

Colonial First State Global Asset Management

**Corporate governance and engagement update**  
 Second-half 2008

**Introduction**

**Colonial First State Global Asset Management is a major shareholder on behalf of our investors in many Australian listed companies. As a result we are in a position of influence on matters of environmental, social and governance issues over these companies.**

Corporate governance addresses issues that face companies, with a key focus on board of directors. It involves financial policies, board composition, remuneration, disclosure of information, standards of corporate behaviour, performance and environmental and social issues.

Colonial First State Global Asset Management is an active shareholder. We are active through exercising proxy votes at company meetings and through direct discussions or 'engagement' with boards of directors and company management.

We take this responsibility of an active shareholder seriously and is one of a top concerns as a fiduciary. We will vote on all issues at company meetings where we have the authority to do so. We believe that voting rights are an integral component of investing. Proxy voting rights are valuable and we believe they are an asset that should be utilised.

Our aim is to select companies that will provide our investors with long term sustainable returns. As part of this we believe that best practice corporate governance practices, sustainability and responsible investing are all key issues that must be considered before investing in a company. We believe that there is a link between companies with good corporate governance, social and environmental practices and sustainable and better shareholder returns.

This report aims to give an update on our corporate governance practices for the second-half 2008. The report looks at how Colonial First State Global Asset Management voted on key issues such as director elections/re-elections, executive remuneration and non-executive remuneration. This report only covers our Australian investment funds' equity investments in Australian listed companies.

We also provide an update on our direct engagement with companies on environmental, social and governance issues via a series of case studies.

**Six-month summary**

Colonial First State Global Asset Management has a policy of voting on all resolutions put forward at meetings of companies in which our funds hold shares<sup>1</sup>. Each resolution is carefully considered by the fund's investment manager and the company's equity

analyst. Guidance is taken from our Corporate Governance and Engagement Policy.

During the second-half of 2008, Colonial First State Global Asset Management voted at 241 company meetings on 1315 resolutions. At these meetings we supported 84% of resolutions, 10% were opposed, and we abstained on 2%. Of the remainder of resolutions (4%), were non-voting resolutions on financial reports and presentations by the Chairman. This is the first period these resolutions have been separately counted. The second-half of the year is the busiest period for company meetings.

With the large fall in the sharemarket over the past 18 months, investors have lifted their interest in resolutions being put forward by companies. There has been a rise of 'shareholder activism', especially in the area of executive and non-executive remuneration. With share prices and company profits falling (or sometimes making a loss) resolutions are being watched very carefully by the general public, shareholder groups and Colonial First State Global Asset Management. We will look at the examples of this later in the report. We welcome the increased scrutiny of company resolutions and are particularly pleased at the focus on remuneration given our strong focus on this element corporate governance.

Colonial First State Global Asset Management is restricted from voting for the approval of share issues when we have participated in the placement and these resolutions are recorded as no action. The majority of our abstentions resulted from non-binding resolutions on company's remuneration reports and financial accounts.

