AMP CAPITAL

Corporate Governance 2011 full year report

FEBRUARY 2012

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Remuneration: Why so many chairmen engaged with AMP Capital this year

In this report last year AMP Capital predicted the new two-strike rule would lead to greater focus on remuneration but would not have a significant impact on the way AMP Capital casts votes.

Six months and 228 remuneration report votes later, this prediction has proven correct. While we experienced a three-fold increase in the number of companies seeking to discuss both our voting process and our specific views on remuneration, our voting statistics have remained fairly constant.

AMP Capital was initially a reluctant supporter of the two-strike rule due to the potential to create unnecessary distraction and unintended consequences. We felt the 25% threshold may have been set too low. However we have been voting against poorly structured remuneration for many years and often the concerns raised have fallen on deaf ears. With the two-strike rule now providing shareholders the opportunity to spill the entire board of a company once it has received two-strikes, it is not surprising companies are now listening to shareholder concerns on remuneration issues.

Since the introduction of the rule, AMP Capital has seen evidence of significant interest by ASX-listed companies around how institutional shareholders approach governance issues. As a result, AMP Capital has interacted with a wide range of company representatives, directors, industry bodies and clients. We were encouraged that industry associations such as the Australian Institute of Company Directors (AICD) and the Australasian Investor Relations Association (AIRA) were proactive in facilitating discussions between various company and shareholder representatives and were pleased to have the opportunity to present our views and respond to questions at various roundtable forums and conferences throughout the year. If this interest eventually results in fairer remuneration structures, then the focus brought about by this rule has merit.

Our discussions with ASX-listed company boards have provided AMP Capital with an excellent opportunity to provide context around our efforts in supporting good corporate governance. Helping boards understand that, as institutional investors, it is important we invest our clients' money in companies that are governed well and use shareholder funds wisely. To that end, we stressed that boards need to be well structured, remuneration needs to be fair, risks need to be managed and companies' activities need to be responsible and sustainable.

The nature of contact from companies has ranged from AMP Capital receiving a phone call from a corporate executive (for example investor relations, company secretary or general counsel) to companies initiating a series of one-on-one meetings where the company chairman initially canvasses shareholder concerns and then holds follow-up meetings where it is demonstrated how those concerns will be addressed.

It is pleasing to see that more companies outside the ASX 300 are keen to understand what is expected in terms of good governance. Some were particularly interested in the link drawn between better governance, investor confidence, better liquidity, improved access to capital and ultimately a lower cost of capital. Although companies perceived as 'poorly governed' can perform well, they will often have fewer investors willing to back them. Most investors will only invest in a company where they are confident that funds will be used wisely.

What is the two-strike rule?

The two-strike rule is new legislation giving shareholders the ability to vote on whether to 'spill' the board of directors (that is, remove the board of directors) over remuneration concerns. Two-strikes occurs when 25% or more of shareholders vote against the adoption of the remuneration report in two consecutive years.

How did AMP Capital vote on remuneration reports?

AMP Capital takes voting on remuneration seriously, considering it is also a means of communicating any concerns and preferred remuneration structures to the relevant company. Despite the potential impact of the two-strike rule, our approach to voting has not changed.

Over the years that AMP Capital has lodged votes on the adoption of remuneration reports, anywhere between 26% and 39% have not received our support. In 2010, 26% of remuneration reports were not supported. Similarly in 2011, 27% did not receive our support.[1]

1. In 2011 AMP Capital submitted votes on 272 remuneration reports; 199 reports were supported and 30 reports were voted against. On a further 43 reports AMP Capital decided to specifically abstain from voting and to communicate directly with the company on particular concerns.

Since the introduction of the two-strike rule, 17 of the ASX 300 companies held by AMP Capital received a 'first-strike'. However, out of these 17 companies AMP Capital did not necessarily vote against the remuneration report. Voting was as follows:

> at four of those companies, votes were cast in favour, as on-balance we had judged the company's remuneration to be acceptable in the context of their particular operating environment[2]

> at six companies, votes were cast against[3], and

> at seven companies, AMP Capital specifically abstained from voting and communicated our concerns to the company.

Where AMP Capital voted against remuneration reports, we did so due to significant concerns with regard to one or more of the following issues: very poor disclosure; unjustified high base-pay; poor correlation between pay and performance; poorly structured incentive schemes; overly generous termination pay and the granting of executive incentives to non-executive directors.

