CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

13 August 2010

Mr John Kluver
Executive Director
CAMAC
Level 16
60 Margaret Street
SYDNEY NSW 2000

By email: john.kluver@camac.gov.au

Dear John

Executive remuneration

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our members have primary responsibility to develop and implement governance frameworks in public listed and unlisted and private companies, and not-for-profit and public sector organisations. A key responsibility of our members is the management of the annual report and the remuneration report to ensure that directors can report to shareholders. Our members are therefore uniquely positioned to provide independent, expert commentary on the legislative framework governing the remuneration report, and the manner in which directors report to shareholders on the remuneration framework they have implemented to align executive remuneration with company performance.

Our members have a thorough working knowledge of the operations of the markets, the ASX Listing Rules, the needs of investors, as well as compliance with the *Corporations Act 2001* (C'th) (the Act). We have drawn on their experience in our submission on the issues referred to the Corporations and Markets Advisory Committee (CAMAC) by the Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law in his letter of May 2010.

General comments

CSA notes that the reference to CAMAC from Minister Bowen canvasses examination of and making recommendations on revising the legislative framework in relation to both the reporting to shareholders on remuneration as covered by s 300A in the Act and the remuneration-setting framework, including incentive components.

CSA is strongly of the view that reporting to shareholders on remuneration can be simplified and our views on how this may be achieved are set out in the general body of this submission.

However, CSA is equally strong in its view that it is neither feasible nor desirable for legislation to determine how incentive components should be structured. CSA firmly believes that decisions as to how to structure incentive components are a matter for the board, which needs to take account of the particular circumstances of the company. Simplifying incentive components through legislation on the basis of making remuneration easier to understand by shareholders is problematic and will lead to undesirable consequences.

CSA does not accept the assumption that making incentives easier to understand for shareholders is in itself a good reason to legislate on this matter, and contends that doing so puts at risk the use of incentives to motivate performance and align it with shareholder expectations. Incentive components need to take into account the financial and operational circumstances of the particular company, which will periodically shift according to the strategy and changing circumstances of the company. For larger companies in particular, incentive components must also be devised to attract and retain the best talent internationally and legislating what incentive components would hinder that flexibility.

CSA believes that the reporting of remuneration-setting frameworks should not be confused with the development and implementation of such frameworks. CSA also notes that the Productivity Commission in its final report to the government clearly recommended that it is a central role of boards to set remuneration and remuneration should remain a largely private matter to be agreed between executives and companies, applying governance processes which properly protect the interests of shareholders as owners. The governance processes include reporting to ensure that there is transparency as to the decision-making of boards on remuneration. CSA firmly supports the Productivity Commission’s recommendation that remuneration frameworks, including the structuring of incentive components, remain a matter for the board.

Notwithstanding that, CSA is of the view that boards should make every effort to explain their remuneration decisions, and any anomalies that may arise in relation to payments, particularly when it may not be readily apparent as to why such anomalies exist.

CSA also notes that remuneration is a complex and dynamic process. Plans are regularly adjusted to achieve particular performance outcomes sought by boards on behalf of shareholders, reflecting changes in the circumstances in which company activity takes place. As a result, regardless of any changes to the legislative architecture governing remuneration, the framework will remain complicated and reporting will remain challenging.

Again, notwithstanding this, CSA is of the view that the complexity of remuneration frameworks is no excuse for boards to resile from clear and transparent disclosures to shareholders. Directors need to make the effort to clearly explain their remuneration decisions, particularly if they are complex.

Remuneration report

CSA Members recommend that the remuneration report could be simplified through some key legislative amendments by:

1. remove the requirement that directors report to shareholders on remuneration using defined terms from accounting standards.
2. mandating that reporting include the actual pay received during the year from all sources including base salary, short term incentives (STIs) and long term incentives (LTIs) (see proposed table), with separate reporting of deferred payments relating to STIs and LTIs to state the maximum number of instruments (not value) that may be received and consider disclosing the anticipated number of instruments based on current performance

3. mandating a two-tier approach to reporting performance against STI targets, which would require a) disclosure of the general nature of the components of the STI targets, and b) to the extent that it was not prejudicial to the company, disclosure of the specific targets relating to those components.

Further detail is provided below on these recommendations.

Recommendation 1: Remove the requirement that directors report to shareholders on remuneration using defined terms from accounting standards

CSA recommends that the current legislative framework which results in remuneration reports being prepared by concepts drawn from, and couched in technical language based on accounting standards, both by virtue of s300A of the Corporations Act 2001 and the obligation to conduct an external audit of such reports, is not conducive to communicating executive remuneration to ordinary shareholders in a readily understood and comprehensible fashion.

Currently s300A of the Corporations Act 2001 refers to the Australian Accounting Standards, and they contain detailed remuneration disclosures required for the purpose of the financial statements and the accompanying notes.

However, in their attempt to be a comprehensive technical reporting requirement, the accounting definitions provided in the accounting standards create confusion in remuneration reporting for ordinary shareholders, as they do not reflect the remuneration actually received by the key management personnel (KMPs) and the five most highly remunerated executives during the period but provide for theoretical valuations of remuneration.

A number of benefits accrue to relaxing the legislative regime that requires directors to report to shareholders on remuneration using defined terms from the accounting standards:

- the remuneration report will reflect ‘actual pay’ terms rather than theoretical accounting valuations of remuneration, which theoretical valuations currently inject ambiguity into the report and often cause confusion among shareholders other readers of financial reports: and

- the directors can much more easily explain the remuneration-setting framework to shareholders.

We would suggest that if the current legislative restrictions associated with the requirement to use accounting terms and concepts were abolished then the objective of reporting to shareholders in plain English would be more easily achieved.

CSA is of the view that having different figures reported in the remuneration from those reported in the financial statements will not cause confusion, given that shareholders are looking for less complex reporting on remuneration. An explanation can be provided in the financial statements of why the figures differ and the benefits this difference extends to shareholders.

In order to relax the legislative constraints that currently require reporting on remuneration to use defined terms from the accounting standards, yet ensure that shareholders can still access the accounting standards reporting, the Act could simply require the directors’ report to note that additional information can be found in the financial statements.

Recommendation 2: Mandating that reporting include the actual pay received during the year from base salary, benefits and bonus and deferrals of payments to future years under short-term and long-term incentive schemes (STIs and LTIs), with separate reporting of deferred payments relating to STIs and LTIs to state the maximum number of instruments (not value) that may be received and consider disclosing the anticipated number of instruments based on current performance

CSA notes that many companies have put considerable effort into drafting their remuneration reports as clearly and simply as possible over the past few years, but due to the interaction with the accounting standards the outcome has not been as effective as hoped. Moreover, while the current wording of s 300A itself is not problematic in terms of meeting the objective of transparent disclosure, it is not always apparent in terms of lengthy narrative disclosures how the different components of remuneration operate.

The key to simplifying reporting to shareholders on remuneration is to provide transparency as to actual pay received and pay either deferred or not received. This is made difficult by the accounting standards. In conjunction with relaxing the legislative constraints that require directors to report to shareholders on remuneration using defined terms from the accounting standards, CSA also recommends reporting actual pay received and deferred benefits received but not vested in the relevant financial year in order to provide clarity and transparency to shareholders on remuneration.

CSA would prefer that this be broken into two components to show firstly those components of remuneration which were received during the relevant financial year and have a fixed and definite value to the executive. The first table would show as follows:

Table 1

	Base salary	Superannuation contributions	Other benefits	**Total Fixed Pay**	STI Cash Bonus Paid	Total
	1	2	3	**1+2+3**	4	1+2+3+4
Jane Smith	$750,000	$75,000	$25,000	**$850,000**	$400,000	$1,250,000
Fred Brown	$450,000	$100,000	-	**$550,000**	$125,000	$675,000

A further table would be prepared to report on the deferred components of remuneration awarded during the relevant financial year but which had not vested by the end of the relevant financial year, as follows:

Table 2

	Deferred At Risk components		
	STI Awards Deferred (Cash)	STI Awards Deferred (No. of Shares)[A]	LTI Awards Deferred (No. of Performance rights/options)[B]
Jane Smith	$400,000	500	1,000
Fred Brown	$125,000	100	500

[A] Represents maximum number of shares that may be received in the event that performance hurdles are meet on [specify relevant vesting dates]

[B] Represents maximum numbers of shares/other securities that may vest in the event that the performance hurdles are achieved – [refer description of LTI plan in body of remuneration report]

CSA recommends that the performance conditions attaching to any deferred awards should be fully disclosed, as should the method by which the expected value of these awards is determined.

Consideration could also be given for companies to explain in the remuneration report in a simple and concise manner how awards granted in previous years are tracking against targets previously disclosed (in terms of number (rather than value) of shares/other securities that would vest if the award was tested at the end of the financial year in question as if it was the real date of testing of the award) or if they have vested or forfeited in the financial year in question. However, CSA notes that this is not a simple task and has the risk of overly complicating the remuneration report. CSA would not be in favour of attempting to forecast the likely prospects of vesting of particular awards in the remuneration report or attempting to attach a value to such forecasts.

CSA notes that it should be made clear to readers of the remuneration report that in relation to awards that have not yet vested, the maximum number of securities that can vest is not necessarily what the executive will receive. CSA also notes that the accounting standards already require detailed disclosure of much of this information that is already included in the financial statements.

CSA also notes that the government has accepted the Productivity Commission's recommendation that the remuneration report include a plain English summary statement of company remuneration policies. Indeed, CSA notes that some companies are already providing non-statutory, short remuneration reports, which are proving useful to shareholders. CSA supports the adoption of a plain English summary if that assists in greater shareholder understanding however CSA is of the view that this should not be subject to legislation.

In our submissions to the Productivity Commission, CSA pointed to the issues that arose with the concise annual report as a precedent for what can happen when a prescriptive approach is chosen as the means to encourage companies to communicate more efficiently with their shareholders. The fate of the concise annual report does not fill CSA with hope that legislating a 'plain English summary' will provide the communication that is being sought.[1]

Both the Productivity Commission and the government have indicated that they are of the view that there has been excessive zeal evidenced by companies in meeting the demands of s 300A through their support for a plain English summary statement of remuneration. However, CSA is of the view that it is the required content of the report, rather than the language of the report, which requires amendment. CSA believes that companies seek to ensure they are not in breach

---

[1] The concise annual report was originally introduced into the Corporations Act to facilitate shareholder communication, but increased regulation saw the concise report increase dramatically in length, such that it no longer met the needs of shareholders. Moreover, the concise annual report became increasingly legalistic as companies strove to ensure that they had met all statutory requirements. This second report became a lengthy, complex document, despite the original intent being to legislatively provide for short-form, meaningful communication to shareholders. CSA contemplates the prescription of a 'plain English summary statement' of the remuneration report with foreboding, believing it will create a second remuneration report that in turn will fail to meet shareholder needs.

of the legislation, given the liability attached to any such breach as well as the potential damage to reputation. Legislating a short-form, ‘plain English’ report will lead to legalistic reports, no matter how well intentioned the legislation or the boards presenting such reports to shareholders.

Recommendation 3: Mandate a two-tier approach to reporting performance against STI targets, which would a) require disclosure of the general nature of the components of the STI targets, and b) to the extent that it was not prejudicial, disclosure of the specific targets relating to those components

CSA strongly supports transparency of remuneration decisions to shareholders, but notes that in relation to disclosure of STIs there are issues of commercially-sensitive information that need to be taken account of.

