

ASX Code: AEF

29 May 2012

## Letter to Shareholders

### This is an important document – please read carefully

Dear Shareholder,

**You will have recently received a Notice of Meeting for a general meeting to be held on 21 June called by a small group of dissident shareholders.**

**We urge you to VOTE AGAINST all resolutions.**

Australian Ethical is a very special Company. At its core is a vision that people should be able to save and invest in a way that helps them achieve their long term financial goals whilst having a positive impact on the environment, society and the planet. Each Board member and senior executive has joined this Company to help fulfil this vision and bring about a positive change in our society.

Organisational evolution is often difficult and painful but it is necessary. That was certainly the view of your Board in 2009 when we took the difficult decision to transition to a new CEO. When Phil Vernon was appointed, he was given a specific brief to evolve the culture of Australian Ethical to be more performance oriented and focused externally on the needs of ethical investors and shareholders.

The reasoning was this: Australian Ethical, like all asset managers, was facing unprecedented challenges from a highly competitive market place, out-dated products, a global financial crisis, and potential regulatory change. The Board's view was that your Company needed to change its culture and its way of doing business in order to survive, thrive and continue to deliver its important mission to grow ethical investment. The challenges that the Board foresaw have indeed come to pass, however Australian Ethical has responded strongly and we continue to explore all options for improving the sustainability of the business.

#### Major progress

The changes that the Management Team has implemented with full Board support include:

- ***Changing from a product to a client oriented culture;*** measures introduced include in-sourcing the client call centre; enabling online Super applications and making a number of senior management appointments to marketing, distribution and client service
- ***Replacing outdated and unsupported systems*** enabling significant improvements in unit pricing accuracy and timeliness and investment performance measurement
- ***Addressing major concerns of ratings agencies and asset consultants*** by:
  - o Relocating the Investment team to a predominantly single location (Sydney)
  - o Introducing performance related pay (for the first time in the Company's history)

- **Major changes to product structure and pricing** in order to retain and grow funds under management. (A recent survey by SuperRatings rated Australian Ethical's member growth, engagement and funds flow as "above" or "well above" benchmark.)
- **Re-engaging with the advisor community** in order to respond to their needs in terms of service and product
- **Reducing costs** to position the Company for a more competitive and low fee environment.

### **Dissident shareholders**

When a company undertakes such a major transition not everybody will be happy and some employees will be unwilling or unable to make the change. Many of the individuals who are the dissenting shareholders or director candidates were employees who were unwilling to come with your Company on its path of continual improvement.

The material that these former employees have circulated to you in the guise of "concerned" shareholders is misleading and inaccurate and some of it might be defamatory. Indeed, the directors have taken legal advice and may commence legal proceedings against these individuals in relation to the defamation. Attached to this letter is a factual response to the inaccurate claims made. This may not be of any interest to you, but if you are not sure how to vote, we urge you to read this important material.

### **Choose a sustainable future for your Company – Vote Against all resolutions**

Australian Ethical is committed to principles of good governance and deserves a truly independent Board managing its affairs in the best interests of all stakeholders. The Board is concerned, from a corporate governance perspective, at the makeup of the proposed board. These concerns are outlined in the attached document.


As we stated in our 14 May announcement, the Board and Management Team, while considering all options, are fully committed to getting on with running the business for the benefit of all stakeholders of Australian Ethical focussing on excellent ethical and socially responsible investments that are making a positive difference, now, and into the future.

As a shareholder you are now being asked to make the choice whether to continue moving forward to successfully face the challenges presented by the economy, the share market and the regulatory environment, or to go back to an approach that may seem comfortable because it is familiar but risks committing your Company to an unsustainable future.

You will find a proxy form enclosed.

**We urge you to VOTE AGAINST all resolutions and allow Australian Ethical a sustainable future.**

Yours faithfully,



**Andre Morony**  
Chairman

## Director Profiles



**Your Board is cohesive, reputable, highly experienced and committed to the highest standards of governance.**

### **André Morony, Chairman**

BEd (Hons), MEd

André joined the Board of Australian Ethical as a Non-Executive Director in June 2008 and was appointed Chairman in February 2011. He Chairs the People, Remuneration and Nominations Committee and is a member of the Investment Committee.

