

Corporate governance and engagement update

First half of 2010



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Colonial First State Global Asset Management or CFSGAM is the consolidated asset management division of the Commonwealth Bank of Australia ABN 48 123 123 124.

Welcome to the Colonial First State Global Asset Management (CFSGAM) Corporate governance and engagement update for the period 1 January – 30 June 2010.

CFSGAM had more than A\$71 billion invested in Australian and global equities at 30 June 2010. As one of Australia's largest investment managers, we are significant shareholders on behalf of our investors in many listed companies around the world.

Active ownership and company engagement are amongst our top priorities as an investment manager and shareholder. We believe there is a correlation between companies with good corporate governance and strong, sustainable shareholder returns. Consequently, we seek to positively influence companies, through voting and engagement, towards best-practice corporate governance for the ultimate benefit of our investors.

CFSGAM holds shares in companies globally and places the same emphasis on active ownership wherever the investment is held. However, this report provides information on our proxy voting only for our Australian shareholdings. We expect to report on our proxy voting globally in future reports.

Six month market summary

There was a positive start to 2010, with optimism about the global economic recovery on the back of record low interest rates and government stimulus. Markets were supported by strong demand from China, upward revisions to earnings forecasts and low interest rates. This sentiment buoyed the S&P/ASX 200 index to a high of 5001 points during mid-April.

However, the mood shifted based on concerns over the financial health of several European nations, and downgrades on European nations began as Standard & Poor's downgraded Greek debt to 'junk' rating. Pessimism and concerns over a double-dip recession were the prevailing sentiments towards the end of the 2009/10 financial year.

A €750 billion crisis fund to rescue heavily-indebted euro zone countries in May went some way to assuage investors' fears. While the global economy, and companies generally, were in a much stronger position than during the global financial crisis, the period ended amid considerable volatility and uncertainty for the months ahead.

Proxy voting rights are an important part of shareholder responsibility, and CFSGAM seeks to vote on all possible resolutions at company meetings. Prior to voting, the relevant investment manager and company equity analyst carefully consider each resolution, with guidance provided by our 'Guidelines and principles for corporate engagement on governance, environment and social issues'. Recommendations from a selection of independent corporate governance research houses are also sought.

CFSGAM is restricted from voting for the approval of share issues where it has participated in the placement, and these resolutions are recorded as 'no action'. The majority of our abstentions result from non-binding resolutions on companies' remuneration reports and financial accounts.

Aggregate voting history

The number of supported resolutions and resolutions voted 'against' remains broadly in line with recent corresponding periods.

There was a marked increase in the total number of shareholder resolutions as a consequence of increased corporate activity during the period. The number of resolutions voted on was a 5-year high, an increase of more than 30% on the first half of 2009. The number of resolutions rose, as companies quickly adapted to post-crisis market conditions through capital raisings, strategic acquisitions and the issuance of new equity to strengthen balance sheets.

Aggregate voting against comparable periods

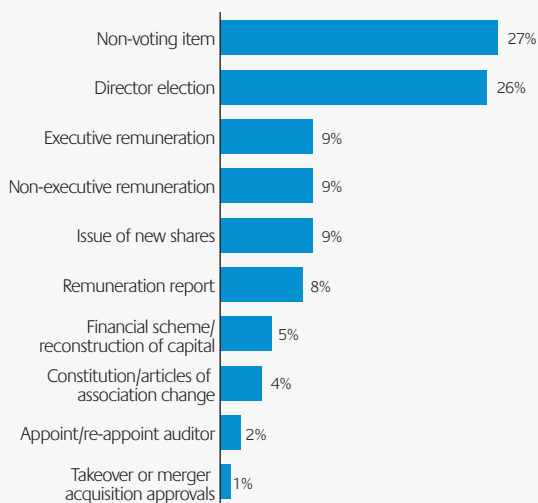
	First half 2010	First half 2009	First half 2008	First half 2007	First half 2006	First half 2005
Company meetings	89	68	75	93	78	68
Resolutions voted on	543	369	442	457	394	289
Resolutions supported (%)	87	84	87	96	87	79
Resolutions against (%)	10	10	9	2	9	5
Resolutions abstained (%)	3	1	4	2	4	16
Resolutions non-voting* (%)	35	5	n/a	n/a	n/a	n/a

Categories of resolutions

The chart below shows the proportion of resolutions that we voted on during the January – June proxy voting season.