CSA is of the view that providing greater transparency to shareholders as to how STIs are structured would be enhanced by mandating a two-tier approach to STI disclosure.

The first tier would involve the legislation requiring disclosure of the general nature of the components of the STI targets, for example:

- Operational performance, which could include:
  - financial performance
  - production targets
  - OH&S, environmental and community impact
  - new customers or growth targets
- Delivery of strategic or capital projects
- Human resources, which could include:
  - talent management
  - succession planning.

Reporting against these components could be on the basis of noting that performance was above, below or on target, or unmet.

The second tier would involve the legislation requiring, to the extent that it was not prejudicial, disclosure of the specific targets relating to those components. This would provide boards with the discretion to report yet not disclose commercially sensitive material.

Definition of key management personnel

CSA agrees with the Australian Institute of Company Directors’ (AICD’s) contention put forward in its Position Paper[2] that:

> ‘The requirement that entities disclose remuneration information in respect of both key management personnel and the five highest paid executives adds to the complexity of the remuneration report whilst accruing marginal (if any) benefit for shareholders in respect of the additional people whose remuneration information is included in the report ... the remuneration report should set out the details of the remuneration for only those persons who fall within the current definition of ‘key management personnel.’

CSA supports the AICD recommendation that:

[2] Australian Institute of Company Directors, Position Paper No 15, *Remuneration Reports*, June 2010

‘the most appropriate mechanism for achieving clarity in the Act and ensuring consistency with the accounting standards is to use the term ‘key senior personnel’ in the remuneration report and to insert a definition of ‘key senior personnel’ into section 9 of the Act. The wording of this definition [should] mirror the current definition of ‘key management personnel’ in the accounting standards/IFRS’.

Conclusion

CSA reiterates that it is of the view that it is feasible to simplify reporting to shareholders on remuneration for the reasons detailed above.

However, in relation to remuneration frameworks and the request from the government that CAMAC explore simplifying incentive components, CSA reiterates its opposition to legislation determining the structure of remuneration frameworks. CSA remains of the view that directors should continue to have the responsibility to determine executive remuneration, as boards are best placed to take into account the financial and operational circumstances of the company, which will periodically shift according to the strategy and changing circumstances of the company. That is, CSA is of the view that boards should retain the discretion to determine the parameters, including quantum, short-term incentives, long-term incentives, performance hurdles and others used in determining remuneration structures. Equally, CSA believes boards should continue to have accountability to shareholders for those decisions.

A centralised, regulated approach for setting remuneration will deprive companies of the ability to respond most effectively to the needs of the day, and almost certainly will drive inefficiencies and unwanted outcomes.

In preparing this submission, CSA has drawn on the expertise of the members of our two national policy committees. We welcome the opportunity to provide comment on the CAMAC Executive Remuneration Information Paper and would be pleased to discuss our views further should this be requested.

Yours sincerely

Tim Sheehy
CHIEF EXECUTIVE

Ernst & Young Centre
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
www.ey.com/au

13 August 2010
John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

CAMAC review of executive remuneration reporting requirements and framework: Ernst & Young submission

Dear John

Ernst & Young is pleased to provide this submission to the Corporations and Markets Advisory Committee ("CAMAC") in response to the Information Paper on executive remuneration released on 13 July 2010.

The Government, in response to the Productivity Commission's ("PC") final report on director and executive remuneration released in December 2009, has asked CAMAC to:

- Examine the existing reporting requirements contained in section 300A of the Corporations Act and related regulations and make recommendations to reduce the complexity of remuneration reports.

- Review the existing remuneration setting framework and make recommendations on how the incentive components of executive remuneration could be simplified.

Our views and comments are based on our experience working with Australian and overseas company Boards and management on a range of executive remuneration-related issues. Ernst & Young does not provide legal advice and consequently we defer to CAMAC, and the legal firms who provide submissions, regarding the best manner to implement any changes within the legislative framework.

In summary, our key views in relation to CAMAC's review are:

1. The remuneration reporting framework should be simplified by encouraging a consistent and logical structure for remuneration reports through a new recommendation in the ASX Corporate Governance Principles and Recommendations which specifies the sections and order for the report.

2. The items required for disclosure that increase complexity and do not add to the reader's understanding should be removed. Full details are contained herein.

3. The regulation of executive incentive arrangements is unnecessary and will prevent companies from being able to tailor their remuneration approach to their specific strategy and circumstances.

    - Different incentive plan approaches will be necessary for different companies, and possibly for the same company, as needs and priorities change over time. The Board, with its deep knowledge of the business, is best placed to exercise judgement in ensuring that remuneration structures are appropriate for a company's circumstances.

- Remuneration structures that are linked to company performance will naturally be complex given the complex nature of, and influences on, company performance. The design of remuneration structures reflects the need for companies to take into account business strategy, market practice, shareholder views, employee perspectives, management of risk and intricate tax, accounting and regulatory rules.

- While regulation of remuneration in the financial services industry has increased globally, the same level of regulation is not required for broader industry from a risk management perspective, and would limit companies' ability to tailor remuneration arrangements to suit their strategic needs.

  However, we believe there are remuneration governance and process principles emanating from the Financial Stability Board's recommendations that have been applied in the financial services sector that are relevant for the broader industry and would benefit many companies.

4. Changes to the complex rules around equity awards may enable companies to simplify executives' incentives. Tax rules, in particular, give rise to significant complexity in the design of equity-based incentive plans and, in many respects, place Australia out of step with the majority of our international competitors.

   Key suggested changes are:

   - Removal of cessation of employment as a taxing point;
   - Taxing share options at exercise rather than vesting; and
   - Removal of the "75% rule" to allow tax deferral for grants of shares.

We trust the information and views provided in this submission are useful. We would be pleased to discuss any aspects of our submission in more detail at your convenience.

Kind regards,

Mike Hogan	Bruno Cecchini	Chris Galway
Partner	Partner	Partner
Human Capital	Human Capital	Human Capital
Tel: (02) 8295 6853	Tel: (03) 9288 8423	Tel: (02) 8295 6476

1. Simplification of remuneration report disclosures

1.1 Effectiveness of the current reporting framework

The remuneration reporting requirements in Australia are strong and effective relative to other developed nations. However, there is room for improvement.

In our experience, companies recognise that the remuneration report is the primary method of communicating their remuneration approach to shareholders. We have found that the following aspects of the current disclosure requirements, however, can hinder attempts to effectively explain executive remuneration approaches:

- **Utility of some disclosures**: Companies' ability to use the remuneration report to articulate their remuneration approach can be undermined by the large volume of mandatory disclosures. Several of the disclosures add length and complication to the report, without adding to shareholder understanding.

  Examples include:

  - The requirement to disclose five year earnings and total shareholder return performance in the link between performance and reward section: This requirement is poorly defined and may not align with the performance period and measures of the company's incentive plans. If this is the case, it solely serves to lengthen disclosures in a way that is not meaningful.

  - Disclosure of the five highest paid executives (in addition to key management personnel ("KMP")): This disclosure introduces variability to year-on-year reporting in terms of who is disclosed, complexity regarding terminology and does not add information where there is overlap between the KMP and the five highest paid executives, which is common.

    We note that the PC recommended the removal of this requirement.

  - The percentage of remuneration consisting of share options: The purpose of this requirement is unclear. Its inclusion does not appear to add any insights for shareholders.

- **Potential misinterpretation of disclosures**: A significant issue for many companies is the requirement to disclose accounting values within the remuneration disclosure tables. These values do not reflect the value earned and delivered to executives, and can therefore mislead the reader. Despite this fact, the commentary frequently quoted in the wider media focuses on these accounting values and represents these values as "remuneration", which is mistakenly interpreted by the public as "take home pay", which it is not. This results in misleading reporting, and adds to the public's misconceptions regarding remuneration quantum.

  We note that, in response to this issue, the PC recommended the additional disclosure of actual levels of remuneration received by the individuals named in the report (see section 1.2.2 for our suggestions on how this may be achieved).

- **The requirement and intent of some components of the legislation is unclear**: There are aspects of the current requirements that are unclear or ambiguous. The absence of a clear rationale for each of the disclosures can result in inconsistent interpretation of the requirements.

Examples include:

- The requirement to discuss the proportions of remuneration that are linked to performance and those that are not: This requirement is interpreted by companies in a range of different ways, including showing target remuneration mix, maximum remuneration mix, and actual remuneration mix (based on accounting values). Some companies describe the mix qualitatively while others list or illustrate by executive. The end result is that the disclosed information cannot be compared on a company by company basis.

- The method used to assess performance: This is often interpreted as being a requirement to explain the performance hurdles (which is in fact covered by a separate disclosure requirement), and is sometimes interpreted as explaining how the performance hurdles are actually assessed (e.g., using an external data provider to undertake the relative Total Shareholder Return assessment).

The problem of interpretation is particularly exacerbated for smaller listed companies who may not use remuneration or legal advisers to assist with interpreting the requirements when preparing the remuneration report.

1.2 Suggested "ideal" remuneration report

1.2.1 Structure and overview of content

A key differentiator that can make a remuneration report comprehensible to shareholders is a clear and logical structure that makes use of headings, tables and diagrams where relevant. Such a structure must be complemented by clearly marked disclosures which provide meaningful information to shareholders on the company's remuneration approach and why this approach is appropriate, given the company's context and business strategy.

The following suggested remuneration report template and content overview is intended to meet these needs[1]:

Topic	Contents
Part A: Executives	
1. Overview / summary	► Description of the company's executive remuneration framework in terms of fixed remuneration and incentives, noting any key changes to the framework in the current year. ► Key details of current year approach: incentive payments (and vesting) and rationale, termination payments and rationale, and any one-off payments. ► Details of any expected reviews of, or changes to, remuneration structures in the coming year.
2. Remuneration strategy	► Remuneration objectives, approach to quantum, approach to remuneration mix, key objectives of each remuneration element (e.g., fixed remuneration, incentives, retention payments) and details of any significant changes.
3. Incentive plans	► Detailed plan descriptions, including overview of the performance measures in the plan, rationale for their selection, their weightings, targets and vesting schedules. An exception should be provided for targets that are commercially sensitive, which will typically apply only to plans with short-term performance targets, but may apply to other incentive plans that use company-specific commercially sensitive targets. ► Details of any outstanding equity grants (i.e., name of plan, grant date, award vehicle, number of instruments and vesting dates, but not the accounting value of the awards).

[1] Note: this "ideal" remuneration report is a refined version of our earlier submission to the PC.

