Directors of TOMORROW

Personal financial risks facing aspiring Company Directors

White Paper prepared by

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EXECUTIVE SUMMARY

Company directors make a valuable contribution to Corporate Australia. It is a privilege to be invited to serve on a company board, however this comes with it considerable risk to personal wealth built throughout extensive careers.

The purpose of this White Paper is to raise awareness amongst aspiring company directors of the importance of early attention to manage these risks and other financial challenges:

- Protection of personal net worth
- Lack of available time
- Lack of awareness of personal financial structures
- Additional scrutiny on share dealings
- Philanthropic structures

The legal and regulatory frameworks boards work within place significant demands on those that hold a portfolio of directorships. The majority of company directors have limited time to dedicate to managing their own financial affairs, and may not have the knowledge of wealth structures and strategies which may be different to those undertaken during their corporate careers.

Company directors benefit enormously from having a relationship with a trusted adviser who will provide a different perspective, and bring together the expertise to optimise financial outcomes while managing risk, so family wealth is not compromised.

"There is almost no other occupation where you are so personally exposed, so the last thing you want to do is to risk your family's security."

- Public Company Director

WHY THIS RESEARCH IS IMPORTANT

The leadership of Australian companies is on the brink of change. Board members who have served as non-executive directors and independent chairman for the past decade are preparing to retire. In their place will rise younger leaders; men and women who have established records in leading large, publicly listed companies, private enterprises, government entities and not-for-profit organisations. These are leaders who have served as chief executives, worked in other C-Suite roles, grown businesses and created new companies.

Importantly, they will also be some of the wealthiest leaders. Their wealth is directly attributable to their successful careers, as well as their choice of investments. However, they face serious financial challenges:

- The burden of the legal and regulatory environment and the substantial risks associated with the role of company director leads directly to concerns about losing personal wealth
- The increased accountabilities, responsibilities and workloads leave little time for personal wealth management
- The lack of awareness of how to best structure wealth and personal finances may mean that the financial security of their family could be at risk
- Their generous nature and desire to help others may not be optimally structured to provide the greatest benefit.

Following extensive research with Australian company directors, we have prepared this White Paper to raise awareness among aspiring directors of the personal financial issues that should be considered before pursing this next stage in their careers.

> *One of the biggest fears of being a company director is being caught up in an action or an event that potentially places your personal wealth at risk, and equally important, places your professional reputation at risk.*
>
> *- Public Company Director*

THE PROFESSIONAL COMPANY DIRECTOR

Previously, managing a portfolio of directorships was an appropriate, and expected, activity for an executive who had resigned from a leadership role but was not yet ready to retire. Being a company director was a relatively comfortable role, and enabled senior business leaders to "make a contribution" to the way Australian organisations were run. The high level of confidentiality required meant that company directors were shielded from the media, and with the exception of the annual general meeting, from the inquiries of shareholders generally.

Today a company director is likely to approach the role much more professionally than in the past. He or she will hold, or aspire to, a portfolio of directorships of organisations ranging from top S&P/ASX 200 listed companies, to arts and sporting organisations, not-for-profit charities and government-owned enterprises.

According to the Australian Institute of Company Directors (AICD), the boards of ASX 200 companies comprise an average of 10 directors. Of these potential 2,000 board seats, about a third of directors hold multiple, or interlocking directorships with other listed companies. Therefore, there are approximately 1,200-1,400 individual company directors serving in Australian corporate life today. This figure does not include those serving on private company boards, or in the public and not-for-profit sectors.

The role of a company director today is approached like a job. Some independent directors have a virtual secretary, while others work from a company office to maintain their corporate environment. There are a growing number of groups of directors getting together in a shared office space with an administrative staff.

The day-to-day role is increasingly busier, more demanding and complex. Recent studies show that the onerous nature of increased compliance obligations has meant more time and energy has to be devoted to board stewardship. The rising exposure of legal liability means less time can be given to strategy which is one of the core competencies of a board.

Most boards in the S&P/ASX 200 meet 30 times annually. Regular monthly board meetings and board sub-committee meetings as well as information discussions and strategic offsite sessions often add up, with one S&P/ASX listed board meeting 72 times, according to a mid-2008 survey by Deloitte.

Today company directors are much more in the public spotlight. They are often well-known to those who follow business and markets, and many are household names. Chairmen make keynote addresses at conferences, non-executive directors write magazine columns and are interviewed by the media, while others may be known through reporting of recent court cases.

In parallel the legal role of the company director has also changed. Public company life is monitored closely by regulators, such as the Australian Stock Exchange (ASX), and the Australian Securities and Investment Commission (ASIC). For some company directors, this environment is tantamount to black letter law and even makes some ponder the merits of pursing a board role.

The leaders of tomorrow's boardrooms are today, like their predecessors, working hard building their careers. They are men and women working in middle to senior management, typically married with children, paying off a mortgage and private school fees.