CFSGAM maintains a focus on executive remuneration and board composition to ensure they are appropriate and in the best interests of the company and its shareholders.

Percentage breakdown of voting resolutions by category first half 2010

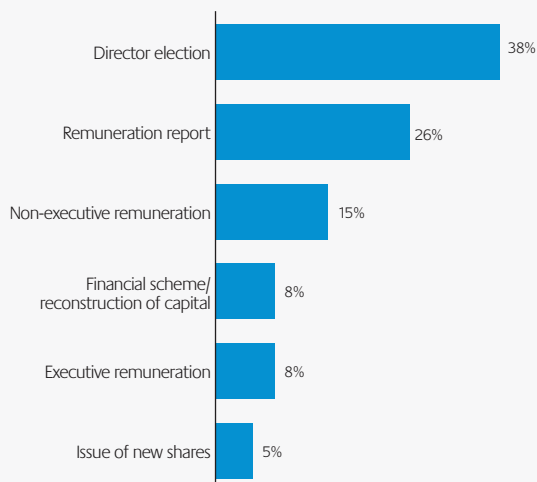


Where we voted against: aggregate voting

When voting against a resolution, CFSGAM will always seek to relay our concerns to company management prior to casting the vote. We believe that this engagement, together with our vote, conveys a powerful message to the companies involved and can assist in improving future governance standards for the ultimate benefit of investors.

It was encouraging to see a considerable reduction in the number of our votes against executive and non-executive remuneration, with both categories down significantly compared to the first half of 2009. This trend suggests that companies are responding to shareholder demand and proposing more appropriate remuneration structures for executives.

Percentage breakdown of resolutions not supported by category first half of 2010



Director elections and re-elections

An effective board of directors is vital to ensure best practice corporate governance. All directorship nominees are examined within the context of other board members to determine whether the individual is a suitable candidate given their industry experience, skills, background and responsibilities.

Director election/re-election resolutions continue to be under close scrutiny to ensure best practice board composition. The total number of votes against the election of directors rose from the previous corresponding period, however this is commensurate with the higher number of director election resolutions.

A number of director election/re-election resolutions were voted against as a result of poor board composition with insufficient representation from independent directors. CFSGAM is of the view that a board should hold a majority of independent directors, with an independent director acting as chairman.

Where we voted against: director election/re-election

Below are examples of why director election/re-election resolutions were not supported.

Australand Property Group

We voted against the re-election of a Director. This decision was made on the basis of board accountability, given the lack of any actual or proposed changes to the board despite the group's disappointing returns to security holders over the past two years.

APN News and Media

A number of recent resolutions to re-elect Directors at APN News and Media have been voted against. In this case, the re-election of two Directors was voted against as both candidates were viewed as associates. We do not believe it is best practice to maintain a board structure with a minority of independent directors.

Director elections/re-elections voting against comparable periods

	First half 2010	First half 2009	First half 2008	First half 2007	First half 2006
Company meetings involving director elections/re-elections	52	49	54	56	52
Resolutions involving director elections/re-elections	136	149	160	148	130
Director elections/re-elections supported (%)	86	94	81	98	97
Director elections/re-elections against (%)	11	6	16	0	3
Director elections/re-elections abstained (%)	4	0	3	2	0

Executive remuneration

Executive remuneration continued to be the subject of particular public scrutiny. Investors demanded that remuneration plans were appropriate, and aligned their own long-term interests with the management of companies in which they invested.

We analyse remuneration resolutions carefully to ensure any increases to base salaries or incentive payments are well justified and will result in enhanced company and management performance. We require full disclosure of total remuneration packages together with appropriate justification in order to assess plans on their merit.

While we will always vote against inappropriate remuneration packages, we will consider managers' contribution to the long-term success of the businesses they manage when assessing the need for an increase in remuneration levels.

To assist in our assessment we actively engage with company management and we welcome companies seeking our views on remuneration structures before resolutions are constructed. Through this dialogue we are able to convey our expectations for remuneration packages. This can contribute towards improving the overall standard of resolutions put forward at company meetings.

During the first half of 2010 we supported 94% of executive remuneration resolutions, which is a considerable improvement on the first half of 2009, where only 71% of resolutions were supported. It is pleasing to see these results improving in an environment of increased scrutiny and higher expectations of executive remuneration standards.