Topic	Contents
4. Remuneration opportunity & contracts	Summary of each executive's remuneration opportunity for the year: ► Fixed remuneration (as at the start of the year and any amendments made during the year). ► Cash incentive opportunities (target and maximum, to the extent the company has specified opportunities). ► Equity incentive opportunities (expressed as a dollar value or a percentage of fixed remuneration with an explanation regarding how this is converted into a number of shares/rights/options). Contractual information: ► Length of contract, notice periods, sign-on arrangements, termination entitlements and details of any guaranteed payments.
5. Performance and reward link (including remuneration outcomes)	► Table presenting current year and prior year individual remuneration data using "actual" values (see section 1.2.2 for discussion regarding the presentation of "actuals"). ► Summary of cash-based incentives paid in the year to each executive. This should include the amount of cash paid in relation to service over the year (i.e., excluding any deferral) and the cash value of any longer-term incentives or retention payments that were paid during the year. For the payments that relate to the current year performance, disclosure should include a high-level summary of the company and executives' performance against targets, the total payment earned (dollar value and as a percentage of maximum), and the split between immediate cash payment and deferral. For payments that relate to multi-years, disclosure should provide a summary of the incentives that was paid during the year, including an explanation of what period the amount relates to and how the value has changed over the period. ► Summary of current year share-based payment vesting by executive, including performance against the relevant hurdles, the number of awards that vested and the value of the vested awards at the date of vesting. ► Summary of the changes in each executive's company shareholdings (number of shares held) and dollar value over the year (split to show both (a) wholly owned shares, vested but restricted shares and vested but unexercised options; and (b) unvested equity awards). Value of equity to be based on share price at year-end less any exercise price (if applicable). ► Details of termination payments made in the current year, including a breakdown of the components of the payment and the rationale for the payment (with reference to contractual entitlements). See Appendix B for an example of how a company may present the information described above.
Part B: Non-executive directors ("NED")	
6. NED policy and outcomes	► Description of the company's NED remuneration framework: fee pool, policy base fees, committee fees, benefits and participation in equity plans, noting any key changes to the framework in the current year ► Current year and prior year individual remuneration data using "actual" values

The above remuneration report would be supplemented by the Notes to the Annual Financial Report, which would include details of the aggregate accounting value of KMP remuneration outcomes (by remuneration element) and a description of the fair valuation methodology used for share-based payments.

1.2.2 "Actual" remuneration disclosures

As included in our template report, we support the disclosure of "actual" remuneration values. However, "actual" will need to be defined. For consistency, we suggest that all remuneration values (not just share-based payments) be disclosed on an "actual" basis. To the extent that definitions for each element are not specified, there is the risk that inconsistencies in approaches will lead to a reduction in comparability of amounts disclosed by different companies. This has already been evidenced by the difference amongst companies who have voluntarily disclosed this information.

We suggest the following definitions:

Remuneration element	Definition (note all values are pre-tax)

Fixed remuneration	Fixed amounts (i.e., salary, superannuation and other benefits) for the 12-month period[2].
Cash incentives paid (split into plans operated by the company*)	Amount of cash paid in relation to service over the year (i.e., excluding any deferral) and the cash value of any longer-term incentives or retention payments that were paid during the year.
Share-based payments (split into plans operated by the company)	Share-based payments that vested during the year (i.e., where there is no longer a “real risk of forfeiture”, although disposal restrictions may still apply). The value would be the cash gain available to executives in relation to equity awards that vested during the year (i.e., the cash gain based on the share price at vesting, before tax, net of any exercise price or other payment required from the executive, if the executive was to have sold the equity at the time the award vested).

** Should state which plans relate to 12-month performance and which relate to greater than 12-month performance periods.*

Some clients have raised concerns regarding the disclosure of “actual” remuneration outcomes where a remuneration element has a lengthy vesting period. The concern is that there will be a potential interpretation disconnect between performance and payment, since shareholders may be reviewing actual remuneration outcomes that relate to performance several years ago. We believe that, for this reason, the “actual” remuneration tables should be included in the “performance and reward link” section with an accompanying description of the time period where performance generated the payment.

Determining the “actual” value of termination payments also requires definition, as the amount currently disclosed in the “termination benefits” column of the remuneration report does not correspond with the value requiring shareholder approval (e.g., it does not include the accelerated accounting expense associated with any early vesting of share-based payments). Accordingly, we recommend adopting disclosure requirements around termination payments that align with the definitions used in the termination benefits legislation. This would require companies to list all the components related to termination for each executive using the same terminology and definitions as used in the legislation.

1.3 Implementation of changes

We recognise that the nature of the remuneration report is such that its final form will depend on many factors, such as the complexity of the company's remuneration approach (particularly where segmentation occurs due to various jurisdictions of operation) and whether there were any significant changes to remuneration policy / practice in the financial year. We therefore suggest that the remuneration report template be implemented through a combination of guidelines and legislation.

Principle 8 of the ASX Corporate Governance Principles and Recommendations, "remunerate fairly and responsibly", could include a recommendation that states:

> The remuneration report should be structured into the following sections and order:
>
> Executives:
>
> 1. Overview/summary
> 2. Remuneration strategy
> 3. Incentive plans
> 4. Remuneration opportunity and contracts
> 5. Performance and reward link (including remuneration outcomes)
>
> Non-executive Directors:
>
> 6. NED policy and outcomes

[2] Due to the complexity associated with valuing benefits (e.g., accruals to defined benefit pension funds), we suggest that the components of fixed remuneration be determined in accordance with AASB124.

The recommendation could be accompanied (in the commentary) by a suggested template for the remuneration report. The template could be in the form of a hypothetical remuneration report, such that it provides an example of the suggested structure, length and specific contents of the remuneration report.

The changes regarding the mandatory content should continue to be through the Corporations Act and the accompanying Regulations.

Appendix A provides a detailed overview of the additions, modifications and deletions required to implement the report structure and content outlined in 1.2.1. While companies would face an initial task of familiarising themselves with the changed requirements, we believe the changes would not increase the ongoing compliance burden. Importantly, our approach would not require a separate “plain English statement” to provide crucial information to shareholders. Rather, the removal of complex accounting disclosures would make it easier to use plain English throughout the report.

Appendix B provides an example of how a company may present information in Section 5: Performance and reward link, including “actual” remuneration outcomes.

2. Simplification of executive incentive arrangements

2.1 The Productivity Commission's findings and our perspective

The PC, through their extensive research into the link between performance and reward, concluded that "Remuneration structures are company- and context-specific and a matter for boards to resolve rather than being amenable to prescriptive direction." (PC report, Finding 2, page 382).

The PC notes that different incentive plan approaches will be necessary for different companies, and possibly for the same company, as needs and priorities change over time. The Board, with its deep knowledge of the business, is therefore best placed to exercise judgement in ensuring that remuneration structures are appropriate for a company's circumstances. The PC also makes the point that the assumption that companies differ from one another is a fundamental principle behind the ASX Corporate Governance Council's "if not, why not" disclosure rule, and that prescribed remuneration structures are unlikely to promote improved performance (PC report, page 219).

In our view, remuneration structures that are linked to company performance will naturally be complex given the complex nature of, and influences on, company performance. The design of remuneration structures reflects the need for companies to take into account various factors (discussed below) when designing incentives.

Further, any review of remuneration needs to consider the global nature of the executive talent pool used by Australian companies. Many Australian companies not only recruit executives into Australia, but also recruit executives into significant international roles in other countries. Australian companies therefore require Australian regulations to be no more stringent than overseas regulations.

On a related point, many of our clients are faced with the issue of having to balance remuneration expectations and practices in more than one market, which can further complicate remuneration design (e.g., while the United States has historically favoured unhurdled option plans, Australian shareholders and advisory groups prefer to see hurdles applied to long-term incentives). This point emphasises the need for companies to be able to tailor the remuneration approach to their commercial needs, which may encompass jurisdictional differences.

2.2 The complexities of designing effective executive incentive plans

Outlined below are the key considerations for companies in designing incentive plans. We believe all elements are important when designing incentive plans. Balancing all considerations will naturally lead to complex incentive outcomes.

Factor	Considerations
Business strategy	The fundamental principle of incentive design is that incentives should be aligned to the business' strategic objectives. As a result, there are a range of different award vehicles, performance measures and targets, and performance periods that are applied, given that company strategies differ.
Market practice	Incentives should be informed (without being led) by market practice to support the company's ability to attract and retain talent.
Shareholder engagement	In today's governance environment, it is important to develop remuneration arrangements that are generally supported by shareholders and shareholder advisory groups. However, companies should place greater weight on what the Board considers appropriate, rather than on what shareholders may support, since the Board is closest to the business' needs. Commercial rationale for the approach should be provided, particularly if differing from shareholder views.
Value to employee	Incentive arrangements should be valued by employees and drive performance. Plans should focus on measures of performance and performance periods that are meaningful to the individual.
Risk alignment	Incentives should support prudent risk management. This issue has been highlighted by the recent global financial crisis and subsequent reviews of remuneration governance within the financial services sector. The Australian Prudential Regulation Authority ("APRA") has stated that performance-based remuneration should be designed in such a way as to discourage risk-taking behaviour, particularly amongst risk and financial control personnel.
Taxation, accounting and regulatory	Incentive plans need to be tax and cost effective and compliant with all legal and regulatory obligations. The existing tax, accounting and regulatory framework for plans, particularly equity-based plans, is extremely complex and often

Factor	Considerations
requirements	conflicts with commercial design objectives and with different areas of applicable legislation (refer section 2.4 for suggested changes to the rules around equity awards).

2.3 Differences between the financial sector and broader industry

The Australian financial services sector, through the recent APRA guidelines, has been the focus of executive remuneration reform. It is recognised that the performance and stability of financial services has significant potential for flow-on effects to the economy. This is the case with many sectors, but arguably more so for the financial sector, given that this sector provides funding for a broad range of companies and individuals. For this reason, the financial sector in Australia is a regulated industry that is governed by legislation.

The above view is supported by the Financial Stability Board ("FSB") and global regulators, who acknowledge the critical role the financial sector plays in the global economy. The FSB and global regulators have made (and continue to make) changes to the way this sector is regulated. For example, and as noted by CAMAC in their Information Paper, both the United Kingdom's Financial Services Authority ("FSA") and the European Commission ("EC") have proposed changes to the rules governing remuneration within the financial sector with the aim of aligning remuneration arrangements with effective risk management.

While regulation of remuneration within the financial services industry has increased globally, the same level of regulation is not required for broader industry from a risk management perspective, and would limit companies' ability to tailor remuneration arrangements to suit their strategic needs.

However, we believe there are remuneration governance and process principles emanating from the FSB's recommendations that have been applied in the financial services sector that are relevant for the broader industry and would benefit many companies. For example, the FSB principle that a company's Board must monitor and review the remuneration system to ensure the system operates as intended may be beneficial for the majority of companies.

2.4 Opportunities for simplification

The majority of the considerations listed in section 2.2 that generate complexity for incentive plans and structures cannot be easily simplified through the implementation of guidelines or regulations.

However, the taxation and regulatory framework is one aspect within the Government's and regulators' control where there are opportunities for incentive simplification. The Government may be able to achieve some of this potential simplification by changing the complex rules around equity awards. The tax rules, in particular, give rise to significant complexity in the design of equity-based incentive plans and, in many respects, place Australia out of step with the majority of developed economies.

► **Cessation of employment taxing point**: Shareholders, their advisory groups and the PC (directly) and the new termination cap legislation (indirectly) promote maintaining individuals in incentive plans post-cessation of employment (e.g., when an executive retires). However, the current laws result in a taxation point in the year employment ceases, despite no benefit being realised by the individual at that time, and indeed may never be realised where performance hurdles apply and are not met.

  This taxation rule generates complexity as companies need to consider approaches to manage the impact of the taxing point arising before awards vest. In some cases, this has resulted in additional plan provisions that apply only to participants who cease employment and remain in the plan, treating them differently to participants who continue to be employed by the company.

  Recommendation: We recommend the removal of cessation of employment as a taxing point, in order to align the taxation point with the time at which the executive is able to realise a benefit from the award. Removal of the taxing point will also enable companies to align executive and shareholder interests in the period up to and beyond cessation of employment without introducing additional complex plan provisions.

  Further, removal of cessation of employment as a taxing point would be consistent with the taxation rules in the majority of Australia's international competitors. Finally, we note that the introduction of reporting obligations requiring companies to provide details of equity awards at the time they are subject to tax should be sufficient to protect tax revenue.