A survey of a sample of these younger directors by governance firm, Boardroom Partners, concluded that tomorrow's director is unlikely to see board work as an ultimate bookend to their career. A directorship, or a portfolio of boards, is one option for continued career progression.

The survey, A Changing Profile, concluded that directors aged 50 years and under are at stages in their lives where 'the right fit' is paramount for their professional and personal lives. If board work isn't satisfying then there are other options they can, and would, pursue.

> *Regulatory hurdles imposed on public company life make it difficult for company directors to focus on the key issues for the success of the organisation. There are increasing concerns by board members that it's just not worth taking the job because of the risk.*
>
> *– Public Company Director*

PERSONAL WEALTH AT RISK

The recent Global Financial Crisis has served as a sobering reminder that directors are personally liable for decisions made in the boardroom. A survey of ASX 200 listed Company Directors conducted by the AICD in December 2008 highlighted that these personal liability risks are having a negative impact on recruitment and retention of suitably qualified directors.

78% of the respondents considered there was a "medium to high risk of being held personally liable for decisions they or their boards had made in good faith". Further, this risk had caused them to "occasionally or frequently take an overly cautious approach to business decision-making, with 64% suggesting that such an approach had inhibited an optimal business decision to a medium to high degree".

These risks also apply to not-for profit boards and include insolvent trading as well as potential criminal penalties on over 600 State and Territory laws for corporate misconduct.

STEPS TO MITIGATE RISK

1. Due diligence

The most important aspect is the due diligence process undertaken prior to agreeing to join a board. Directors are approached for their diverse range of skills, corporate leadership and business acumen and may get caught up in the seduction of the selection process. It is critical that directors undertake their own due diligence, review company financials, corporate objectives and principals, and whether the companies' values are aligned with their own. At the end of the day it is a judgement call as to which boards you chose to join.

2. D&O Insurance

There is a widely held belief that Directors and Officers insurance provides complete coverage. As part of the due-diligence process, applicants should request a copy of the policy and ask questions in relation to previous instances when the cover has ever been called upon.

3. Structure personal wealth

During your corporate career, if you are an aspiring company director it is essential to raise this with your financial and tax advisers so appropriate ownership and structures can be put in place as personal wealth is being built.

You've worked too hard throughout your career for something that was within your control but overlooked or delegated to damage your reputation or put your personal wealth at risk. The time to get your affairs structured is now, not when a problem arises.

KEY FINANCIAL CHALLENGES

1. Personal wealth at risk

The potential risk to personal net worth was the most common financial issue facing directors in our research. The environment described in the previous section can result in a significant financial exposure. This is a very legitimate concern given the frequency of corporate malfeasance or collapse and the ensuing courtroom dramas.

There are directors who have $5 million in accumulated wealth from their executive careers, and they ask, quite reasonably, 'why would I risk that for a $100,000 of annual board fees?

- Public Company Director

2. Lack of time

The next key challenge is a lack of available time. Where once the typical company director was semi-retired and had ample discretionary time, today's younger directors are involved in myriad activities, including family, social and leisure commitments. This challenge is accentuated by the concerns about board work centred on the increased responsibilities, accountabilities and workload which has been borne by directors following a period of governance reform in Australia and overseas.

The time and energy that is devoted to ensuring that 'all the boxes are ticked' in terms of compliance with respective regulatory authorities can be seen as taking the attention away from what is the real work of the board. What directors want to focus on is ensuring the company is growing, is financially sound and that it's returning value to shareholders.

- Public Company Director

3. Lack of awareness

There appears to be an assumption that the management of personal financial affairs as an employee should be the same when that individual becomes a company director. This demonstrates either a lack of knowledge of the risks or lack of awareness of the various options available to restructure one's personal wealth. The old approach of 'just putting everything in my wife's name' is not just sexist, it is old-fashioned. A modern director is likely to have complex wealth management requirements especially if he or she has a fluid approach to their career, moving from paid employment, consulting and board work.

Like the cobbler's children, the financial management skills of business are not often replicated at home. Many company directors have not reviewed their structure in years so may be inefficient or fail to provide proper asset protection.

- Tax Partner, Big Four accounting firm

4. Additional scrutiny on share dealings

Whilst there may be a perception that company directors are at an advantage when it comes to investing in shares, they are often too close to the issues affecting individual businesses. This can affect their judgment in relation to their personal investment holdings and result in increased risks to their family wealth.

To ensure the personal and business objectives of a company director are aligned, directors may be allocated, purchase with their own money, or leverage other investments to own stock in the companies they govern. This creates a greater level of risk than other ordinary shareholders as:

- more concentrated holdings and lack of diversification translates into greater risks and volatility
- directors are subject to "black-out" periods so are unable to transact as and when it suits their personal circumstances
- more onerous disclosure requirements, including obtaining approval prior to trading.

With the Global Financial Crisis, some directors are putting off planned retirement due the drop in their superannuation balances, largely due to the concentrated holdings in director held companies.