Where our concerns were minor, or when it may have been the first time an issue had been raised with the company, AMP Capital often chose to abstain from voting and to raise issues directly with the company. Where this approach has no impact we will often vote against the issue the following year.

Looking forward

AMP Capital continues to hold the view that it is unlikely entire boards will be spilled over shareholders' remuneration concerns. Companies who work to understand shareholder concerns, and improve their remuneration structure and reporting, are well positioned and should have nothing to fear. Australian shareholders are unlikely to vote out directors who are generally considered to be doing a good job. It is expected those companies who received a 'first-strike' against their remuneration will engage with shareholders prior to their next Annual General Meeting (AGM) to seek to address concerns raised. AMP Capital is open to engaging with companies and strongly encourages this to occur outside the peak of the proxy voting season. Given the AGM cycle, proxy voting is extremely seasonal with a mini-peak occurring in April and May and the main peak in October and November.

2. It appears in some cases shareholders may have voted against these remuneration reports due to concerns over increases in base pay and/or poor disclosure. However, on the basis of AMP Capital's analysis of the particular situation, we regarded the overall remuneration structure as acceptable.

3. See page 5 of this report for a list of companies where AMP Capital voted 'against' the remuneration report during 2011. Note: This list also includes companies outside the ASX300.

Aligning pay with performance: a shareholder's perspective

As an investor, it is important to AMP Capital that funds invested on our clients' behalf are put to good use by the companies whose securities we purchase.

As such our analysts and portfolio managers consider a vast number of factors with the aim of identifying companies that will provide the best relative returns for our investors. We not only analyse factors such as financial measures, strategy, business efficiency and the sustainability of the business model, but given how important it is that our clients' capital is allocated efficiently we also monitor how companies use that capital to reward and retain their people. Ultimately we believe that over the long term all these factors will be reflected in a company's share price and dividend return, with those companies best at effective allocation of capital delivering better total shareholder returns relative to their peers.

In recent discussions with company representatives, we noted that companies appeared particularly interested in shareholder views on the preferred structure of incentive plans and specifically the appropriateness of particular performance hurdles such as total shareholder return (TSR).

Remuneration: the big picture

In order to consider the merit of one particular remuneration structure or performance hurdle over another, it is important to step back and consider shareholders' goals and how remuneration can play a part in achieving those goals.

This is particularly important when discussing CEO pay. CEO pay can not only represent a sizeable expense for shareholders, but the structure of CEO pay also plays a significant role in encouraging particular behaviours. In most cases there are three components to CEO pay, the first of which is fixed, with the second two components ideally at-risk and paid only for superior performance:

> firstly, the CEO will generally receive a fair level of fixed or base pay for performing the usual tasks of running the company

> secondly, boards will usually have agreed to pay the CEO a bonus if he or she achieves certain additional short-term goals (ideally specific goals which not only help move the company in the right direction but are easily identified and measured over a one-year period), and

> finally, it is often considered appropriate to provide the CEO with an additional incentive that balances these short-term measures and focuses on the achievement of long-term goals aligned with the shareholders' goal of achieving a good relative long-term return on their investment.

When reviewing a company's remuneration, AMP Capital assesses all three aspects of remuneration.

Base pay is considered acceptable where it is set at a level that adequately rewards the CEO and senior management for carrying out the day-to-day tasks of running a company of that particular size and complexity.

AMP Capital appreciates companies that provide clear disclosure of their short-term incentive (STI) targets, as this gives comfort regarding the appropriateness of the hurdles and also how challenging it will be for the executives to meet them. We look for a balance between financial and non-financial measures and also operational and strategic measures. While short-term performance measures vary greatly between industries, a simple example of STI measures for a mining company could include consideration of cash costs, production, safety and reserve replacement.

Beyond both fixed-pay and the portion of remuneration directly controllable by the executive in the short-term, the long-term incentive (LTI) is the component that ideally provides a direct link between the interests of shareholders and executive pay. Interestingly despite this clear objective, the LTI is often seen as the most controversial component of pay, due in part to the sheer quantum but also due to the messages its structure can send.

While AMP Capital acknowledges many companies view long-term incentives as purely a retention mechanism, shareholders have difficulty justifying rewards based purely on continuity of service, with no reference to performance.

What is the best long-term incentive structure?

AMP Capital has voted on behalf of our clients on executive remuneration for many years and as such we have formulated strong views as to how we would like to see incentive schemes structured.[4]

Within the context of remuneration structures that also provide fixed pay and short-term bonuses (STI), it is not surprising many shareholders prefer LTI performance measures that focus directly on delivering value to shareholders.

