in a mining company it was absolutely clear.

So the starting point was accepting responsibility to expertly manage all of the financial and societal and environmental impacts of our business, and with the focus on managing risk. From this we've moved on to understand the role of stakeholder interests more broadly in driving sustainable value in all sectors of the business.

And here, let me define what I mean by sustainability. There are three pillars that support sustainability and they are the financial, environmental and social pillars. Modern managers have to expertly manage all three. These are the pillars on which you build a business. At Westpac the heart of this is what we call our service-profit business model. By creating a business where people want to work, we improve employee retention and are better able to attract quality staff - a critical issue for a services business facing profound demographic changes in the not too distant future, such as a shrinking pool of workers as our population ages.

And motivated employees positively influence customer satisfaction, and this drives customer loyalty. Being an ethical and responsible institution that people want to work in and customers want to do business with gives us the best chance to maximise shareholder returns.

I'd like to emphasise this point. The objective of our commitment to corporate responsibility is to drive shareholder value through the existing business strategy; that is to positively impact the employee and customer components of our service-profit model; and also to drive business opportunity through new sustainability-linked products and services.

Beyond this our aim is to maximise intangible value over the medium term. That is, to build the long term and more intangible drivers of capacity, performance and value within Westpac, including: improved reputation and social licence to operate; reduced regulatory and other operational risk; enhanced operational efficiency; and enhanced innovation and creativity.



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In terms of outcomes, we do know that the corporate responsibility ethos at Westpac has been a driver of both employee and customer attraction and retention. We have taken costs out of the business; have an improved reputation with our key stakeholder groups and a more robust social licence to operate. And major regulatory risks seem to be better managed.

So I hope I've caught your attention by focusing on the business case first up. It goes without saying that I believe that companies embracing sustainability will generate more long-term shareholder value than those ignoring these risks and opportunities.

Secondly I'd like to touch on the role of directors in all of this.

From my discussion so far, clearly the sustainability agenda is at the heart of what are conventionally understood as the central concerns of directors: financial performance, governance and strategy. But beyond this, directors have a critical role in building a values and principles-based culture which is at the heart of being responsible and transparent and from which everything flows. Westpac's approach to corporate responsibility and governance has certainly been more about principles and values than compliance or rules.

Which takes us to the topical and related issue of legislation and regulation. Well, here is the paradox: Legislation to some extent now lags pragmatic practice, because progressive boards already recognise they have responsibilities that extend well beyond statutory responsibilities to shareholders.

But you cannot regulate or prescribe good behaviour. And I don't think that the lack of accountability we have seen at both organisational and individual levels can be simply fixed by new regulations. We need to promote business cultures that self-regulate and self-correct.

This debate is at the heart of the two current inquiries. Westpac's view is that prescriptive legislation either in terms of redefining directors' duties or for non-financial reporting is neither necessary nor desirable - but we are more amenable to non-prescriptive approaches.

And here we are watching with interest the implementation in the UK of the new Operating and Financial Review or 'OFR' requirements. UK directors are now required to provide a balanced and comprehensive analysis of the business which - I would argue in line with their core obligation - is future-focused, setting out the material trends and factors underlying future performance.

The intent is to supplement existing reporting with improved non-financial, qualitative and forward-looking information, which includes social and environmental issues to the extent that they have a material bearing on the current or future financial performance of the business.

This might include the importance of corporate reputation, or the quality of relationships with stakeholders. There is no longer any argument here about whether or not social and environmental performance can be fundamental to a company's future performance.

Which brings me to my final point.

Progressive companies have moved well beyond the corporate paradigm of a single-minded and short-term focus on financial performance. However the current level of engagement by mainstream (in comparison with SRI specialists) financial markets on sustainable business practice is limited.



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On the contrary the current short-sightedness of the corporate world and financial markets is frustrating our ability to manage business with a view to the future, and to realise the strategic and competitive benefits of doing so.

So far we have seen institutional investors engage around specific risk areas. For example the Carbon Disclosure Project is projecting the direct and indirect cost impacts on business from climate change. There are now 155 signatories to the project: institutional investors concerned with identifying the winners and losers in a future impacted by climate change.

And the local "Investor Group on Climate Change" is researching the climate-related investment risk in Australian organisations.

Beyond this I know local investors like BT and Westpac have been involved in the Who Cares Wins initiative by the Global Compact or the Enhanced Analytics Initiative.

But my view is that we must ask investors like yourselves to look at sustainability more holistically. But the real drivers for change in corporations must be the owners. It must be the owners who decide how their assets are to be managed and they have the ultimate power to get what they want.

Whilst progressive organisations have a part to play through voluntary reporting and direct engagement with mainstream equities analysts and fund managers, I would suggest the development of more sophisticated procedures and data which will allow the assessment of total performance is now required by the market.

To be glib, making the intangible, tangible, is now a major objective. And this is very much a task requiring a collaborative effort, with investors like yourselves central to success. And within this context we need to have a debate on how shareholders, or if you like owners, tell us, the people who manage the enterprise on their behalf, what they want. To my mind we are becoming too distant and the AGM is an imperfect mechanism for overcoming that distance. And if this is the case, then what more should we have than a once yearly reporting mechanism?

Finally I'd like to leave you with a quite different thought. And that is with all the talk of the business case and shareholder value, we must not lose sight of the context in which business and indeed financial markets operate. Now, more than ever, we are examining our own society and the threats to it. Business is an important part of that society

Business has been given more rights than we have had for a long time - perhaps for some of us more rights than we have ever had. In accepting those rights we must also show that we accept the obligations - obligations to build an acceptable culture in our organisations that has honesty and fair dealing as its centre piece. That, by example, we demonstrate and drive high standards of financial, social and environmental care.

If we don't do this, if we don't give the lead, then what kind of society will we be part of?

Leon Davis
Chairman
Westpac Banking Corporation