

# FINANCIAL REVIEW

News - Opinion

## **Equity grants to directors should require consent**

**GEOF STAPLEDON, MARTIN LAWRENCE**; **Geof Stapledon** is managing director and Martin Lawrence is lead analyst, Institutional Shareholder Services, Australia

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## LISTING RULES

Fund manager concerns about changes to a key listing rule are legitimate, write **Geof Stapledon** and Martin Lawrence.

Investor concern has led the recently renamed ASX Ltd to take the unusual step of reconsidering the whole issue of shareholder approval for equity grants to directors.

The rule that governs this area - listing rule 10.14 - was amended only recently, in October 2005, to remove the requirement for shareholder approval if the shares were bought on-market.

Some in the corporate community have asked why institutional investors are concerned about the rule change, arguing that dilution is the underlying rationale for the listing rule, and where shares are bought on-market there isn't any dilution.

However, the strength of feeling about the issue among fund managers and superannuation funds indicates there is more to it than that, and that this isn't just a technical listing rule amendment. The ASX should therefore be commended for responding to investor concerns and reopening the debate on listing rule 10.14.

Consider this scenario: a junior miner with three directors in total - one non-executive and two executive - establishes an executive share ownership plan that will acquire shares on-market. A placement is made to institutions for the purposes of general working capital. Performance rights representing 5 per cent of the company's equity are then granted to all three directors with no performance hurdles attached and a vesting period of 12 months. A substantial amount of money from the placement is expended buying stock on-market to satisfy the grants.

As the listing rule stands at present there is nothing to prevent the above scenario occurring and no contemporaneous disclosure to ensure that investors are given early warning.

As it stands, there are at least four reasons for reinstating the shareholder approval requirement.

First, requiring shareholder approval in advance of an equity grant to the CEO or other executive director means there is contemporaneous and detailed disclosure of key terms and conditions of the grant in the notice of meeting. In contrast, where shares are bought on-market and no shareholder approval is sought, disclosure comes months later in the annual report. Sometimes the disclosure of key terms and conditions has been materially less precise.

Second, investors do not regard dilution as the only rationale for listing rule 10.14. Shareholders have been as interested in performance hurdles, vesting schedules, change of control provisions, size of the grants and the like.

Third, it is an oversimplification to suggest that there is never a dilution concern where equity incentives are satisfied through an on-market purchase. Fourth, the listing rule - as stated by the ASX in a waiver granted to a company - is "directed at preventing a related party obtaining securities on advantageous terms and increasing their holding proportionate to other holdings".

No supporter of the October 2005 change to the rule has yet been able to explain the difference between related parties increasing their holding as a result of shares or options being issued to them and shares being purchased for them using shareholders' funds.

The change to the rule appeared to happen in a vacuum: no compelling case was presented as to why the long-standing right of shareholders to approve grants of equity to related parties needed to be removed - particularly as the only rationale for granting equity to executive directors is so that they better serve shareholders.

Given this, it is in the interests of investors and the interests of Australia's reputation for investor protection that the ASX, having taken the important first step of seeking comment on listing rule 10.14, amends the rule and restores the protection investors have so long enjoyed.