It is AMP Capital's view that while financial and operational measures can provide guidance as to what an executive could focus on to deliver returns for shareholders, TSR hurdles have merit as they focus on the actual achievement of that performance.

We acknowledge critics of the relative TSR measure may liken it to a share-market lottery, or cite cyclicality, the lack of an appropriate peer-group and the fact that negative returns may still earn rewards as major concerns. While for some Australian companies we acknowledge an appropriate peer can be a challenge, AMP Capital argues that no other measure provides the same degree of alignment with shareholder interests. Some criticisms of the TSR measure can be addressed by using traditional options (which require an increase in the absolute share price before delivering real value to the executive) and longer (e.g. at least three-year) performance measurement periods (as these smooth performance volatility within the peer group). Measuring a company's returns relative to an appropriate peer group adjusts for aspects that might be reflected in share prices but are not in the companies' control, including economic growth and commodity prices.

Relative TSR ...no other measure provides the same degree of alignment with shareholder interests.

While relative TSR may not be a perfect performance hurdle in all circumstances, it is often the best of those available. Relative TSR is not only closely aligned with shareholder interests, but also has the added benefit of being easily defined, measured and communicated. This contrasts with financial hurdles which may not translate into good performance for shareholders, the clearest examples being risky or costly acquisitions made to boost earnings in an attempt to meet executives' earnings per share (EPS) performance hurdles. As long-term relative TSR captures the performance shareholders care about, incentive schemes using this measure provide the clearest link between pay and performance.

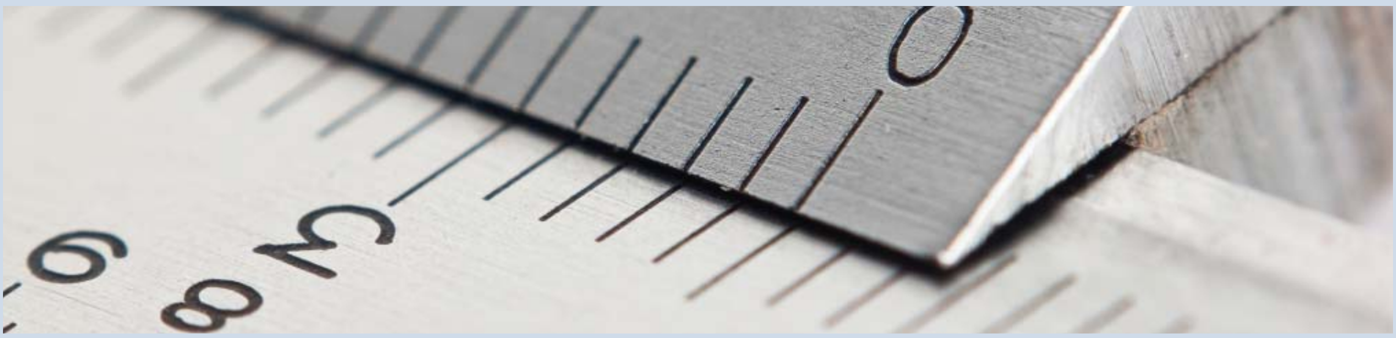
Conclusion

AMP Capital is an investor of clients' funds. This is a responsibility we take seriously and as such it is important the companies we have chosen to invest in on behalf of our clients are governed well and allocate capital efficiently to provide a solid return. As it is important our clients derive a strong relative return from the investments we make on their behalf, it would make sense for there to be a strong link between executive pay and long-term relative TSR.

For many years AMP Capital encouraged companies to structure LTI plans that focused solely on relative TSR measures. While we appreciate the simplicity of the TSR measure, we do acknowledge the benefit of companies adding an additional (financial, strategic or operational) performance hurdle over which the executive has greater control. For some companies hurdles based on earnings per share growth or return on capital can also be appropriate.

Regardless of which performance measure is used, it is important companies demonstrate the appropriateness of the hurdle and how its achievement has been proven to drive shareholder value.