- **Tax treatment of option plans**: The changes to the taxation of employee share schemes (which apply from 1 July 2009) have introduced significant complexity regarding the tax treatment of share options. Under the new tax rules, share options are generally taxed before they are exercised, with the taxing point typically being at vesting. Under the current valuation rules for equity awards, a tax liability can arise on share options even if they are not “in the money” at vesting. If the participant does not exercise the options before they expire (for example, because the options remain ”underwater”), the tax rules do not provide for a refund of the tax paid at vesting.

  The tax treatment of options under the new rules has caused many companies to significantly amend or simply terminate their option plans. Share option plans, which previously provided a straightforward and well-understood form of equity incentive, are for many companies no longer a viable scheme due to the tax complexities in Australia. Further, this tax treatment poses a problem for small to medium enterprises, particularly early stage companies, who often use options in lieu of cash remuneration to attract skilled and motivated employees due to limitations in capital and cash flow. This sector is a major driver of innovation and productivity, which in turn drives strong economic growth (and tax revenue).

  Recommendation: We recommend the taxation rules are revised such that options are taxed on exercise, rather than vesting. This will ensure individuals are not taxed until they realise a benefit. The approach is consistent with the former rules in Australia and most other developed economies.

- **Removal of 75% rule for shares**: The current tax legislation requires that at least 75% of permanent employees in Australia with at least three years service have (or have previously had) the opportunity to acquire shares or rights/options under an employee share scheme in order to defer tax on grants of shares until the vesting point. The rationale for retaining this requirement when the tax rules were changed is unclear and is likely to limit the number of companies that can offer shares to executives as a form of equity incentive without giving rise to adverse tax implications for participants.

  Recommendation: We recommend removal of the 75% test. This will ensure consistency of treatment between using shares and using rights or options as the vehicle to deliver equity incentives.

Appendix A – Suggested changes to disclosure requirements

The following includes our suggested changes to the current disclosures required by the Corporations Act in respect of the remuneration report. The summary table is a refined version of the table included in our earlier submission to the PC, of which CAMAC has a copy.

Where no change is noted to a particular section of the *Corporations Act 2001* (the “Act”) or regulation of the *Corporations Regulations 2001* (the “Regulations”) (together, the “legislation”), we recommend that disclosures be retained.

Suggested change	Comments
1. Modify	
(a) Description of performance and remuneration link 300A(1)(b) 300A (1AA and 1AB) AND (b) Vesting percentages of bonuses and share-based payments 2M.3.03 (1) item 12	It is difficult to specify the precise disclosures that would illustrate how company performance and remuneration are aligned because of differing business strategies for different companies (and therefore differing performance measures and performance periods). The specificity of 300A (1AA and 1AB) encourages companies to detail earnings and shareholder returns over the required period in isolation of remuneration outcomes. In most companies' remuneration reports, this information does not increase shareholder understanding. We suggest replacing these requirements with a revised requirement, as detailed below. The revised requirement should include disclosure of the following: ► Summary of cash-based incentives paid in the year to each executive. Should include the amount of cash paid in relation to service over the year (i.e., excluding any deferral) and the cash value of any longer-term incentives or retention payments that were paid during the year. For the payments that relate to the current year performance, disclosure should include a high-level summary of the company and executives' performance against targets, the total payment earned (dollar value and as a percentage of maximum), and the split between immediate cash payment and deferral. For payments that relate to multi-years, disclosure should provide a summary of the incentive that was paid during the year, including an explanation of what performance period the amount relates to (and how the value has changed over the period). ► Summary of current year share-base payment vesting by executive including performance against the relevant hurdles, the number of awards that vested and the value of the vested awards at the date of vesting. ► Summary of the changes in each executive's company shareholdings (number of shares held) and dollar value over the year (split to show both (a) wholly owned shares, vested but restricted shares and vested but unexercised options; and (b) unvested equity awards. Value of equity to be based on share price at year-end less any exercise price (if applicable). ► Details of termination payments made in the current year including a breakdown of the components of the payment, and the rationale for the payment (with reference to contractual entitlements).
(c) Remuneration mix 300A(1)(e)(i)	Inconsistent information is disclosed. To promote more consistent disclosure, we recommend modifying the requirement to explain the relative proportion of remuneration related to performance under 300A (1)(e)(i) to specifically require disclosure of the following (as a proportion of total *target* remuneration): ► Fixed (not related to performance) ► Performance-based (split into its constituent components, for example, short and long-term incentives) Total target remuneration should be based on “remuneration opportunity” for target levels of performance (refer 2b overleaf).
(d) Presentation of prior year individual remuneration data 2M.3.03 (1) 2M.3.03 (2) items 6, 7, 8, 9 and 11	Individual remuneration data for the current and prior year should be presented in the same table (some companies currently present two tables) so that the remuneration for each individual can be easily compared to the prior year. Executive remuneration (including executive directors) and non-executive director remuneration should be presented in separate tables to simplify presentation and increase shareholder understanding.
(e) Share option and right disclosures 2M.3.03 (1) item 15 2M.3.03 (3)	The disclosures specific to share options and rights would be equally relevant for other share-based payment vehicles (e.g., restricted shares and cash payments linked to share price) as all have an associated accounting expense. The wording of the disclosure requirements for share options and rights should therefore be extended to cover all forms of share-based payments.

Suggested change	Comments
2. Add	
(a) Actual remuneration outcomes for each KMP (realised values)	Per the PC Recommendation and Ernst & Young prior submissions to the PC. We caution that "actual" needs to be defined. We propose the following definitions: ► Fixed remuneration: Fixed amounts (i.e., salary, superannuation and other benefits) for the 12-month period[3] ► Cash-based incentives: Amount of cash paid in relation to service over the year (i.e., excluding any deferral) and the cash value of any longer-term incentives or retention payments that were paid during the year. Should be split into the different plans operated by the company clearly showing what plans relate to 12 month performance and which relate to greater than 12 month performance periods. ► Share-based payments: Share-based payments that vested during the year (i.e., where there is no longer a "real risk of forfeiture", although disposal restrictions may still apply). The value would be the cash gain available to executives in relation to equity awards that vested during the year (i.e., the cash gain based on the share price at vesting, before tax, net of any exercise price or other payment required from the executive, if the executive was to have sold the equity at the time the award vested). Should be split into the different plans operated by the company. *Note that all values are pre-tax.* Determining the "actual" value of termination payments also requires definition as the amount currently disclosed in the "termination benefits" column of the remuneration report does not correspond with the value requiring shareholder approval (e.g. it does not include the accelerated accounting expense associated with any early vesting of share-based payments). Accordingly, we recommend adopting disclosure requirements that align with the definitions used in the termination benefits legislation (i.e., specifically listing all the components related to termination using the same terminology as the legislation).
(b) Remuneration opportunity	Summary of remuneration opportunity of each executive for the year, including: ► Fixed remuneration (as at the start of the year and any amendments made during the year) Cash incentive opportunities (target and maximum, to the extent that these are provided for) should be split into the different plans operated by the company clearly showing what plans relate to 12 month performance and which relate to greater than 12 month performance periods. ► Equity incentive opportunities (expressed as a dollar value or a percentage of fixed remuneration with an explanation regarding how this is converted into a number of shares/rights/options). Split by the plans that the company operates.

[3] Due to the complexity associated with valuing benefits (e.g., accruals to defined benefit pension funds), we suggest that the components of fixed remuneration be determined in accordance with AASB124.

Suggested change	Comments
(c) Selected items from the Productivity Commissioner's disclosure checklist Bullets 1, 2, 3 and 5 of the PC's Finding 2.	We suggest that the following disclosures be included in the remuneration report (perhaps as guidance for what is intended by 300A (1)(a)(i)): i. Rationale for remuneration policy (in terms of strategy, risk profile and shareholder alignment) ii. Rationale for remuneration mix policy (see also 1b) iii. Details and rationale for remuneration and performance benchmarking comparator groups iv. Details of any mechanisms to guard against extreme incentive payments from formulaic incentive plans We suggest that companies disclose points i, ii and iii in the Remuneration Strategy section of the remuneration report (see section 1 of this report), alongside the key objective and features of each remuneration element (e.g., fixed, STI and LTI). Point iv should be disclosed in the detailed STI plan description (see section 1 of this report). Note that point i should focus on incentive arrangements, as the information companies disclose in relation to fixed remuneration policy tends to be generic and provides limited insight to shareholders. While we agree that companies should consider the full range of potential outcomes when designing remuneration (bullets 4, 6, 7 and 8 of Finding 2), we do not believe they should be required to disclose how or whether they have done so, as this would add unnecessary complexity to remuneration reports.
(d) Termination payments	Where termination payments are made during the year, the remuneration report and Notice of Meeting should disclose the value of the termination payment (calculated with reference to the definitions in the termination payment approval requirements). The disclosure requirements should be amended accordingly. While the current legislation does not specify a method for valuing equity awards, we believe that the methodology should be consistent with the "actual" values. The disclosure should be accompanied by the company's rationale for the payment and the proportion of the payment that was pro-rated for time and performance. Where the individual is potentially entitled to payments in future years in relation to their current role (e.g., vesting of LTI awards that are not accelerated and therefore vest per the original grant conditions), the "actual" value of any amounts that are expected to vest / be paid to the individual in future years should also be disclosed[4]. Where the value of the future benefit is not known, the maximum value based on the number of equity awards and the current share price (less any consideration paid or exercise price payable) should be disclosed.
3. Move to the Notes to the Annual Financial Report	
(a) Fair valuation methodologies (not required disclosure in the remuneration report)	Per the PC recommendation and Ernst & Young prior submissions to the PC.
(b) Accounting value of remuneration outcomes for each KMP. 2M.3.03 (1) items 6 and 11 2M.3.03 (2)	Accounting costs (including those associated with share-based payments) should be disclosed only in the Notes to the Annual Financial Report and only in aggregate (i.e., for all KMP). Accounting values are useful to indicate the cost of the company's remuneration approach and are therefore more relevant as a supplement to the financial statements. Individual accounting disclosures for KMP would be unlikely to increase shareholder understanding when "actual" values are already disclosed. Disclosure of both accounting values and actual values on an individual basis will result in unnecessary complexity and encourages comparisons that are not meaningful. As aggregate accounting costs of KMP remuneration are already a required disclosure in the Notes to the Annual Financial Report, the requirements to disclose accounting values in the remuneration report should be removed and replaced with requirements to disclose actual values.
4. Remove	
(a) Methods used to assess performance conditions 300A (1) (ba) (iii)	The requirement to disclose how the satisfaction of performance conditions is assessed and why it is assessed in this way tends to yield inconsistent information about company *process and approvals*. For example, companies might specify who carries out the calculations and the specific formula used. What is more relevant is information about *vesting schedules*: how different levels of performance affect the quantum of the incentive payment / award.
(b) Minimum and maximum values of bonuses and share-based awards in future periods 2M.3.03(1) item 12(h)	The value of deferral into future periods is typically linked to a variable that has no meaningful maximum and cannot be reliably forecasted (e.g., share price). The other requirements of 2M.3.03 already provide sufficient information regarding the impact of current year grants on remuneration in future periods as they require disclosure of the vesting date and relevant vesting criteria.