André is a highly regarded and experienced individual within the Government and finance industry. His career spans over 40 years and started at the Commonwealth Treasury where he worked in a number of financial policy areas. He also represented Australia for three years at the Organisation for Economic Cooperation and Development (OECD) in Paris.

After leaving Government in 1986, André's roles included Chief Economist and Chief Investment Officer at Bankers Trust Australia (now BT) and Chief Investment Officer for the Commonwealth Government's superannuation scheme (ARIA). He currently sits on the investment committee of GESB, the Western Australian Government employees' superannuation fund.

### **Phil Vernon, Managing Director**

BEd, MCom, MBA, FCPA, GAICD

Phil joined Australian Ethical as Chief Executive Officer in December 2009 and was appointed Managing Director in July 2010. He is also a director of Australian Ethical Superannuation.

Phil has 25 years experience in financial services including funds management and superannuation. Prior to Australian Ethical he was a member of the Executive Committee of Perpetual Limited heading up a business of 400 people. He has extensive experience in strategy, people management and leadership, corporate governance and industry regulation.

Phil was a champion of responsible investment within Perpetual at a time when they were facing criticism from the environmental movement for its significant shareholding in Gunns. With connections in the Tasmanian environment movement he had a unique insight to both sides of the debate. Phillip furthered his commitment in the area and is currently a Director of Planet Ark, a not for profit environmental organisation and RIAA, the Responsible Investment Association Australasia.

**Justine Hickey, Non-Executive Director**

BCom, SAFin, GAICD, ASIP

Justine has been an independent Non-Executive Director since March 2007. She chairs the Investment Committee and is a member of the People, Remuneration and Nominations Committee.

Justine has over 20 years experience as a senior executive in the investment and funds management industry. Previously she was Head of Equities at Suncorp Investment Management in Brisbane and a Portfolio Manager at Flemings Investment Management (now JP Morgan) in the UK.

Justine is a director of Rio Tinto Staff Super Fund Pty Ltd and a member of the investment committees of boutique fund manager, Dalton Nicol Reid and the University of Melbourne. Justine is the chairman of Evolve Foundation (previously the Youth Enterprise Trust Foundation), whose mission is to assist disadvantaged young people to transition into a confident and productive adulthood. She is also a director of RSPCA Queensland, the state's oldest, largest and leading animal welfare charity. Justine is a member of the Responsible Investment Association of Australasia.

**Steve Newnham, Executive Director**

BA, LLB, DFP

Steve joined the Board in December 2010 as a Non-Executive Director. In 2012, he became an Executive Director, chiefly responsible for sales and marketing.

Steve has over 20 years experience in the financial industry. He was Head of Distribution at Zurich Financial Services, chairman of a financial planning dealer group Financial Lifestyle Solutions, director of a wrap platform and a financial planning administration business, and Executive Vice President of BT Financial Group. He was also an early member of the Financial Planning Association Future 2 Foundation awareness and fund raising committee.

Steve has significant involvement with community and social justice activities, working on homeless shelter support schemes, indigenous fellowship programs, environmental and drought relief projects and mental health awareness initiatives. In addition, he has been a member of the Australian Rowing and Surf Lifesaving teams and spent 15 years as a surf lifesaver.

**Louise Herron, Non-Executive Director**

BA, LLM, GAICD

Louise was appointed a Non-Executive Director in February 2012. She is a member of the People, Remuneration and Nominations and the Audit, Compliance and Risk Committees.

Louise has an enviable track record in both business and social enterprise. She has been a corporate advisor for almost 10 years, in a range of different contexts. She is currently Executive Director of Ironbark Corporate Advisory, a firm she co-founded in 2007. She has also worked in an advisory capacity with likes of Carnegie Wylie, Investec and Macquarie Bank. Previously, Louise was a partner at law firm Minter Ellison for over 10 years.

Louise is a champion of the arts and currently chairs the NSW Major Performing Arts Board and is a director of the Australia Council for the Arts. She is a Trustee of Sydney Grammar School and was Chair of the Belvoir Street Theatre in Sydney from 2002 to 2011.

Louise recently led a tour of Chairs and CEOs of Australian major performing arts companies to New York. The aim was to understand best practice in private support for the arts, to be inspired and importantly to adapt what was learnt to the Australian environment.