We continue to monitor our voting patterns in relation to executive remuneration packages to see if standards are improving, and whether companies where we

have previously voted against have reviewed their executive remuneration structure. We monitor executive remuneration packages which we have not previously supported to ensure our expectations are being addressed.

As shown in the table below, our voting patterns have been mixed over time. We will continue our work with executives and board members to ensure they understand what we, and other shareholders, consider to be appropriate in order to consistently have a high proportion of executive remuneration resolutions supported.

Resolutions supported

Voting against resolutions is not the only way to convey our requirement for well defined and suitably structured remuneration packages. By voting in favour of appropriate executive remuneration proposals, we send a clear signal to the company and the broader market about practices we will support.

Where we voted against: executive remuneration

Below are examples of where executive remuneration resolutions were not supported.

Australand Property Group

CFSGAM voted against the award of rights to a Director, as the Economic Value Add and Total Shareholder Return hurdles attached to three-quarters of the proposed grant were not disclosed. This was a concern, given the Board's recent executive remuneration decisions and the lack of disclosure around these targets, even on a retrospective basis.

Austar United Communications

We voted against the award of an equity grant to the Chief Executive, believing that his total remuneration package is too high relative to peers.

Executive Remuneration voting against comparable periods

	First half 2010	First half 2009	First half 2008	First half 2007	First half 2006	First half 2005
Company meetings involving executive remuneration	32	21	39	21	15	16
Executive remuneration resolutions voted on	48	31	86	46	38	22
Executive remuneration resolutions supported (%)	94	71	87	85	95	77
Executive remuneration resolutions against (%)	6	29	12	15	5	23
Executive remuneration abstained (%)	0	0	1	0	0	0

The figures above do not include remuneration reports. CFSGAM reports on these resolutions separately.

Non-executive remuneration

It was pleasing to see a reduction in the number of votes against non-executive remuneration, following a high proportion of votes against in the first half of 2009. This improvement is in the face of increased investor focus on company management to ensure that their fees are appropriate and justified. Companies with poor management or sub-standard financing arrangements now face tough opposition from shareholders to have unwarranted executive remuneration increases or incentive payments approved.

Remuneration reports

Remuneration reports typically set out a board's remuneration policy for employees, executives and directors. We have high expectations for remuneration reports and require appropriate remuneration packages, structures and full disclosure on all remuneration policies. While this proxy resolution is not binding, it must be put to vote by shareholders.

The percentage of remuneration reports we voted against was the highest in recent comparable periods.

Where we voted against: remuneration reports

Below are examples of why remuneration report resolutions were not supported.

Australand Property Group

We do not believe the level of bonuses paid to executives in 2008 and 2009 was commensurate with shareholder returns over these periods.

APN News and Media

In our view, Directors' fixed salaries are too high while short-term and long-term incentive payments are based on earnings per share growth, which we do not believe is an appropriate measure for the award of performance-related pay, as it is not necessarily difficult to achieve in a geared company structure.

Non-executive remuneration voting against comparable periods

	First half 2010	First half 2009	First half 2008	First half 2007	First-half 2006
Company meetings	21	9	24	21	14
Company meetings (%)	24	13	32	23	18
Resolutions involving non-executive remuneration	48	16	24	25	22
Non-executive remuneration resolutions supported (%)	87	44	96	96	91
Non-executive remuneration resolutions voted against	13	56	0	4	9
Non-executive remuneration resolutions abstained (%)	0	0	4	0	0

Remuneration report voting against comparable periods

	First half 2010	First half 2009	First half 2008	First half 2007	First half 2006
Company meetings involving remuneration reports	42	43	43	47	39
Company meetings (%)	47	63	57	51	50
Resolutions involving remuneration reports	42	43	43	48	39
Remuneration report resolutions supported (%)	74	81	90	94	77
Remuneration report resolutions voted against (%)	21	19	5	2	13
Remuneration report resolutions abstained (%)	2	0	5	4	10

Company engagement

CFSGAM is an active shareholder through proxy voting and direct discussions with company management and directors. Our scale and reputation in the investment management industry provides our investment managers with the opportunity to engage in dialogue with individual companies on environmental, social and governance (ESG) issues.

We seek to highlight areas for potential improvement, encourage disclosure on ESG issues and recognise companies that are making progress in addressing ESG considerations. Through this engagement we seek to positively influence companies towards ESG best-practice for the ultimate benefit of our investors.