[4] The accounting cost will be captured in the Notes to the Annual Financial Report

Suggested change	Comments
(c) Other accounting disclosures regarding options 300A (1)(e)(iii), (Iv) and (vi)	The following accounting disclosures provide minimal, if any, increment to shareholder understanding: ► Accounting value of options exercised during the year (actual value at vesting and actual value of shareholdings is more relevant); ► Accounting value of awards lapsed during the year (percentage is more relevant); ► The percentage of remuneration consisting of options (overall remuneration mix is more relevant).
(d) Description of incentive plans that do not relate to current year grants 2M.3.03 (1) item 12	Descriptions regarding incentive arrangements should only be provided for those under which current year grants were made (or future year grants have been contracted). Disclosure for prior year plans would have been mandated in the relevant year and can detract from current year information. For completeness, there should be a reference directing the reader to the relevant year's remuneration report for further detail on legacy plans.
(e) Individual disclosures for the five-highest paid executives if they are not KMP. 300A(1)(c)(iii) and (iv)	Per the PC recommendations and Ernst & Young prior submissions to the PC. In our view, it is relevant to disclose information for all KMP as these are the individuals who have the ability to make decisions on behalf of the company and its shareholders. Consequently, it is for these individuals that shareholders require information to assess the extent to which remuneration is aligned with their interests.

Appendix B – Performance & reward link structure and content

The information set out below is an example of how a company may present the information contained within Section 5: Performance and reward link, as suggested in our "ideal" remuneration report. This section includes "actual" remuneration outcomes for the current and prior year.

5. Performance and reward link

5.1 Overall remuneration earned for 2009/10

The following table summarises the remuneration earned by each executive (i.e., the cash values received and the value of shares that vested during the year) and the comparatives to the prior year.

Executive		Fixed remuneration ($000s)			Cash- based incentives ($000s)	Share-based payments ($000s)		Total remuneration realised ($000s)
		Base salary	Superannuation	Non-monetary benefits	Short-term incentive earned	Deferred short-term incentive (value vested during year)	Long-term incentive plan (value vested during year)	
Executive A	**2010**							
	2009							
Executive B	**2010**							
	2009							
Executive C	**2010**							
	2009							
Executive D	**2010**							
	2009							
Executive E*	**2010**							
	2009							

* Executive E ceased employment with the company on dd/mm/yy. Details of his termination benefit are provided in section 5.2.

The incentive amounts illustrated above were determined as follows:

Cash-based incentives

Both the company and executives performed well against the targets set, with most, but not all, targets being met or exceeded.

Executive	Total short-term incentive earned		Cash short-term incentive paid ($000s)	Short-term incentive deferred to future years ($000s)
	Value ($000s)	As a % of maximum opportunity		
Executive A				
Executive B				
Executive C				
Executive D				
Executive E				

Share-based payments

The deferred amounts from the 2007/2008 short-term incentive vested during the year. The following table summarises the amounts that were earned in 2007/2008 and how their value changed based on the share price movement from the deferral date to the date of vesting.

Executive	Short-term incentive earned in 2007/08		Deferral		
	Cash value ($000)	Deferral ($000)	Number of shares/rights	Value at deferral on dd/mm/yy (share price of $X)	Value at vesting on dd/mm/yy (share price of $X)
Executive A					
Executive B					
Executive C					
Executive D					
Executive E					

In terms of the long-term incentive plan, tranche 2 of the 2006/2007 grant (i.e., 50% of the 2006/2007 grant) and tranche 1 of the 2007/2008 (i.e., 50% of the 2007/2008 grant) was tested. Performance against target was as follows:

► **Tranche 2 of 2006/2007 grant**: The Compound EPS growth for the period was 12% p.a. which exceeded the stretch target for the 2006/2007 grants of 10% p.a. Therefore 100% of the tranche vested.

► **Tranche 1 of 2007/2008 grant**: The Compound EPS growth for the period was 8% p.a. which was below the threshold target for the 2007/2008 grants of 9% p.a. Therefore no portion of the tranche vested and the tranche lapsed.

The value realised is summarised below:

Executive	Grant	Number of shares granted	Number of shares vesting	Value at vesting on dd/mm/yy (share price of $X)
Executive A	Tranche 2 of 2006/2007 grant			
	Tranche 1 of 2007/2008 grant			
Executive B	Tranche 2 of 2006/2007 grant			
	Tranche 1 of 2007/2008 grant			
Executive C	Tranche 2 of 2006/2007 grant			
	Tranche 1 of 2007/2008 grant			
Executive D	Tranche 2 of 2006/2007 grant			
	Tranche 1 of 2007/2008 grant			
Executive E	Tranche 2 of 2006/2007 grant			
	Tranche 1 of 2007/2008 grant			

5.2 Executives who ceased employment during the year

As a result of a change to the company's operation structure, Executive E's employment was terminated on dd/mm/yy. In accordance with his contract, he received the following payments at termination:

Component	Payment
Statutory entitlements	
Accrued leave	$X
Long service leave	$X
Termination benefit	
Payment in lieu of notice period	$X
Early vesting of 2008 long-term incentive grant*	$X

* Pro-rata for time (two-thirds of the performance period had elapsed) and performance (a performance test at cessation date indicated awards were tracking at full vesting). The value presented is based on share price at the date of termination.

5.3 Changes in value of shareholdings

The following table summarises the fluctuations in **vested** shareholdings and the value of those shareholdings by executive.

Executive	30 June 2009				30 June 2010				Change in value
	Shares held	Vested but restricted shares	Vested but unexercised options	Value (share price of $X)	Shares held	Vested but restricted shares	Vested but unexercised options	Value (share price of $X)	
Executive A									
Executive B									
Executive C									
Executive D									
Executive E									

The following table summarises the fluctuations in **unvested** shareholdings and the value of those shareholdings by executive.

Executive	30 June 2009			30 June 2010			Change in value
	Unvested shares/rights	Unvested options	Value (share price of $X less any exercise price)	Unvested shares/rights	Unvested options	Value (share price of $X less any exercise price)	
Executive A							
Executive B							
Executive C							
Executive D							
Executive E							

AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Level 2
255 George Street
Sydney NSW 2000
www.companydirectors.com.au
ABN 11 008 484 197

T: +61 2 8248 6600
F: +61 2 8248 6633
E: aicd@companydirectors.com.au

13 August 2010

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

Executive Remuneration: Invitation For Comments

This letter represents the submission by the Australian Institute of Company Directors in response to the invitation for comments included in the Corporations and Markets Advisory Committee's (CAMAC's) Information Paper "Executive Remuneration", published on 13 July 2010.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 26,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

What are the areas where the existing reporting requirements contained in section 300A of the Corporations Act and related regulations could be revised in order to reduce complexity and more effectively meet the needs of shareholders and companies? How best to revise the legislative architecture to reduce the complexity of remuneration reports?

The Australian Institute of Company Directors believes remuneration reports and the requirements governing them are unduly complex, place a significant burden on companies and in many cases are of limited use to shareholders and other readers. In light of this, we issued a proposal for reform of remuneration reporting requirements on 4 June 2010 (please see enclosed Position Paper No. 15 "Remuneration Reports" June 2010[1]).

Our reform proposal involves a substantial overhaul of existing requirements in the Corporations Act governing the content of remuneration reports. This includes, amongst other things, moving to a principles-based obligation tied to the information shareholders would reasonably require to make an informed assessment of:

- the governance structures in place for determining the remuneration of key senior personnel;
- the company's remuneration philosophy and policies for key senior personnel;
- the remuneration outcomes for key senior personnel in the reporting period (i.e. the remuneration received by the key senior personnel in the current year in "actual pay" terms); and

[1] Available at http://www.companydirectors.com.au/Representation/Policies+And+Papers/2010.

- the current entitlements of key senior personnel to future remuneration.

The proposal also involves:

- more specific requirements under these four broad headings (where appropriate) in the Corporations Regulations; and

- the inclusion of a definition of "key senior personnel" in the Corporations Act (consistent with the current definition of key management personnel in the Australian Accounting Standards).

We consider reform of the requirements relating to remuneration reports is made more pressing given the stated intention of the Federal Government to introduce a mechanism whereby a sufficiently high negative vote on a company's remuneration report triggers a potential board spill mechanism (the so called "two strikes and re-election resolution" proposal).[2] Given the potential impact of such a mechanism on a company's governance and value, we believe it is of particular importance that requirements relating to remuneration reports promote, and do not work against (as they currently do), the presentation of remuneration information in a clear, concise and meaningful way.

What are the areas where the existing remuneration setting framework could be revised in order to simplify the incentive components of executive remuneration arrangements?

The proper alignment of executive and shareholder interests is important to the ongoing success of companies, and the contribution businesses in turn make to the broader economy through job creation, disposable income, retirement funding, investment opportunities, a major source of Government revenue, and so on. As such, it is important to all Australians.

The Australian Institute of Company Directors believes it would be a grave policy error to attempt to mandate simplification of remuneration incentive components. Such an approach will inevitably have negative consequences for companies and their broader contribution to the economy and society.

We note that a conclusion of the extensive Productivity Commission Inquiry into executive remuneration undertaken last year was that legislation should not prescribe aspects of executive remuneration packages (e.g. remuneration caps); rather, the focus should be on enhancing the effectiveness of governance arrangements.[3] Further, the Commission acknowledged the important role that boards play in determining appropriate remuneration arrangements, as well as the likely negative consequences of a prescriptive regulatory approach to remuneration arrangements.

We note that complexity in remuneration arrangements has arisen as a consequence of various factors, including:

- A response to legislative requirements. In the United States, attempts to "cap" particular elements of remuneration (whether through prohibition or adverse taxation implications) have led to a "squeezing of the balloon" (i.e. payment of remuneration in some other form) and greater complexity in remuneration

---

[2] Joint Media Release from The Hon Chris Bowen MP, Minister for Financial Services, Superannuation & Corporate Law with The Hon Wayne Swan MP, Treasurer, and Senator The Hon Nick Sherry, Assistant Treasurer, "Government Responds to the Productivity Commission Report on Executive Remuneration", 16 April 2010.

[3] Productivity Commission Inquiry Report, Executive Remuneration in Australia, No.49, 19 December 2009.

arrangements[4] – with some of these practices subsequently being "imported" to Australia. Further complexity is added in the Australian context as a consequence of detailed "black letter" legal requirements relating to termination payments[5] and taxation of equity-based incentive grants[6] – making incentive payments and other aspects of remuneration arrangements more complicated.

- Calls by shareholders and others for greater alignment between performance and rewards, combined with the desire of the relevant executive to have a clear sense, in advance, of likely remuneration outcomes under different scenarios.

- Companies seeking to demonstrate a comparative advantage to both executives and shareholders in linking performance and rewards.

Some of the factors that are likely to add further to complexity of remuneration arrangements include:

- Greater focus being directed (sometimes unduly) to adjusting remuneration bonuses to take account of the risk impact of decisions made, as a response to issues connected with the recent global financial crisis.

- The bonus clawback arrangements proposed by the Federal Government in April 2010.[7]

We believe there are overwhelming arguments against attempting to simplify remuneration arrangements through legislative measures. These arguments include:

- Performance assessments are typically multi-dimensional in nature. Attempts at simplifying incentive components will invariably weaken the linkage between performance and reward.

- The design of remuneration arrangements is an important way in which companies can show competitive advantage. Reducing the ability of companies to recognise and reward excellent performance (due, for example, to simplified performance indicators) will make it more difficult for companies to attract executives in the market for corporate talent, particularly where companies are operating in the global market for executive services.