## Response to claims made

**Claim:** “Destruction of staff morale”, “large number of staff departures”

**Fact:** Recent staff surveys show encouraging levels of staff engagement. Our staff survey conducted in September 2011 indicated that 97% of employees indicated they were satisfied or very satisfied with their current role. The Employee Status Report can be found in the Shareholder tab of our website. An additional survey conducted in April 2012 confirmed this positive trend.

Voluntary staff turnover is not significantly different from historical averages. Total turnover has included a significant proportion of redundancies (approximately 50%) over the past year.

The independent directors regularly consult with our HR Manager and elected employee representative to ensure that we address any staff issues or concerns.

**Claim:** “Shareholder value is going out the door”; “dropping” dividend

**Fact:** These are the most difficult times that financial services companies have been through for many, many decades for the following reasons:

- Markets remain volatile and low, some 40% lower than they were at their peak in late 2007
- Investors remain nervous about investing in the equities market and managed funds in general and are tending toward investing in cash and term deposits
- Regulatory change is putting pressure on business models and ultimately fees.

In general, Australian Ethical’s performance has remained solid relative to its peers in the financial services industry through this challenging time. In particular:

- Our funds under management and hence revenues have remained relatively stable
- Our net flows have compared favourably to peers. Almost every fund manager in Australia is experiencing net outflows
- Our dividends have remained relatively stable over the past four years
- Our total shareholder return (share price plus dividends) has been competitive relative to our peers

These trends and comparisons are illustrated in the recent shareholder presentation found on our website.

**Claim:** Australian Ethical’s Chairman denied two shareholders a vote on a matter that concerned his remuneration at the 2011 AGM

**Fact:** The relevant agenda item at the AGM concerned the 2010/11 AEI Remuneration Report which contained no remuneration increase for any AEI Director. A former staff member (Mr James Thier, one of the candidates for an AEI directorship) and a close family member were denied a vote, as required under the Corporations Act, because his remuneration details were included in the Report. A complaint was made to ASIC. ASIC informed us that they intend to take no action.

**Claim:** “lost opportunities”; declined to “receive” a \$14m “grant”

**Fact:** There was no “lost opportunity”. Your Board and Management Team decided against entering into this proposed new business (involving a grant from the federal Government to a fund to encourage social lending in Australia) because we concluded that the Company did not have the resources or experience to do so without taking on imprudent levels of risk.

What is omitted from the claim about this “lost opportunity” is that Mr James Thier and Mr Howard Pender made a submission on behalf of the Company without review by the Management Team and without approval from the Board. The Company received legal advice that:

- Mr Thier and Mr Pender’s submission contained information that was considered to be misleading and deceptive and could have breached the Commonwealth Criminal Code (1995); and
- our fiduciary duty requiring us to act in the best interests of investors.

**Claim:** “Increasing levels of remuneration”

**Fact:** Our CEOs remuneration is well below the average remuneration for CEOs of equivalent sized companies. In fact, the CEO’s salary is in the bottom 25%. This data comes from FIRG, a well respected source of finance industry remuneration data.

The ratio of the salary of the lowest paid employee to the highest paid employee in our Company (the CEO) has stayed relatively constant over the last three years.

Director’s fee levels are well below market and have not increased since 2008. Fee levels will remain unchanged in 2012.

**Claim:** “Treatment of stakeholders may be contributing to the net outflow of investor funds”

**Fact:** Almost every fund manager in Australia is experiencing net outflows. Fortunately Australian Ethical continues to achieve good growth in its Super business so overall net fund flow has been flat.

The SuperRatings 2011 Benchmark Report for Australian Ethical Super observed that “*member contribution growth of 11.6% and transfer contribution growth of 22.8% sat above industry metrics and culminated in total contribution growth of 11.6% which was above benchmark and illustrating an ‘improving’ five year trend*”.

The Board remains cognisant of the Company’s need to be more client and advisor focussed. This is what has been behind the significant organisational changes since 2009. We are confident that our client service is improving.

**Claim:** That disclosures to shareholders have “not indicated the reality” and been “propaganda”

**Fact:** The Board, three of whom are professional non-executive directors, is committed to best practice governance and completely rejects any claim that any notifications to shareholders and the ASX have been anything other than correct in fact and inference. The Board has been advised that the dissident shareholders’ claims could be defamatory.