4. AMP Capital's preferred incentive structures are detailed on page 5 of this report.

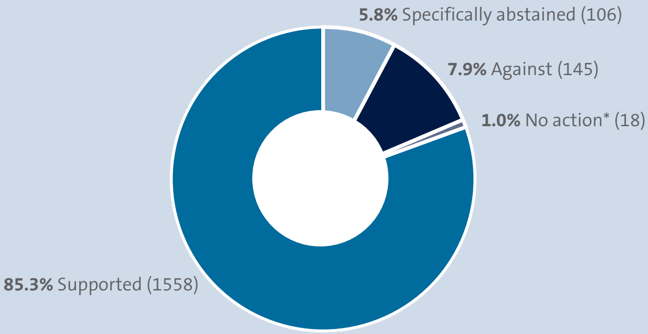


AMP Capital proxy voting statistics:

1 January to 31 December 2011

Voting 2011

AMP Capital voted on 1827 resolutions at 365 company meetings



* Resolutions where AMP Capital was excluded from voting eg. participated in share issues

AMP Capital's shareholder activism

AMP Capital takes the responsibility of investing our clients' money seriously. As such we are actively committed to encouraging good corporate governance at the companies owned in the portfolios we manage.

Whilst our lodgement of proxy votes has an impact on governance, we believe communication, either via letters or our meetings with company directors, to be a more constructive and effective form of shareholder activism.

Each year many governance-related letters are written to company chairmen. We continue to be pleased with the companies' positive response – 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 some 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.

Following on from the introduction of the two-strike rule (see page one), the number of companies seeking to engage with AMP Capital almost tripled over the last six months. While some increase in engagement had been anticipated, it was not possible to accommodate all companies' requests for meetings and dialogue during the already busy proxy season. As such we encourage companies to meet with shareholders well outside of the proxy season peaks.

Non-executive director (NED) remuneration

In 2011, 62 companies owned in AMP Capital portfolios sought approval for an increase in the maximum aggregate level of fees that could be paid to the company's NEDs.

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

AMP Capital Proxy Voting Statistics (2001 to 2011):

	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Number of company meetings where votes were submitted:	365	349	406	418	496	413	381	396	336	349	341
Number of resolutions voted on:	1827	1748	2007	2154	2482	2,049	1,824	1,622	1,335	1,700 (est)	1,500 (est)
Meetings where all resolutions supported (by AMP Capital):	64% 235	69% 240	55% 224	59% (248)	58% (290)	64% (265)	63% (238)	74%	74%	78%	68%
Meetings where incentive issues considered: (since 2005 includes Rem reports)	79% 290	80% (279)	83% (337)	82% (341)	72% (357)	79% (327)	68% (261)	33% (129)	27% (91)	26% (92)	31% (105)
Meetings where remuneration reports considered:	74% 271	72% (252)	71% (288)	75% (314)	68% (337)	76% (312)	57% (219)	n/a	n/a	n/a	n/a
Remuneration reports not supported (by AMP Capital):	27% (73/271)	26% (66/252)	37% (108/288)	39% (122/314)	36% (120/337)	31% (97/312)	31% (68/219)	n/a	n/a	n/a	n/a

directors be aligned with the shareholders they represent rather than potentially being influenced by incentive structures that may not reflect the experience of the public 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.

Share and option incentive plans

In 2011 AMP Capital submitted votes on 292 incentive-related resolutions (not including votes on remuneration reports, NED fee increases and termination payments).

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

Alacer Gold	Gujarat NRE Cooking Coal
Ampella Mining	Integra Mining
Aston Resources	Ivanhoe Australia
Aurora Oil & Gas	Kagara Zinc
Ausdrill	Karoon Gas
Carnarvon Petroleum	Nufarm
Carsales.Com	Oceana Gold
Coalspur Mines	OM Holdings
Cudeco	Tower Australia
Dart Energy	White Energy
Foster's Group	

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 a significant portion of the CEO's remuneration to be aligned with that goal.

The underlying reasons for not supporting long-term 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 lacked sufficient alignment with the interests of shareholders

> proposed plan amendments would increase the value to employees, without any corresponding benefit to shareholders

> participation of NEDs in executive schemes, and

> 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. We have become wary of incentives that vest automatically on change of control after seeing instances where company executives and directors engaged in behaviour that could potentially destroy shareholder value while themselves reaping significant personal gains.

AMP Capital also specifically abstained from voting on incentive schemes in several other 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, often leading to useful dialogue.

Remuneration reports

Since the introduction of the non-binding votes on remuneration reports in 2005, Australian investors have had a mechanism by which to review and comment on the approach to remuneration used by the companies in which they invest. The impact of a shareholder's 'against' vote on remuneration is now greater since the introduction of the two-strike rule (see page one).