- The appropriateness of particular remuneration arrangements may well vary from company to company (depending, for example, on type of company, size, sector, geographical reach, etc) and change over time. Such arrangements should be left to

---

4 In 1993 the United States Congress passed a law that stipulated only US$1 million of an executive's salary would be tax deductible (Refer to the Omnibus Budget Reconciliation Act of 1993 (U.S.), Section 162(m) of the Internal Revenue Code (IRS par. 9001B, sec. 1.162). This resulted in a "squeezing of the balloon" effect towards short term incentives and long term equity-based incentives. See Martin Gritsch and Tricia Coxwell Snyder, "The impact of current tax policy on CEO stock option compensation: a quantile analysis", Academy of Accounting and Financial Studies Journal, September 2005.

5 Refer to the Corporations Act, Part 2D.2, Division 2.

6 Current taxation requirements relating to equity-based grants in many cases effectively result in entitlements being "cashed out" on cessation of employment. The Australian Institute of Company Directors and others (e.g. Regnan) have previously argued that this taxation trigger point should be removed. This was also a recommendation of the Productivity Commission in December 2009, but was rejected by the Federal Government in April 2010. Refer to Joint Media Release from The Hon Chris Bowen MP, Minister for Financial Services, Superannuation & Corporate Law with The Hon Wayne Swan MP, Treasurer, and Senator The Hon Nick Sherry, Assistant Treasurer, "Government Responds to the Productivity Commission Report on Executive Remuneration", 16 April 2010.

7 Joint Media Release from The Hon Chris Bowen MP, Minister for Financial Services, Superannuation & Corporate Law with The Hon Wayne Swan MP, Treasurer, and Senator The Hon Nick Sherry, Assistant Treasurer, "Government Responds to the Productivity Commission Report on Executive Remuneration", 16 April 2010. It was noted that the Federal Government would release a discussion paper exploring an additional proposal, not identified by the Productivity Commission, to "clawback" bonuses paid to directors and executives where the company's financial statements are materially misstated.

evolve. For instance, currently some companies are looking at ways of deferring a proportion of remuneration in order to allow the impact of executive decisions giving rise to bonuses to become better known before bonuses are paid; but again we note taxation arrangements are not helpful in this regard (see above).

- Boards and companies will be judged by shareholders as to the appropriateness of the remuneration arrangements they put in place, including the extent to which there is unwarranted complexity. In other words, the market has the capacity to discipline boards (e.g. voting on remuneration report, director re-election process) and companies (e.g share price impact) where there is too much complexity.

- To the extent there have been issues with the complexity of remuneration arrangements, these have tended to be associated with particular top 100 listed companies, reflecting in part the complexity of their activities and their global nature. In the same way that it could be said that the Federal Government erred in dramatically reducing the shareholder approval threshold for termination payments for all companies regulated by the Corporations Act when the issue of large termination payments tended to be associated with certain top 100 listed companies[8], we believe it would be wrong to contemplate legislative change that has a widespread application in an effort to reduce complexity of incentive arrangements.

Some groups have advocated that relative total shareholder return is an appropriate basis for determining executive rewards. While such a measure may be appropriate in some cases, possibly in combination with other performance measures, we do not support it being mandated; nor do we consider the measure represents a "silver bullet" for the difficulties many companies face in setting executive remuneration. We note:

- The global financial crisis has highlighted that while a relative total shareholder return measure is seen by some investors and others to be appropriate in "boom" time, this view is not necessarily maintained in "difficult" times. In difficult times, it is evident that many shareholders (particularly smaller ones) prefer rewards linked to absolute total shareholder returns (i.e. where total shareholder returns fall in absolute terms so do executive rewards) – notwithstanding that an executive, when compared to his or her peers, may have demonstrated outstanding performance to stop further losses. Such conflicting or changing views make it more difficult for companies to put in place arrangements that are likely to be acceptable to all parties under changed economic circumstances.

- A focus on total shareholder returns (absolute or relative) alone may well promote skewed decision making, such as short-termism. Conventional thinking tends to be that multiple performance measures (with total shareholder returns commonly being one) are often appropriate.

- Total shareholder returns (absolute or relative) as a performance measure may not be appropriate for all executives, depending on the roles they serve in the company. In some cases, for example, it may be more appropriate to tie an executive's reward to say, divisional outcomes.

- Even with relative total shareholder returns as a performance measure, there can be complexities involved in determining peer groups, where there is deferral of rewards, etc.

---

[8] See the submission by the Australian Institute of Company Directors to Federal Treasury in response to the "Exposure Draft: Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009" 29 May 2009. Available at - http://www.companydirectors.com.au/Representation/Submissions/2009/2009-18+Submission+to+Treasury+on+Exposure+Draft+Corporations+Amendment+%28Improving+Accountability+on.htm

How best to revise the legislative architecture to simplify the incentive components of executive remuneration arrangements?

For the reasons outlined in the previous section, the Australian Institute of Company Directors is strongly opposed to a revision of the legislative architecture with a view to forcing (directly or indirectly) simplification of incentive components of executive remuneration. As well as being wrong in principle, we believe, in light of attempts overseas to limit various components of remuneration packages (see above), such an approach is likely to have unintended negative consequences for the companies concerned, their shareholders and the broader economy. We would also anticipate that companies and their advisers would, legitimately, look for ways to work outside such requirements, in turn creating further complexity.

We remain convinced, however, that repeal or simplification of certain existing requirements as they relate to equity-based incentive schemes will assist in simplifying remuneration arrangements, such as:

- removal of employment cessation as a taxation trigger point[9]. In this regard we believe that CAMAC should lend its support to the recommendation made by the Productivity Commission in December 2009 about removing the cessation of employment trigger for the taxation of equity or rights that meet certain conditions.[10]

- repealing the existing 12-month base salary threshold for shareholder approval of termination payments and replacing it with a two-year total remuneration threshold[11]. This latter threshold would reduce the need for companies to include additional terms in remuneration agreements, designed to address the severity of the 12-month base salary threshold (which is applied on a pro-rata basis in the first year of employment).

The Australian Institute of Company Directors would be happy to elaborate on any of the points made in this submission should this be required.

Yours sincerely

John H C Colvin
CEO & Managing Director

---

[9] See the submission by the Australian Institute of Company Directors to the Productivity Commission in response to the Commission's Issues Paper titled "Regulation of Director and Executive Remuneration in Australia", 29 May 2010, at page 36.

[10] See Recommendation 13 in the Productivity Commission Inquiry Report, Executive Remuneration in Australia, No.49, 19 December 2009, at page xxxix.

[11] See the submission by the Australian Institute of Company Directors to Federal Treasury in response to the "Exposure Draft: Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009" 29 May 2009 (weblink provided above).

42/120 Collins Street
Melbourne 3000

GPO Box 1472
Melbourne 3001

Telephone +613 8664 2664
Facsimile +613 8664 2666

www.bca.com.au

13 August 2010

Corporation and Markets Advisory Committee
Level 16
Metcentre
60 Margaret Street
SYDNEY

By email: john.kluver@camac.gov.au

Dear Sir/Madam

CAMAC inquiry into aspects of Executive Remuneration

The BCA is pleased to make this submission to the Corporations and Markets Advisory Committee's (CAMAC) inquiry into simplification of reporting requirements and incentive components of executive remuneration.

The BCA acknowledges that there are issues of public discussion around the complexity of current executive remuneration disclosure but believe that it is important to ensure that any policy responses regarding executive remuneration pay proper regard to the central role that boards play in determining executive remuneration - including in setting appropriate incentives to align remuneration with meaningful measures of individual company performance appropriate to the particular circumstances of individual companies.

Any moves to dilute the authority of boards to determine appropriate remuneration structures – including incentive components - through overly prescriptive legislation is to be avoided.

As with other inquiries (such as the Productivity Commission's review of executive remuneration), CAMAC has an important role to play in ensuring that public debate and potential policy changes are based on a thorough understanding of the facts about contemporary public company practice in Australia, respect of the proper role and responsibility of directors and objective assessment of the potential costs and adverse implications of adopting specific regulatory responses.

The government has stated that it is seeking CAMAC's advice on how best to revise legislative architecture to facilitate simplification of reporting requirements on remuneration. In our view, CAMAC should consider a principles-based response to this issue. Given the inherent complexities associated with reporting modern, sophisticated incentive payment structures, it would be of significant concern if CAMAC was to recommend a 'prescriptive' legislative approach to deal with those issues.

Executive remuneration reporting and practices have evolved in Australia significantly in recent years and should be given time to evolve further. The BCA considers that effective, company-specific approaches need to be supported, not discouraged or constrained by new regulations. The aim should be to promote for a:

- reporting requirements that are principles-based, allow flexibility for boards to set remuneration arrangements to suit each company's circumstances, and provide clear and concise information for shareholders; and

- remuneration incentive packages that take into account the specific circumstances and objectives of individual companies.

Simplification of reporting requirements

The government has asked CAMAC to:

- examine the existing reporting requirements contained in section 300A of the Corporation Act and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies; and

- make recommendations on how best to revise the legislative architecture to reduce the complexity of remuneration reports.

Many executive remuneration reports have become complex for shareholders and the community to easily comprehend. Accordingly the BCA considers that there is scope for improving useful information for shareholders.

A range of proposals have been developed to improve the legislated reporting requirements of remuneration reports, and many of these were summarised in CAMAC's information paper. Various proposals have also been put forward by groups such as the Australian Shareholders' Association (ASA) and the Australian Institute of Company Directors (AICD). The complexity of the issues surrounding this debate, as well as the many views on improved reporting, highlight the difficulty associated with detailed prescription.

The aim of simplification should be to ensure that clear and concise information is provided on executives' current and prospective future pay. However, the variety of remuneration arrangements currently in place in Australia makes it difficult to prescribe requirements to achieve meaningful or standardised disclosure.

Against this background, the BCA concurs with the AICD's view that a principles-based approach to remuneration reporting should be adopted. Principles make clear the expectations for reporting, rather than the specifics. A principles-based approach also allows boards to determine appropriate and meaningful information that enables investors to make an informed assessment of remuneration practices.

There are a range of salient issues that need to be acknowledged in the area of remuneration reporting.

For example, the Productivity Commission in its final report on executive remuneration recommended that remuneration reports should include:

- a plain English summary of remuneration policies; and

- disclosure of actual remuneration received and total company shareholdings of individuals identified in the report.

The government supported this recommendation and requested CAMAC's advice on how best to revise legislation to reflect these reporting features.

The BCA supports the reporting of 'actual' remuneration received by executives. However, caution must be taken to ensure that legislative requirements for reporting retain the flexibility to report on the individual circumstances of an organisation and its executives. For example, 'actual remuneration' will often be delayed by a year following the remuneration report, because determination of bonuses and long term incentives may not be settled by the time the remuneration report is published.

Accordingly, it should be the role of companies to ensure that there is clarity around reporting of remuneration and the role of policy makers should be to ensure that legislation facilitates appropriate flexibility in this reporting. The BCA believes that the current legislative framework largely achieves this objective.

CAMAC should also be mindful that many apparently appealing proposals in this area can, on closer inspection, lead to more confusion and lengthy explanations. For example, the Productivity Commission recommended that the remuneration report include total company shareholdings of individuals in the report (Recommendation 8). Care must be taken to ensure that requirements to report aggregated shareholdings leads to useful information being disclosed. For example, the retirement of one executive who holds a significant parcel of shares will cause the reported aggregate shareholding to decline. Unless explained in detail, shareholders might be misled into thinking that the executive team, as a whole, was reducing its holdings in the company.