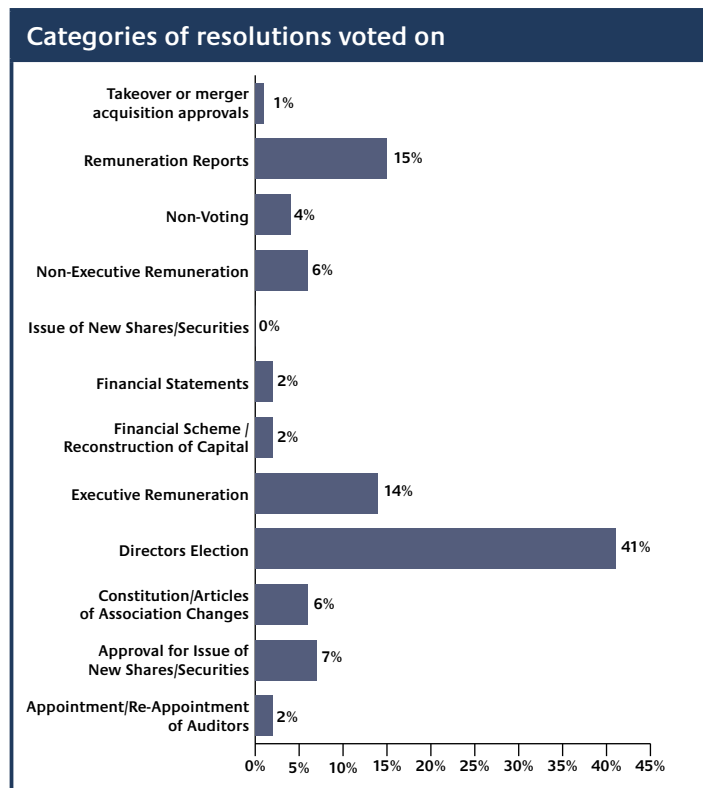
**Aggregate voting history**

	Second half 2008	Second half 2007	Second half 2006	Second half 2005	Second half 2004
# company meetings	241	268	248	236	278
# resolutions voted on	1315	1455	1366	1286	1526
% resolutions supported	84%	87%	90%	83%	86%
% resolutions against	10%	7%	8%	8%	9%
% resolutions abstained	2%	6%	2%	5%	5%
% resolutions no action	0%	0%	0%	0%	0%
% non-voting *	4%				

\* Please note this report is the first to include a category for non-voting resolutions. These relate to the receiving of financial reports and presentations by the Chairman and the board.

<sup>1</sup> The Corporate Governance Update covers Colonial First State Global Asset Management's proxy voting patterns on Australian listed companies held by our Australian domiciled funds.

The chart below shows the type of issues that were voted on during the recent proxy voting season. Director elections/re-elections, executive remuneration packages and remuneration reports were the most common topics for resolutions.



Sharemarket volatility, the rising cost of corporate debt funding and risk aversion by investors saw resolutions for corporate activity continue to be muted. We expect that resolutions for issue of new shares to rise in first-half of 2009 given the large number of equity capital raisings to take place.

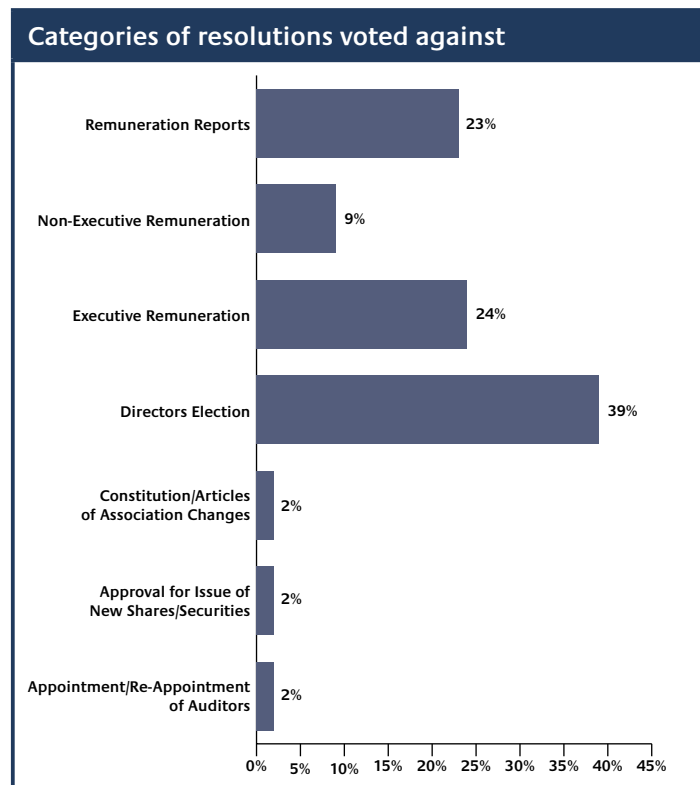
## Where are we saying no?

There was a pick-up in 'against' votes in second-half of 2008. Over time Colonial First State Global Asset Management has lifted its expectations of companies in relation to best practice corporate governance. The bulk of these 'against' votes came from the contentious categories of executive remuneration, director elections and remuneration reports. Although executive remuneration makes up only 14% of resolutions, they made up 24% of our 'against' votes. There was a strong pick up in the second-half of 2008 in votes against such resolutions. We examine why later in the report.

The other area representing a high proportion of 'against' votes was non-executive remuneration. Much of this has arisen given different expectations of management and shareholders in the face of deteriorating economic and profit conditions. The global financial crisis and subsequent global recession has highlighted companies that have been poorly managed or had sub-standard financing arrangements. Companies like this that are still pushing for large executive remuneration increases or incentive payments have faced a tough fight to have these packages approved. Colonial First State Global Asset Management is analysing each company and resolution carefully to ensure remuneration increases and incentive payments are well justified and based on good company and management performance.