**Finally we ask you, as a responsible shareholder, to think carefully about the governance implications of appointing the board sponsored by the dissident shareholders.**

Over several years Australian Ethical has been moving to a model of best practice in regards its board makeup. This has involved board renewal through the hiring of independent non-executive directors with significant expertise in the financial services industry. It has also involved an agreed process of founder directors stepping aside from the Board to allow this renewal. Ms Caroline Le Couteur stepped down in 2008, Mr James Thier in 2010 and Mr Howard Pender in 2011. Mr Tim Xirakis and Mr Stephen Hyam chose to leave the Company in 2011.

To return these people (or their close relatives or associates) as directors would not, in the Board's opinion, be in shareholder's best interests. They are not independent, they have limited or no funds management experience outside of Australian Ethical and would have a disproportionate influence over the board when compared to the size of their shareholding of 15.1% as recently notified to the Australian Stock Exchange.

**We urge you to VOTE AGAINST all resolutions.**

**FOR ALL ENQUIRIES CALL:**  
(within Australia) 1300 737 760  
(outside Australia) +61 2 9290 9600

**FACSIMILE**  
+61 2 9290 9655

**ALL CORRESPONDENCE TO:**  
Boardroom Pty Limited  
GPO Box 3993  
Sydney NSW 2001  
Australia

**Your Address**

This is your address as it appears on the company's share register. If this is incorrect, please mark the box with an "X" and make the correction on the form. Securityholders sponsored by a broker should advise your broker of any changes. **Please note, you cannot change ownership of your securities using this form.**

## YOUR VOTE IS IMPORTANT

**FOR YOUR VOTE TO BE EFFECTIVE IT MUST BE RECORDED BEFORE 6:30 pm on TUESDAY 19 June 2012**

## TO VOTE ONLINE

**Reference Number:**

Please note it is important you keep this confidential



**STEP 1 : VISIT** [www.boardroomlimited.com.au/vote/aeigm2012](http://www.boardroomlimited.com.au/vote/aeigm2012)

**STEP 2: Enter your holding/Investment type**

**STEP 3: Enter your Reference Number and VAC:**

## TO VOTE BY COMPLETING THE PROXY FORM

### STEP 1 Appointment of Proxy

Indicate here who you want to appoint as your Proxy  
If you wish to appoint the Chairman of the Meeting as your proxy, mark the box. If you wish to appoint someone other than the Chairman of the Meeting as your proxy please write the full name of that individual or body corporate. If you leave this section blank, or your named proxy does not attend the meeting, the Chairman of the Meeting will be your proxy. A proxy need not be a security holder of the company. Do not write the name of the issuer company or the registered security holder in the space.

#### Proxy which is a Body Corporate

Where a body corporate is appointed as your proxy, the representative of that body corporate attending the meeting must have provided an "Appointment of Corporate Representative" prior to admission. An Appointment of Corporate Representative form can be obtained from Boardroom Pty Limited.

#### Appointment of a Second Proxy

You are entitled to appoint up to two proxies to attend the meeting and vote on a poll. If you wish to appoint a second proxy, an additional Proxy Form may be obtained by telephoning Boardroom Pty Limited or you may copy this form.

To appoint a second proxy you must:

- complete two Proxy Forms. On each Proxy Form state the percentage of your voting rights or the number of securities applicable to that form. If the appointments do not specify the percentage or number of votes that each proxy may exercise, each proxy may exercise half your votes. Fractions of votes will be disregarded.
- return both forms together in the same envelope.

### STEP 2 Voting Directions to your Proxy

You can tell your Proxy how to vote

To direct your proxy how to vote, place a mark in one of the boxes opposite each item of business. All your securities will be voted in accordance with such a direction unless you indicate only a portion of voting rights are to be voted on any item by inserting the percentage or number of securities you wish to vote in the appropriate box or boxes. If you do not mark any of the boxes on a given item, your proxy may vote as he or she chooses. If you mark more than one box on an item your vote on that item will be invalid.

### STEP 3 Sign the Form

The form **must** be signed as follows:

**Individual:** This form is to be signed by the security holder.

**Joint Holding:** where the holding is in more than one name, all the security holders must sign.

**Power of Attorney:** to sign under a Power of Attorney, you must have already lodged it with the registry. Alternatively, attach a certified photocopy of the Power of Attorney to this form when you return it.