The Productivity Commission recommended that a 'plain English' summary of the remuneration report be prepared (Recommendation 8). The BCA supports the objective for reports to be drafted in 'plain English'. However, the BCA considers that it may be difficult to define 'plain English' appropriately in legislation or guidance. Such a requirement may effectively require companies to obtain legal advice to ensure that reports are drafted in 'plain English'.

Introducing the requirement that a summary of the remuneration report be prepared may not achieve the intended aims. In the BCA's view, the concept of a summary document could raise further questions about whether additional layers of reporting will actually achieve improved clarity for shareholders. Past experience has demonstrated that adding reporting requirements can instead merely increase the number of pages of reporting. For example, concise annual reports have proven to have had varying degrees of success, as they have been seen to add an additional layer of reporting burdens and costs and have not necessarily benefited shareholders.

Further questions remain, such as whether a summary document must have the same auditing requirements under the accounting standards as the bulk of the remuneration report. Even if auditing is not legally required, most companies may feel compelled to seek auditor sign-off to ensure consistency with the full remuneration report, thereby adding compliance effort and costs to annual remuneration reporting. The length and detail currently required in remuneration reports is very often driven by the requirements of auditors that full descriptions of employee reward schemes and their salient rules are contained in these reports, even for relatively minor or legacy elements of the company's overall remuneration arrangements.

The CAMAC information paper summarises guidance and legislative reporting requirements from within and outside Australia. The BCA would be very concerned if legislative arrangements from for example, the United States, were to be recommended for Australia, given Australia's comparatively good performance in corporate governance. Australia has a good record of corporate governance, with a unique and well respected regime which incorporates legislation and an 'if not, why not' reporting approach through ASX Corporate Governance Council Guidelines. The Productivity Commission found in their final report on executive remuneration that *"while there had been rapid growth in executive pay (prior to the global financial crisis), the evidence does not indicate widespread failure in remuneration-setting across Australia's 2000 listed companies, nor significant adverse impacts on the performance of the corporate sector as a whole."*[1]

It would be erroneous for Australia to follow the path of great prescription, such as that outlined in the United States legislative reporting framework, and in particular the reporting of the CEO pay as a proportion of the median annual total compensation of all employees of the issuer. These types of requirements go beyond simplification of reporting requirements and instead raise consideration of issues such as quantum, salary caps and proportions of average earnings that have already been considered through the Productivity Commission inquiry. The Productivity Commission found that a *"key contributor to growth (and recent fall) in executive pay has been the strong shift to performance-based remuneration, especially (long-term) equity-based incentives. This change has been motivated by the need to align the interests and actions of CEOs and senior executives with the longer term interests of companies and their shareholders. This trend has been particularly marked for the largest companies."*[2]

Reporting of proportions of pay relative to average earnings may be meaningless unless it properly acknowledges the risk-based nature of significant elements of modern incentive pay. Again, under a properly designed, performance-linked remuneration structure, total pay (base pay and incentive/"at risk" pay) may vary significantly from year to year—up or down. These changes would inevitably require lengthy explanation if they are to avoid confusing both casual or professional readers alike. Proportional reporting may also deter performance-based pay and lead to de facto limits on executive remuneration. The Productivity Commission stated that *"prescriptive pay constraints (such as caps) are not called for, as they would be impractical, weaken the role of boards and have perverse economic consequences."*[3] It would therefore be very damaging to the economy to be revisiting issues that have already been dealt with by the Productivity Commission in this CAMAC inquiry.

The BCA considers that the usefulness of information relating to executive remuneration for shareholders will depend on the detail and definitions contained in the requirements.

---

[1] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p 357.
[2] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p 358.
[3] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p 357.

Simplification of incentive components

The government has asked CAMAC to:

- examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements; and
- make recommendations on how best to revise the legislative architecture to simplify the incentive components of executive remuneration arrangements.

The BCA does not believe that simplification of incentive pay structures is a matter that warrants any new regulation or legislation at present.

It is important to recognise that business must offer attractive incentives to secure and retain talented executives and future leaders. Increased forces of globalisation, including the prospects of pursuing employment opportunities overseas have been increasingly relevant factors for Australian executives especially within the professional services, resources and financial sectors. In this environment, Australian companies seeking to attract and retain skilled workers must be able to offer globally competitive conditions and remuneration packages – both in terms of structure and quantum – for all executives. This important consideration should, in the BCA's view, take precedence over any felt need to mandate simplification for pay arrangements.

The quantum of executive pay rather than its complexity appears to be at the heart of community concerns about remuneration. A critical issue for boards is, therefore, the need to align executive remuneration to meaningful measures of company performance that boards consider to be of most importance to the company's circumstances. These circumstances may change, sometimes significantly, from year to year.

As with any commercial negotiation, the amount and structure of remuneration will reflect a risk–return trade-off. Within this context and against the backdrop of the broader market considerations discussed above, a company board has to determine four key issues:

- The split between fixed and performance-based (or 'at risk') pay.
- Within performance-based pay, the split between long-term and short-term incentives.
- The nature of performance hurdles or benchmarks.
- The form of any reward (cash, shares, options).
- Entitlements associated with termination in various circumstances.

The key aspect of the debate is how to better link an executive's variable or 'at risk' remuneration with those factors that drive company performance over which executives have the ability to influence. This is not a simple exercise.

Inevitably a diversity and indeed complexity of measures and targets will be required within and across companies. This should not be surprising. Large companies are complex as are the vast majority of contracts that relate to their operation. This raises the vexed issue of how to ensure that there is clarity around performance incentives and hurdles and how to foster a broad understanding by shareholders of remuneration priorities, strategies and outcomes when many of the targets a board may set are commercially sensitive and would if made public provide information to competitors that may damage the company to the disadvantage of shareholders.

Non-professional shareholders often assume that pay should mirror company share price and that share price is the proper measure of management performance. This is often not the case, especially over short periods (under 2-3 years). Share price may be driven by investor sentiment to the company's sector or industry, or general economic conditions rather than the financial performance of the company in any given period. Moreover, many of the objectives set by boards may reflect long-term strategies that will not be reflected in financial performance in any given period.

It is generally understood that the goal of simplification of incentive arrangements is to drive more clearly aligned outcomes. However, there is a significant risk that legislative measures designed to simplify arrangements will result in more prescription and will cause companies and executives alike to instead view incentive arrangements as too difficult with the result that the highly desirable emphasis on performance-linked/"at risk" pay will be reduced.

For example, there are a range of equity-based instruments that may be use to align the interests of executives with shareholders, such as shares, options or share appreciation rights.[4] Recognising the range of the possible instruments, the Productivity Commission in its recent review of executive remuneration highlighted that:

> *"..there is not a simple answer to the question of what the 'right' equity-based instrument is. A remuneration structure that works well at one company might prove disastrous at another. And what works well for an individual company at one point in time might not at another. Choosing the best equity-based instrument/s therefore requires careful consideration of the company's circumstances."* [5]

Performance hurdles are equally complex, with a range of methods of linking payments to specific performance benchmarks. Experience shows that efforts to use common and more widely understood metrics (such as total shareholder return or relative total shareholder return) do not always produce the desired results.

For example, as share prices have fallen, using measures such as relative total shareholder return as a performance benchmark may in fact reward volatility and market 'catch-up' rather than management out-performance. In contrast, in a rising market, relative total shareholder return is seen as being superior to total shareholder return, which simply rewards all for market momentum.

[4] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p 193.
[5] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p. 198.

Similarly, it is also often difficult to prescribe appropriate proportions of the components of pay (such as fixed, short-term, long-term and bonuses). For example, while some have argued, on the basis of simplicity, for a return to a greater proportion of fixed pay, it is hard to see how this achieves a strong alignment with long-term shareholder interests.

Whilst the Productivity Commission recognised that simplicity around incentives could have advantages, they also noted that companies are different and that simplification of incentive arrangements is therefore a risk, stating:

> *"'prescribed' or standardised pay structures might not be helpful in promoting improved performance (in much the same way that imposing standardised investment strategies across all companies would not be appropriate), yet could also be driving unnecessary complexity."*[6]

The recent changes to the taxation arrangements for employee share schemes, provides an example of how greater prescription has acted to discourage businesses, both large and small, from using equity options.[7]

Share options have in the past been particularly important for start-up companies. Start-ups have traditionally used deferred payment alternatives as a mechanism to encourage investment and attraction of skilled executives where payment of cash salaries is not a viable option. There is evidence, however, that the new taxation arrangements may be discouraging the use of options, with risks to entrepreneurship and innovation.

Given the various complexities in determining superior performance, there is a strong case to be made for the continuing unfettered authority of boards to determine the details around equity-based incentives, including the size and quantum of at-risk payments.

There is already considerable guidance available to boards in considering the appropriate structure of incentive arrangements, including for example guidance provided by the Australian Prudential Regulation Authority (APRA).[8] However, APRA recognises the primary role of boards in establishing executive remuneration packages stating that *"APRA's modus operandi is to let companies work out their own approach, within the ambit of APRA's prudential standards, and for APRA then to challenge any company which is not, in APRA's opinion, operating appropriately."*[9]

It is with this in mind that the BCA would be deeply concerned if CAMAC were to recommend legislation to develop a 'prescriptive' regime to deal with incentive arrangements. Businesses and their commercial objectives differ and change over time and therefore incentive arrangements must be capable of flexibility to suit different circumstances. This important principle should override a desire for simplicity or standardisation of executive remuneration arrangements.

---

[6] Productivity Commission 2009, *Executive Remuneration in Australia*, Report No. 49, Final Inquiry Report, Melbourne, p. 219

[7] Patrick Durkin, 'Companies opt out of option rewards', *The Australian Financial Review*, Monday 26 July 2010, p. 5

[8] Chapter 5, CAMAC information paper

[9] John Trowbridge, *'Executive Remuneration The Regulatory Debate'*, Executive Member APRA, 2009 Remuneration Forum, CGI Glass Lewis and Guerdon Associates, Sydney, 16 March 2009

* * *

I trust that you find this submission useful.

If you have any questions or comments, please contact Ms Leanne Edwards, Assistant – Director, Regulatory Affairs on (03) 8664 2614 or leanne.edwards@bca.com.au.

Yours sincerely

Graham Bradley AM
President

Macquarie Group Limited
ABN 94 122 169 279

No.1 Martin Place
Sydney NSW 2000
GPO Box 4294
Sydney NSW 1164
AUSTRALIA

Telephone (61 2) 8232 3333
Facsimile (61 2) 8232 7780
Internet http://www.macquarie.com.au

13 August 2010

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

E-mail: john.kluver@camac.gov.au

Dear Mr John Kluver

Executive Remuneration – Information Paper - July 2010

Macquarie Group Limited (Macquarie) would like to contribute to the review the Corporations and Markets Advisory Committee (CAMAC) is undertaking at the request of the Minister for Financial Services, Superannuation and Corporate Law, Mr Chris Bowen.

Macquarie's remuneration framework has delivered superior shareholder returns over many years by aligning the short and long-term interests of staff and shareholders, and by attracting and retaining high quality people. While the principles have remained, the framework has been amended and has evolved in line with market conditions over the years.

Macquarie supports the increased debate on reporting of remuneration. Australia is already well regarded in its remuneration disclosure practices.