Colonial First State Global Asset Management will continue to vote against remuneration reports containing contentious and inappropriate remuneration packages. Given the high proportion of executive remuneration and director election resolutions voted against, greater time and effort will have to be spent in discussion with executives and board members to ensure they understand what we, as shareholders consider appropriate.

The chart below shows the categories of resolutions where we voted 'against' in the second-half of 2008. It shows the most contentious categories were director elections/re-elections, executive remuneration and remuneration reports.



## Update on Director Elections/Re-elections

Board composition is a key corporate governance issue, and one that Colonial First State Global Asset Management pays close attention to. We not only examine the directorship nominee to determine whether the individual is a suitable candidate given their industry experience, skills, background, other responsibilities and the current composition of the board, but we place this nominee in the context of overall board composition.

Given recent events and a lift in the number of corporate collapses and sub standard board performance in selected circumstances, Colonial First State Global Asset Management is taking a firm stance on director elections/re-elections.

During the second-half of 2008, Colonial First State Global Asset Management voted on 541 resolutions for director elections/re-elections, we supported 89% of these and voted against 9% of resolutions. The percentage of 'against' has slowly been rising although was down from 16% in the first-half of 2008. The reasons behind this short-term change in the trend are discussed below.

## Director elections/re-elections

	Second half 2008	Second half 2007	Second half 2006
# company meetings involving director elections/re-elections	214	224	214
% company meetings	89%	84%	86%
# resolutions involving director elections/re-elections	541	529	543
% director elections/re-elections supported	89%	94%	94%
% director elections/re-elections against	9%	6%	4%
% director elections/re-elections abstained	2%	0%	1%
% director elections/re-elections no action*	0%	0%	1%

\* No action relates to Commonwealth Bank of Australia shares which by ASIC regulation No Action must be taken.

At Colonial First State Global Asset Management we not only want to make sure the nominee is the best person for job but also that the board is composed according to best practice. It is our belief that boards should be made up of a majority of independent directors. A number of the votes against director elections/re-elections resulted from Colonial First State Global Asset Management disagreeing on the nominee being classified as an independent director. This was a continuation of what happened in the first-half 2008.

Over the second-half of 2008, Colonial First State Global Asset Management voted against 49 resolutions involving director elections/re-elections. A number of these resolutions were voted against given poor board composition with insufficient independent directors. In most cases, the nominee was judged to be an affiliated director rather than an independent director as what was classified by the company.

Under Investment and Financial Services Association (IFSA) guidelines, a board should hold a majority of independent directors, with an independent director as chairman. IFSA defines an independent director as:

- not a substantial shareholder or officer of the company
- not an officer or associated with a substantial shareholder of the company
- has not in the past three years been a principle or employee of the company or a major consultant to the company
- is not a material supplier of the company or an officer or associated with a material supplier of the company
- has no material contract with the company (apart from being a director), and
- is free from any interest/business/other relationship with the business which could be perceived to materially impact on the director's ability to act in the best interests of the shareholder.

Director elections/re-election resolutions were voted against for ANZ Banking Group, Australian Stock Exchange, Billabong International, Bluescope Steel, Computershare, Crown, FKP Property Group, Insurance Australia Group, National Australia Bank and Transurban Group.

A lack of independent directors or the incorrect classification of independent directors saw Colonial First State Global Asset Management vote against Crown and Computershare. In the case of Computershare, we voted against the re-election of a director. Our view was that the director was incorrectly classified as independent when the director was actually affiliated with the company. With the change in classification, Computershare did not have enough independent directors on its Board to meet best practice board structure and the resolution was voted against.

A similar situation occurred with Crown, where Colonial First State Global Asset Management voted against a director election/re-election. We felt there were overall issues with the governance structure of the company with too few independent directors to represent the interests of retail and institutional shareholders. IFSA guidelines also state that the Chairperson should be independent and Crown did not have an independent Chairperson. We also felt it was a time for a refresh of the board and to bring the structure up to best practice guidelines.

In this proxy season there was an increase the number of directors nominees putting themselves up for election. This was the case for companies such as ANZ Banking Group, Australian Stock Exchange, BHP Billiton, Insurance Australia Group and National Australia Group. Colonial First State Global Asset Management believes that the board of directors through its nomination committee should present directors for election given they have the knowledge of skills and experience required of directors for their particular company.