**Companies:** this form must be signed by a Director jointly with either another Director or a Company Secretary. Where the company has a Sole Director who is also the Sole Company Secretary, this form must be signed by that person. **Please indicate the office held by signing in the appropriate place.**

### STEP 4 Lodgement of a Proxy

This Proxy Form (and any Power of Attorney under which it is signed) must be received at an address given below not later than 48 hours before the commencement of the meeting at **6:30 pm on Thursday, 21 June 2012**. Any Proxy Form received after that time will not be valid for the scheduled meeting.

**Proxies may be lodged using the reply paid envelope or:**

**BY MAIL -** Share Registry – Boardroom Pty Limited, GPO Box 3993, Sydney NSW 2001 Australia

**BY FAX -** + 61 2 9290 9655

**IN PERSON -** Share Registry – Boardroom Pty Limited, Level 7, 207 Kent Street, Sydney NSW 2000 Australia

**Vote online at:**

**[www.boardroomlimited.com.au/vote/aeigm2012](http://www.boardroomlimited.com.au/vote/aeigm2012)  
or turnover to complete the Form →**

### Attending the Meeting

If you wish to attend the meeting please bring this form with you to assist registration.



# Australian Ethical Investment Ltd

## STEP 1 - Appointment of Proxy

I/We being a member/s of **Australian Ethical Investment Limited** and entitled to attend and vote hereby appoint

the Chairman of the Meeting (mark with an 'X')
 **OR**

If you are not appointing the Chairman of the Meeting as your proxy please write the full name of the individual or body corporate you are appointing as your proxy here.

or failing the individual or body corporate named, or if no individual or body corporate is named, the Chairman of the Meeting, as my/our proxy at the **General Meeting of Australian Ethical Investment Limited** to be held at **The Hall, University House, The Australian National University, Corner of Balmain Cr & Liversidge St, Acton, ACT 2601 on Thursday, 21 June 2012 at 6:30 pm** and at any adjournment of that meeting, to act on my/our behalf and to vote in accordance with the following directions or if no directions have been given, as the proxy sees fit.

## STEP 2 - Voting directions to your Proxy – please mark to indicate your directions

Ordinary Business		For	Against	Abstain*
Resolution 2	That Mr André Morony, who currently holds office as a director of the Company be removed from that office immediately.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 3	That Mr Timothy Xirakis, who has been duly nominated in accord with clause 11.3 of the Company's Constitution and, being eligible, offers himself for election, be elected as a director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 4	That Ms Penelope Le Couteur, who has been duly nominated in accord with clause 11.3 of the Company's Constitution and, being eligible, offers herself for election, be elected as a director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 5	That Mr James Thier, who has been duly nominated in accord with clause 11.3 of the Company's Constitution and, being eligible, offers himself for election, be elected as a director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 6	That Ms Suzanne Jones, who has been duly nominated in accord with clause 11.3 of the Company's Constitution and, being eligible, offers herself for election, be elected as a director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 7	That Mr Stephen Hyam, who has been duly nominated in accord with clause 11.3 of the Company's Constitution and, being eligible, offers himself for election, be elected as a director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 8	That Mr Phillip Vernon, who currently holds office as a director of the Company be removed from that office immediately.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 9	That Mr Stephen Newnham, who currently holds office as a director of the Company be removed from that office immediately.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 10	That Ms Louise Herron, who currently holds office as a director of the Company by virtue of her appointment pursuant to clause 11.4 of the Company's Constitution and, being eligible, has offered herself for election in accord with clause 11.4 of the Company's Constitution NOT be re-elected a director of the Company and be removed from that office immediately.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Resolution 11	That Ms Justine Hickey, who currently holds office as a director of the Company be removed from that office immediately.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

In addition to the intentions advised above, the Chairman of the Meeting intends to vote undirected proxies against each of the items of business.

\*If you mark the Abstain box for a particular item, you are directing your proxy not to vote on your behalf on a show of hands or on a poll and your votes will not be counted in computing the required majority on a poll.

## STEP 3 - PLEASE SIGN HERE This section *must* be signed in accordance with the instructions overleaf to enable your directions to be implemented.

Individual or Securityholder 1	Securityholder 2	Securityholder 3

Sole Director and Sole Company Secretary

Director

Director/Company Secretary

Contact Name .....

Contact Daytime Telephone .....

Date / / 2012