> *A company director was forced to hand in his resignation after selling shares contrary to its share trading policy. A sudden price drop resulted in a margin call with the sale taking place outside of the company trading window, a breach of the companies' internal trading policies.*
>
> *- article Sept 07*

5. Philanthropic interests

The recent AICD Directors Social Impact Study emphasises just how much the director community "gives back to Australian society".

Our research shows that many company directors are generous people, seeking to help others in a wide range of pursuits. However, not all of them have been optimising their charitable activities and many may be unaware of the options to establish charitable trusts and Private Ancillary Funds (PAF's) for their families giving strategies.

> *"Individual directors and their families can leave a meaningful footprint or legacy by establishing a charitable foundation. It gives them an effective tool to make a difference long into the future.*
>
> *Head of Philanthropy, NAB Private Wealth*

ADDRESSING THE CHALLENGES

Some directors manage their own affairs – when they go home from the boardroom they log on to the internet and check their stock portfolios. Others have their financial affairs professionally managed.

– Public Company Director

Aspiring directors should start thinking early about the appropriate strategies and structures to build, manage and protect their wealth, aligned with family values, goals and objectives.

1. Ownership of lifestyle assets

Consideration should be given at the outset to ownership of the family home and other lifestyle properties and assets, depending on the current and future career and business intentions of spouses and estate planning intensions.

2. Structuring investment assets

Entities such as family discretionary and hybrid trusts provide flexibility as circumstances inevitably change, are an effective risk management vehicle and provide for continuity of inter-generation wealth.

3. Role of the family superannuation fund

Superannuation (depending on contribution patterns) is protected from creditors and is a tax-effective vehicle to hold company stock, other investment assets and life and disability insurances.

4. Importance of asset class diversification

Asset Allocation is the most important strategic decision impacting on investment returns as markets move through the economic cycles. The income, growth, tax and risk characteristics vary across asset classes, and a robust investment process that seeks to minimise short term risk whilst optimising long term return outcomes is the foundation of a sound wealth plan.

Unsystematic risk, that is, exposure to concentrated holdings such as direct equities, employee stock options and private equity, should be minimised or effective risk management and hedging strategies undertaken to ensure core savings and wealth are not compromised.

5. Estate & succession planning

It is surprising the number of individuals, including those with significant wealth and complex family structures do not have a well thought out and documented estate and family succession plan. Further, some who have asset protection strategies in place may not have considered what happens with inherited assets, for example in the death of a spouse who owns the family home that would then become at risk?

ABOUT THE AUTHOR

Stacey Martin, CFP Dip FP, is a Senior Wealth Adviser with NAB Private Wealth, and has a thriving practice located in the Sydney CBD. Stacey has been advising senior executives on their personal wealth management for more than 15 years, following a decade in financial markets.

Acting as their "personal CFO", Stacey Martin and her team have a unique insight into the financial challenges and complexities faced by Company Directors, C-Suite and senior executives and private business owners. She appreciates the responsibilities of company directors and enjoys working through the issues to help them solve their personal financial challenges.

Bringing together specialist tax advisory and legal services, estate planning experts and investment market specialists, Stacey provides advice on family wealth structures, hedging and funding solutions for employee share plans, asset allocation and portfolio management, as well as personal risk insurance solutions.

With the global presence of NAB, the practice has also expertise in cross border planning issues faced by executives with offshore assignments and returning expatriates.

Philanthropy is an increasing focus since the introduction of Private Ancillary Funds in supporting clients' involvement in charitable giving and on not-for-profit boards.

Company directors benefit enormously from having a trusted adviser who will provide a different perspective. The adviser brings together all of the expertise required to optimise financial outcomes while managing risk, so family wealth is not compromised, and peace of mind is achieved.

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BOARD RECRUITMENT

The Australian Institute of Company Directors

The AICD is Australia's pre-eminent organisation for directors, dedicated to making a difference in the quality of governance and directorship. The Directorship Opportunities service has almost 9,000 subscribers. Of organisations who have used this service to post a director vacancy, 87% have resulted in a successful appointment.

www.companydirectors.com.au Ph: 1300 739 119.

Chartered Secretaries Australia

CSA's Directors Resume register is designed to assist members of CSA to progress their careers and organisations to identify suitably qualified and experience candidates for governance positions.

www.csaust.com Ph: (02) 9223 5744

Women on Boards

WOB is the leading advocate for improving gender diversity on Australian boards. The work to improve women's access to, and opportunities to be selected for, board positions in ASX listed & private companies and in the public unlisted (NFP), Government, sport, rural and community sector.

www.womenonboards.org.au Ph: (02) 9331 8851

Specialist Recruitment Firms

There are a range of search firms who specialise in attracting the right talent, experience and skills to complement the needs of today's boards.

USEFUL LINKS

Australian Bureau of Statistics	www.abs.gov.au
Australian Prudential Regulation Authority	www.apra.gov.au
Australian Securities and Investment Commission	www.asic.gov.au