## Update on Executive Remuneration

With the unprecedented falls in share prices and company profit growth slowing or falling, executive remuneration has attracted significant media coverage. Our investment managers and analysts have also been watching remuneration developments carefully. Colonial First State Global Asset Management believes that well defined and appropriately structured remuneration packages are vital in aligning the long-term interests of management and shareholders.

Colonial First State Global Asset Management is of the firm belief there should be full disclosure of total remuneration packages and with appropriate justification. Once full disclosure is achieved, plans can be assessed on their merit. This is of particular importance during tougher economic times. Companies are cutting dividends, reducing costs and downgrading profit forecasts. It is important that executives play a key role in promoting restraint through carefully considering remuneration plans. At the same time we understand company management is working harder than ever and we remain cognisant of this when determining the need for an increase in remuneration levels.

We maintain an active dialogue with company management, where possible and we are actively sought out by companies for our views on remuneration structures before resolutions are constructed. Through this forum we are able to express our expectations and requirements for remuneration packages and improve the standard of resolutions put forward at company meetings.

During the second-half of 2008, we voted on 179 company resolutions involving executive remuneration, supporting 77% of resolutions, voting against 18% and abstaining on 5%. This is a deterioration on recent periods and could be explained by a tougher stance given recent economic conditions. Colonial First State Global Asset Management's commitment to ensuring appropriate executive remuneration structures are in place.

The table below shows that voting patterns through time have been mixed. The level of resolutions supported has reverted back to past levels after a good result in second-half of 2007. We hope this standard is resumed over time.

Executive remuneration*			
	Second half 2008	Second half 2007	Second half 2006
# company meetings involving executive remuneration	89	58	69
% company meetings	37%	22%	28%
# executive remuneration resolutions voted on	179	166	181
% executive remuneration resolutions supported	77%	90%	78%
% executive remuneration resolutions against	18%	10%	22%
% executive remuneration abstained	5%	0%	0%
% executive remuneration no action	0%	0%	0%

\* Does not include remuneration reports. Colonial First State Global Asset Management reports on these resolutions separately. See below.

Executive remuneration resolutions involving incentive payments make up the majority of resolutions dealing with executive remuneration. They are also the most contentious and where much of our time is spent analysing resolution details.

Executive Remuneration packages we voted against in the second-half of 2008 included AJ Lucas, ANZ Banking Group, Becton Property Group, Flexigroup, Mortgage Choice, Sims Metal Management, Straits Resources, Tabcorp and Valad Property Group.

We voted against a resolution for AJ Lucas involving a grant of performance rights. We felt there was a lack of justification and explanation in relation to the performance grants and ongoing performance hurdles. In line with our desire for full disclosure, AJ Lucas did not provide a valuation of the grants. It was for these two reasons that Colonial First State Global Asset Management voted against the resolution. For a similar reason, we voted against a resolution for Becton Property Group. In line with our desire for full disclosure, Becton did not provide remuneration details for 2009 and without knowing this, the resolution could not be analysed in detail.

Colonial First State Global Asset Management also voted against an executive remuneration package for Valad Property Group. In this case, we felt that the substantial incentive payments in the form of options were not warranted given the disappointing performance of the company.

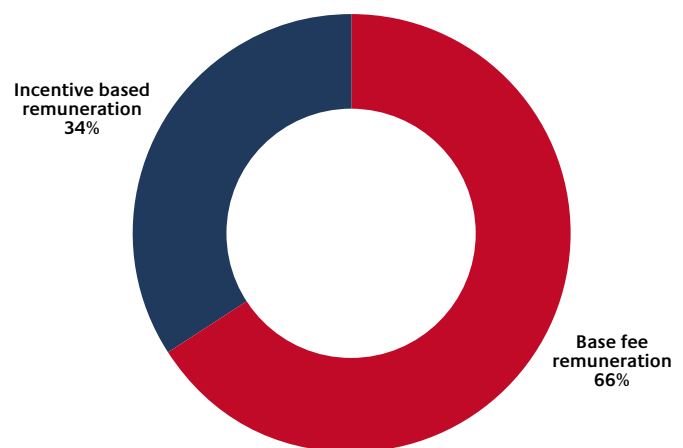
Colonial First State Global Asset Management believes that it is not just voting 'against' resolutions that get the appropriate corporate governance message across. As a large shareholder, by voting in favour of executive remuneration proposals, we send a clear signal to the company and the market about practices we will support. In our March 2008 Corporate Governance report we outlined what characteristics we support in executive remuneration resolutions.