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 2011 AMP Capital submitted votes on 271 remuneration reports, supporting 198 (73%) of them. The remuneration reports AMP Capital voted against (as opposed to either 'supporting' or 'abstaining') over this period include:

Adamus Resources	Ivanhoe Australia
Austar United	Leighton Holdings
Bathurst Resources	Mcpherson's
Bow Energy	Murchison Metals
Cabcharge	News Corporation
Carnarvon Petroleum	Nexus Energy
Cudeco	Nufarm
Dart Energy	Pacific Brands
Energy Resources	Prima Biomed
Extract Resources	Qrxpharma
Fleetwood Corporation	Servcorp
GUD Holdings	Virgin Blue
Gujarat Nre Coking Coal	White Energy
Hillgrove Resources	

AMP Capital voted against remuneration reports which exhibited one or more of the following criteria: poor disclosure; poor alignment with shareholder interests; inclusion of non-executive directors in executive incentive plans; excessive quantum and poorly structured performance hurdles. Poor performance hurdles may include those that are absolute rather than relative, not sufficiently challenging, too short-term, purely accounting-based or allowing too many opportunities for re-testing.

Another area of concern is excessive termination payments (both actual and potential) made to some departing senior executives – particularly as actual payments often bear little resemblance to previously agreed limits.

AMP Capital also specifically abstained from voting on 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 issues for shareholders. Despite its significance, AMP Capital acknowledges 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 cannot observe the dynamics of the board, nor its overall effectiveness.

In any proxy season, most company meetings are Annual General Meetings which require shareholders to vote on the election or re-election of directors. Votes cast 'against' directors would generally reflect concerns including poor board attendance, an insufficient number of independent directors to represent public shareholders (including too many executive directors on boards that are not majority independent) and finally, issues related to poor governance.

AMP Capital supported the majority of directors seeking re-election in 2011, those not supported were predominantly self-nominated, non board-endorsed candidates who we considered not ideal candidates. However companies where AMP Capital voted against at least one company-endorsed director include:

Cabcharge	Integra Mining
Cudeco	News Corporation
FKP Property	Nexus Energy
Harvey Norman	

In addition, AMP Capital specifically abstained from re-electing directors at several other 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.

Termination payments

Recent amendments to the Corporations Act 2001 (Cth) have tightened restrictions on termination payments that can be made to executives without shareholder approval.

The amendments now mean any employment contracts entered into (or varied) on or after 24 November 2009 require shareholder approval for termination benefits (paid to directors or certain executives) in excess of one year's base salary. Previously, termination benefits could reach up to seven times a recipient's total annual remuneration before shareholder approval was required.

These changes were first announced in March 2009 as part of the Federal Government's focus on excessive retirement payments following significant negative media surrounding this issue.

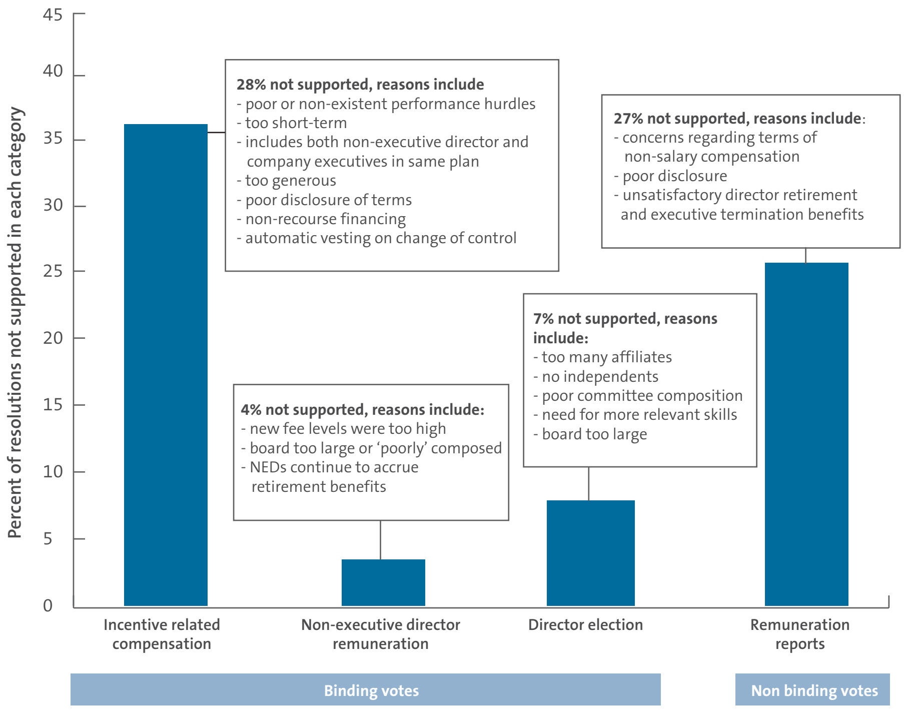
In 2011, companies where AMP Capital did not support at least one resolution relating to the actual, or potential, payment of termination payments include:

Boart Longyear	Ivanhoe Australia
Iluka Resources	Leighton Holdings

It has been interesting to observe how different companies have acted in response to the new rules. Some companies have taken a very conservative approach, interpreting an increase in the CEO's base pay as 'an amendment to their employment contract', this in turn leading them to then seek shareholder approval for termination payments under that 'new' contract. In contrast, other companies were far more opportunistic and moved to lock in generous termination payments by amending employments contracts just prior to the November 2010 deadline.

AMP Capital will continue to monitor these developments with interest.

Resolutions not supported by AMP Capital Investors in 2011



Source: AMP Capital voting statistics

Governance in brief

Inquiry into the future of the AGM

On 6 December 2011, David Bradbury, Parliamentary Secretary to the Treasurer announced the Gillard Government will ask the Commonwealth's corporate law advisory body to examine the future of the company annual general meeting (AGM).

The media release stated:

The Corporations and Markets Advisory Committee (CAMAC) will look at how the AGM may operate into the future and how it might better deliver opportunities for shareholder engagement.

"The AGM plays a vital role in providing information to shareholders and holding directors accountable," said Mr Bradbury.

"The Gillard Government believes in the importance of shareholder engagement. That is why we reformed Australia's executive remuneration laws and introduced the two-strikes test, so that boards must justify the pay of executives and so that shareholders are given the power to have a say.

"The AGM is an essential part of the shareholder engagement framework and this inquiry will help to inform future policy directions about how the regulations governing the operation of the AGM might be refined to encourage improved outcomes for companies and shareholders.

"I have asked CAMAC to examine the future of the AGM, with particular regard to the impact of technological innovations and globalisation on the methods of information distribution and the way in which shareholders interact with companies."

The terms of reference for the inquiry are:

> the future of the AGM in Australia, including how documents and meeting forms should change to meet the needs of shareholders in the future

> the risks and opportunities presented by advancements in technology, in the context of maintaining the ongoing relevance and efficacy of the AGM, and

> the challenges posed to the structure of the AGM by globalisation, including potential increases in international share ownership and dual-listing.

"While the AGM will continue to be a forum for shareholders to have their say, the way in which this occurs will continue to evolve. I look forward to this inquiry looking closely at the emerging opportunities for better transparency, accountability and shareholder engagement through the AGM."

AMP Capital's view

As a large investor in the Australian sharemarket AMP Capital has various opportunities to engage with companies throughout the year and rarely attends Annual General Meetings. In its current form we consider AGMs to be more relevant to retail shareholders or smaller institutions.

When voting on resolutions at company meetings AMP Capital lodges instructions via directed proxy votes well before the meeting. For many years AMP Capital has been concerned about the issue of 'lost votes' and encourages improvements that would help reduce problems associated with the current highly manual and cumbersome voting mechanisms.

More women on ASX boards

For some time AMP Capital has been interested in the gender diversity of ASX boards, especially as research demonstrates the benefits of such diversity.

In this report last year we reported on initiatives such as the AICD's mentoring program and also the introduction of the ASX Corporate Governance Council's guidelines on diversity. Since first gathering our own data on gender diversity last year, AMP Capital has witnessed considerable progress.

The following statistics show a substantial jump in the number of women now serving as company directors on the boards of companies AMP Capital has invested in. In 2010, 60% of boards in the sample had no women directors, pleasingly in 2011 this had dropped to 47%. Also the number of boards with two or more women has increased from 11% of the sample in 2010 to 17% in 2011.

	2010	2011
Number of companies in sample	234	213
Percentage of directors that are women	7.70%	10.50%
Boards with no women	60%	47%
Boards with one woman	29%	36%
Boards with two or more women	11%	17%

Only 2% of boards in the sample are led by women. These are Caltex, G8 Education, Prima Biomed, QBE Insurance, Skilled Group and Telstra. Pacific Brands has the highest number of women directors as currently four of the seven directors are women.

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

Financial Planners	**AMP Capital's Investment Representative on 1300 139 267**
Personal Investors	**Your Financial Adviser or call us on 1800 188 013**
Wholesale Investors	**AMP Capital's Client Service Team on 1800 658 404**

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