CFSGAM is a signatory to the United Nations Principles for Responsible Investment and our engagement practices are in keeping with Principle 2; 'We will be active owners and incorporate ESG issues into our ownership policies'.

Our investment teams in Australia and overseas undertook private collaborative engagement, primarily on corporate governance, and we supported engagement undertaken as part of the corporate governance research process by RiskMetrics for Australian companies.

Examples of ESG issues we engaged in included:

- activities in conflict zones
- benefits and compensation
- bribery and corruption
- climate change
- distribution of fair trade products
- human rights
- labour issues
- social licence to operate
- management quality, and
- occupational health and safety.

We also have collaborative initiatives with third-party engagement providers to help gather necessary information to help us get maximum value from engagement.

Engagement examples

Examples of our active ownership, and how these have influenced our investment decisions, are outlined below.

Australian-listed major corporate

The Australian Equity, Core team engaged with the Chairman of a major corporate during the period regarding adjustments in the company's governance and sustainability process. We noted that the corporation has a focus on improving customer satisfaction and has improved structures within the organisation to improve the focus on governance and environmental and social stakeholders. This positively impacts our view on management given the changes in the executive team and improving relationships with the Government and community. We are concerned that in the case of this Company the transparency around remuneration and KPIs could be improved. This is the subject of ongoing discussions between CFSGAM and the Chairman and other Board members. The team also provided feedback on Company's equivalent of a Sustainability Report, suggesting there was potential to improve the content in order for the document to be a more useful reflection of how management was incorporating ESG practices across the organisation.

American Water works

The Global Listed Infrastructure team held a conference call with American Water Works to discuss the different regulatory environments that the company operates in. As a provider of water and wastewater services to approximately 15 million people in the US and Canada, compliance with environmental standards is paramount. This company stands out for its excellence in transparency to stakeholders. We noted that the company issued a partial report addressing numerous indicators from the G3 Reporting Framework issued by the Global Reporting Initiative. This will hopefully encourage other companies to follow suit.

Emerging natural gas producer

The Global Resources team made a small investment into an emerging natural gas producer in Europe. There was a risk around the management of the company, given the previous corporate history of the Managing Director. It was a high risk, but potentially high return, investment opportunity given the growth profile in production.

We gained some comfort following a meeting with the Managing Director, where the Global Resources team questioned him on his past performance. This comfort proved unwarranted, however, when an announcement was released reducing the stated proven reserves by 90% at one of the company's fields. The Global Resources team subsequently exited the stock.

Shortly after this announcement, the company declared that the decline rate of pressure at the wellhead of its second gas field was much higher than estimated in previous well tests. This meant that the reservoir performance and projected field life would be adjusted so that daily production rates were reduced. This episode reinforced our commitment to maintain our focus on management track record.

Agricultural processing company

Allegations of tax fraud in Indonesia were directed at a large diversified agricultural processing company listed in Singapore. The Global Resources team engaged with one of the company's largest shareholders; a US-listed global agricultural products trader and processor with a board seat.

The US company reiterated its long-term holding in the company and believed the Singapore-listed company had acted reputably. The Singaporean company in question quickly made a public announcement denying the allegations and stating that its Indonesian subsidiaries are in full compliance with all relevant VAT regulations in the country. The investigation is ongoing, and the team will continue to monitor and engage on the issue.

Australian-listed industrial company

Members of the Australian Equities, Core Team recently engaged with management of an Australian listed industrial company to better understand the Company's management and attitudes toward corporate governance and sustainability issues. In this particular case the focus related to events leading up to and management actions post a safety incident. Work place safety is one area of focus for Core Equities and discussions by the analyst pertained to the process, accountabilities, focus and outcomes that have arisen from this event. Dialogue continues as part of our process of understanding and gauging the level of management commitment, not only on work place safety, but other ESG issues. We continue to engage with management about increasing disclosure around sustainability issues.

Agricultural company

A small agricultural company with operations in China reported excellent production and revenue growth in its first half results, but the company's margins weren't as high as expected due to a sharp increase in the value of fertiliser purchases. The Global Resources team was concerned by this, as the company purchases its fertilisers from a business that is owned by the company's Chairman.

The Global Resources team spoke with management to discuss the company's results and raise this related party transaction issue. The company explained that a recently established plantation resulted in the increased need for fertilizer without any product being produced, as it takes seven years for the plantations to reach full productive capacity. The Global Resources team will continue to keep a close eye on these related party transactions.

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