Over the six-month period, we voted for executive remuneration resolutions for Billabong International, Brambles, National Australia Bank, Stockland Group, Qantas, Woolworths and Western Areas, among others.

We continue to monitor our voting patterns in relation to executive remuneration packages to see if the standard is improving. We are particularly interested in seeing whether a company where we voted against a resolution previously has reviewed its executive remuneration structure. It is particularly disappointing to see repeat offenders. From the second-half 2007 proxy voting season, there appears to be no repeat offenders. We will continue to monitor executive remuneration packages where we have voted against previously to ensure the message is getting through.

## Update on non-executive remuneration

In the second-half 2008, we voted on 76 resolutions involving non-executive remuneration. These can be broken down into resolutions relating to incentive based director fees and base director fees. The majority (66%) of resolutions were increases to base director fees.



Of the 76 resolutions voted on non-executive remuneration, we voted in favour of 83% of resolutions, voted against 16% and abstained on 1%. This was a deterioration from second-half of 2007 where Colonial First State Global Asset Management voted in favour of 95% of resolutions and voted against 5%. This is disappointing and while we understand that directors need to be rewarded according to the complex and time consuming work they undertake, it is important an increase in base director fees is well justified.

**Non-executive remuneration**

	Second half 2008	Second half 2007	Second half 2006
# company meetings	60	95	60
% company meetings	25%	35%	24%
# resolutions involving non-executive remuneration	76	129	70
% non-executive remuneration resolutions supported	83%	95%	90%
% non-executive remuneration resolutions voted against	16%	5%	10%
% non-executive remuneration resolutions abstained	1%	0%	0%

Over the second-half of 2008, Colonial First State Global Asset Management voted against 12 resolutions on non-executive remuneration. Of these, three were related to base director fee increases, while the remainder related to incentive payments involving option grants. We are firmly of the view that the granting of options for non-executive directors should not occur and will vote against resolutions of this kind. In exceptional cases an exception will be made and will only occur in the case of small companies who are trying to reduce cash outflows. We believe that directors should hold the same type of securities as ordinary shareholders as this will better align interests.

Colonial First State Global Asset Management voted against non-executive remuneration resolutions for Kingsgate Consolidated, Lynas Corporation, OM Holdings, Transurban and Hills Industries.

**Update on remuneration reports**

The remuneration report has grown in importance since 2005 when they were introduced as part of proxy voting. The remuneration report sets out the board’s remuneration policy for employees, executives and directors. The proxy resolution is not binding but must be put to vote by shareholders. Since 2005, Colonial First State Global Asset Management has been monitoring the quality of those reports and has taken a harder line on what we expect from each report in each proxy voting season. We require appropriate remuneration packages, policies and structures and full disclosure on all remuneration policies.

In the second-half of 2008, Colonial First State Global Asset Management voted on 201 remuneration report resolutions. We supported 165, opposed 30 and abstained on six.

The table below shows how these statistics differed from prior periods.

**Remuneration reports**

	Second half 2008	Second half 2007	Second half 2006	Second half 2005
# company meetings involving remuneration reports	201	207	196	164
% company meetings	83%	78%	79%	70%
# resolutions involving remuneration reports	201	207	196	164
% remuneration report resolutions supported	82%	81%	92%	57%
% remuneration report resolutions voted against	15%	18%	7%	9%
% remuneration report resolutions abstained	3%	1%	0.5%	34%

As the table above shows, there has been a slight improvement on reports supported since the second-half of 2007 although the number of against votes remains higher than we would prefer.

Remuneration reports were voted against for Asciano, Australian Wealth Management, Boral, Cabcharge Australia, FKP Property Group, Mortgage Choice, Paladin Energy, Qantas, Straits Resources, Suncorp-Metway, Transurban Group and Valad Property Group.

In the case of Boral, the remuneration report provides good disclosure of remuneration policy and structure of remuneration packages. However, Colonial First State Global Asset Management was unhappy with several aspects of remuneration structures. Of particular note was that the Chief Executive Officer’s short term incentive payment and total package was considerably larger than peers and the previous year. We had issues with the following:

- Not enough information was released as to why this large increase occurred.
- The Chief Executive Officer’s salary was considerably larger than the rest of team which could create morale issues.
- The focus on Total Shareholder Return as the single long term performance goal metric. A customised metric for the company would be useful given the industry specific issues that Boral is facing.

In the case of ‘against’ votes we will always attempt to relay our concerns to the company. We believe this, in conjunction with our ‘against’ vote, is a powerful message and should assist the company to improve its governance standards.

### An update on the proxy season as a whole

It is pleasing to note that Colonial First State Global Asset Management was not alone in many of its 'against' decisions in the second-half of 2008. Much of this was in relation to executive remuneration packages and remuneration reports, with market conditions changing considerably but executive remuneration remained the same.

There were a total of eight remuneration reports defeated over the proxy season and included Valad Property Group, Transurban and Boral. You will notice that these names also appear on Colonial First State Global Asset Management's list of companies whose remuneration reports we voted against. It is pleasing to see that with resolutions defeated, the message would have been received clearly by the company and action will be taken.

It is also pleasing to note that in the early stages of 2009, some companies have announced changes to remuneration policies have included pay freezes or even in some cases pay cuts by top executives and forgoing of incentive payments. It is pleasing to see some response to recent events.

Director elections also saw large 'against' votes across the board, in particular to directors who had been involved in companies that had failed.

### Engagement of environmental, social and governance issues

Colonial First State Global Asset Management is committed to engaging with companies on environmental, social and governance issues. Over the past 18 months we have raised our commitment in this area. We also publish a Responsible Investment Report that outlines the work we are doing in relation to these issues. The latest report can be found on our website.

We are an active shareholder through our proxy voting but we are also active in direct discussion with company management and directors. Our size and standing in the industry puts our investment managers in a privileged position to communicate to individual companies on environmental, social and governance issues. Through our discussions, our aim is to raise issues for potential improvement, encourage disclosure on these issues as well as applaud those companies that we believe are doing well in these areas.

Four examples of our direct engagement with companies on environmental, social and governance issues and how these have influenced our investment decisions are detailed below.

#### Case One – Origin Energy

Colonial First State Global Asset Management had discussions with Origin Energy regarding the impact of regulatory change for renewable energy, and how this will impact their business. Origin Energy acknowledged it creates a longer term liability for its business, and they will need to either invest in this business or contract out this business to satisfy this longer term liability effectively. Origin will look at capital allocations in this area (or contracting where this makes sense).

Colonial First State Global Asset Management were supportive of their approach and the thought given to this particular area. We encouraged an ongoing engagement with the investment community to communicate the mitigation of the risk on renewable energy. Colonial First State Global Asset Management also encouraged ongoing reporting and transparency and engagement of investors.

#### Case Two – Suncor Energy

Colonial First State Global Asset Management has been investors in Suncor Energy for many years. Suncor Energy is an integrated oil company, developing the Athabasca oil sands basin in Canada. Suncor is held as part of our global equity portfolios.

Suncor, similarly to other oil and gas companies, is a significant CO2 emitter and environmental risk is a source for significant liability for the company. Suncor is committed to and has policies in place for sustainability, environmental and social leadership. Suncor is focused on reducing the operational greenhouse gas emissions as well as investing in renewable energy, especially wind power and bioethanol.

This was the first one-on-one meeting with the company since signing the United Nations Principles for Responsible Investment (UNPRI). Colonial First State Global Asset Management took the opportunity to explain our more formalised Responsible Investment process and had a healthy discussion around Suncor's renewable initiatives, carbon trading in Canada and workforce retention strategies.

#### Case Three – Wesfarmers

Colonial First State Global Asset Management has started to be singled out for our work on Responsible Investment. During reporting season Wesfarmers expressed interest in Colonial First State Global Asset Management's approach to responsible investment and requested further dialogue so they could get feedback on their approach to sustainability and investors interests.

Two meetings were held with Wesfarmers where Colonial First State Global Asset Management asked questions around environmental, social and governance issues that could have the potential to impact long-term shareholder returns. Colonial First State Global Asset Management also emphasised the importance of reporting on the management of environmental, social and governance risks and opportunities to the market, further promoting the need for full disclosure by companies. Wesfarmers has taken our feedback on board and will look to adjust reporting more in line with investors' requirements.

#### Case Four – Asciano

During reporting season Colonial First State Global Asset Management held discussions with Asciano regarding their corporate governance practices, in particular their disclosure obligations over the past 12 months. Colonial First State Global Asset Management was clear in what they expected in terms of governance behaviours by listed companies and used the ownership of Asciano to encourage better governance moving forward. The governance behaviours will be monitored in an ongoing way and any further concerns will be raised directly with the company.

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