To this end, Macquarie advocates:

- A principles-based approach
- Boards should have discretion to determine how executives should be remunerated
- Regulation should not dictate the type of incentive scheme a company should implement
- Simplification of the Remuneration Report needs to be considered against the backdrop of the requirements of all shareholders, some of whom want the detail
- The legislative architecture should support good remuneration practices

The supporting paper provides details to support these points.

We appreciate your consideration of this paper.

Please do not hesitate to contact me or Nicole Sorbara on 8237 5015 if you wish to discuss this letter in more detail.

Yours sincerely

Helen M. Nugent

Dr Helen Nugent AO
Chairman, Board Remuneration Committee
Macquarie Group Limited

Executive Summary

Macquarie supports the effort to reform Executive Remuneration advocated by the Productivity Commission, APRA and other regulatory bodies.

While there has been significant debate as to what will make remuneration reporting simpler and more transparent, varied views exist on items to be included/deleted and the nature of what is disclosed. This is to be expected given the different needs of different interest groups.

Macquarie considers that, subject to considerations of risk, regulation should not dictate the type of incentive scheme a company should implement, nor should it restrict or diminish the flexibility of companies to attract, retain and motivate employees to achieve improved company performance.

It is important that company Boards and remuneration committees develop incentive schemes which are appropriate to their circumstances having regard to risk and which are aimed at driving superior executive performance which in turn drives shareholder returns.

Macquarie advocates a principles-based approach to remuneration, with responsibility resting with Boards and remuneration committees to implement incentive schemes to suit their particular circumstances.

In turn, shareholders should be provided with sufficient information in the Remuneration Report to be able to evaluate a company's remuneration policy and remuneration outcomes in light of the company's performance.

Remuneration reporting should be useful, understandable and transparent. In this context Macquarie acknowledges that a fine line exists between report readability and length, with the need to balance transparency and simplicity.

However, a prescriptive approach to incentive schemes or remuneration reporting does not ensure that remuneration packages are appropriately structured nor does it simplify the process. Moreover, it might possibly result in perverse outcomes such as has occurred with overseas interventions.

Detailed Response

Macquarie has considered the Minister's request for advice and would like to present the following comments on the items identified by the Minister.

REMUNERATION REPORTING

Examine the existing reporting requirements contained in section 300A of the Corporations Act and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies.

Make recommendations on how best to revise the legislative architecture to reduce the complexity of remuneration reports.

- Macquarie does not consider that any significant changes are required to the existing reporting requirements for Remuneration Reports. However, there are some amendments which may be useful to meet the needs of shareholders. Each of these suggestions is outlined in further detail below.

Simplification needs to be considered against the backdrop of the requirements of all shareholders, including the needs of both retail and institutional shareholders.

- Macquarie supports the Government's efforts to make Remuneration Reports more concise, useful, readable and transparent.

- However, as acknowledged by the Productivity Commission, tension exists between report readability and length, with the need to balance transparency and simplicity.

- Different companies have different shareholder bases, with different types of shareholders having different needs. From Macquarie's perspective, there is a need to focus on the needs of both retail and institutional shareholders as well as regulators, investors and other stakeholders.

- Macquarie supports in principle the idea of including a plain English summary of a company's remuneration policies, primarily for the benefit of retail shareholders. At the same time the needs of institutional investors should be met through greater detail.

- Macquarie supports individual remuneration disclosures being limited to Key Management Personnel (KMPs).

- Macquarie does not take the view that the Remuneration Report should be radically reduced in scope. Our consultation with institutional shareholders would suggest they are supportive of the richness of data reported and disclosures made. Institutional shareholders continue to express greater interest in the detail behind remuneration arrangements, policies and the accounting quantum of remuneration.

- The government in its response to the recommendation in the Productivity Commission report has indicated that it will introduce various changes to simplify the disclosure requirements of the Remuneration Report. One foreshadowed change is the requirement to disclose *the actual levels of remuneration received* by the individuals named in the Remuneration Report. Macquarie does not consider it appropriate to mandate that actual pay *received* in the current year should be included in the Remuneration Report.

- Most organisations consider and structure executive remuneration to reward, motivate, and align the interests of shareholders and executives. One of the key aspects of the

Remuneration Report is the link between performance and reward. This is critical to shareholders to understand whether:

- the remuneration granted is fair in relation to the performance achieved;
- the Board is achieving its function in setting effective executive remuneration and;
- the remuneration structures and awards are aligned with the interests of shareholders.

- Boards generally consider the actual pay *awarded* in relation to the individual's performance, financial results and other factors, when setting levels of executive remuneration for a given individual in any given year.

- Macquarie's view is that the actual pay *awarded* in the current year should be included in the Remuneration Report. This will enable shareholders to see how the remuneration awarded is aligned with the current year's performance.

- Actual pay awarded would include any remuneration approved by the Board for an individual's performance in a given year. This would show fixed remuneration, variable/and or performance based remuneration, equity awards and any other incentives granted in the year.

- The conditions, restrictions, vesting and other relevant factors should continue to be disclosed in their relevant sections of the Remuneration Report.

- Macquarie does not consider that it is appropriate to mandate that actual pay *received* in the current year should be included in the Remuneration Report.

- While many companies consider performance-based incentives in two broad categories: Short term incentives (STIs) and Long term incentives (LTIs), this is not universally the case. For an organisation like Macquarie, the main form of performance-based remuneration is profit share, of which, a significant portion is deferred and vests over seven years. As a result, actual pay *received* may include current year fixed and short term performance-based remuneration as well as remuneration deferred from the previous seven years.

- The actual pay *received*, being broadly cash received and awards vested in the current year (in relation to remuneration awarded in prior years), is not the main focus of Board decision making regarding remuneration.

- For deferred remuneration, a number of factors may change during the vesting period, for example the economic climate, market conditions and the composition of the Board. The actual pay *received* approach will include deferred awards when they vest. Therefore, there is no alignment between current year company performance and remuneration.

- It is worth noting that remuneration reporting in the United States has recently shifted to reporting actual remuneration *awarded* and approved by the Board. This would include the total value of fixed, short and long term incentives awarded in that year. The structure, delivery, performance hurdles and vesting would be detailed in supporting schedules.

- Appendix 1 includes a summary of suggested items for inclusion in the Remuneration Report.

Accounting values of remuneration should be reported in the financial statements section of the annual report.

- Accounting values of remuneration continue to be an important element in the requirements of institutional shareholders. Thus, it is Macquarie's view that this information should be included in the Financial Report of the Annual Report on an individual basis, for KMP's.

- This may reduce confusion for some shareholders attempting to understand complex accounting concepts, while still providing the data to those shareholders interested in the statutory values required to perform analysis on the financial statements.

REMUNERATION ARRANGEMENTS

Examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements.

Make recommendations on how best to revise the legislative architecture to reduce the complexity of remuneration reports and simplify the incentive components of executive remuneration arrangements.

Macquarie considers that a principles-based approach with Board discretion is the best approach. No significant changes are required to the legislative architecture to simplify remuneration reports or executive incentives. Further detail is outlined below.

Adopt a principles based approach to executive remuneration.

- In recent years, executive remuneration practices have come under close scrutiny from governance groups, regulators, governments, politicians and the broader community due to the significant changes in global financial markets.

- Numerous initiatives have been launched globally with a number of common themes as to what constitutes a good principles-based remuneration framework including:

  - Incentive arrangements should align with shareholder interests.
  - Incentive arrangements should align with prudent risk taking and should not reward excessive risk taking.
  - A significant portion of performance-based remuneration should be deferred and remain at risk.
  - Termination benefits should not reward poor performance.
  - Companies should have a formal, written remuneration policy approved by the Board.
  - Companies should have an independent Remuneration Committee which is responsible for ensuring that remuneration policy is appropriate.
  - A separate remuneration policy for non-executive directors and executive directors should be in place.

- A principles-based approach allows organisations flexibility to respond to a global and domestic marketplace and their individual company circumstances, while recognising and managing risk.

- A prescriptive approach will not simplify remuneration arrangements and in fact may have unintended consequences such as curtailing a company's ability to respond to changing market factors. Perversely, it may also drive up remuneration levels.

- A principles-based approach is consistent with guidance from financial services regulators such as APRA and the Financial Stability Board, following the Global Financial Crisis.

- Generally, regulators are concerned with the risks created by the structure of remuneration arrangements, not with the absolute amounts of remuneration or specific instruments, which remain a matter for remuneration committees and Boards.

- Prescriptive regulation may make Australian companies less globally competitive for talented executives.

- Macquarie considers that adopting a principles-based approach would enhance the remuneration framework, provide greater transparency and strengthen the relationship between the interests of a company's executives and the interests of shareholders.

Boards should have discretion to determine how executives should be remunerated.

- A one size fits all approach to incentive arrangements is not appropriate. For example, even the simple short-term incentive, long-term incentive approach does not work equally well across all industries. Different industries have different time horizons. At Macquarie, a significant portion of what may classically be described as STI - the annual profit share allocation - is deferred for up to 7 years. In other words, the supposed STI has the characteristics of an LTI.

- Boards are best placed to assess both the level of remuneration that needs to be paid to attract and retain executives, and how remuneration should be structured to recognise risk and ensure returns to shareholders are sustainable over the long term.

- Boards also need to have the ability to respond to both individual company circumstances and the environment in which the company operates.

- A prescriptive approach may restrict the Board's ability to adapt their remuneration arrangements to suit their particular circumstances (lifecycle, growth plans, environmental factors, market conditions and risk profile), i.e. a company in a growth phase may have different remuneration arrangements to a well established company.

No significant changes are required to the legislative architecture.

- The legislative architecture should support incentive arrangements that comply with the general principles advocated by the various governance groups and regulatory bodies as set out above.

- The legislative architecture that governs remuneration arrangements is broad and covers employment law, tax law and corporation and securities law, as these all influence how incentive arrangements are designed.

- Macquarie would like to draw attention to areas where the legislative architecture is not aligned with the remuneration framework or areas where best practice remuneration incentives place an additional administrative burden on companies.

The taxation of employee share schemes on termination of employment

- Under the tax legislation covering employee share schemes, termination of employment triggers a tax event for employees, even in circumstance where vesting is deferred beyond termination of employment.

- Like many global financial services regulators, shareholders consider that good governance practice requires companies to retain profit share amounts post termination to maintain alignment and ensure that executives consider the long-term consequences and implications of transactions post employment.

- To avoid placing employees in an adverse cash-flow position, both APRA and the Government's Consultation Paper, released subsequent to the Budget legislation, suggest that companies allow partial vesting of shares to enable realisation of funds to pay that tax on cessation of employment.

- This suggestion is flawed because it will reduce alignment with shareholders during the vesting period post termination as alignment would be on a post-tax rather than pre-tax basis.

- In addition, there could be circumstances where a determination is subsequently made not to vest amounts post termination, yet the employee will already have received some shares to cover tax liabilities. For example, at Macquarie, during a period of up to 2 years post termination, a determination can be made not to vest shares if it is found that the employee has committed a disqualifying event (e.g. fraud). If some shares have already been released, it will be difficult and expensive to recoup these funds. This is not in the best interests of shareholders.

Corporations and Securities laws

- ASIC provides limited exemptions from some of the regulatory burdens that can otherwise complicate the offering of company shares to staff (Class Order 03/184). For example, ASIC gives relief from the obligation to make certain share scheme offers under a prospectus or product disclosure statement, and relief from provisions of the Australian Financial Services licensing and disclosure regime.

- One of the conditions of this relief is that no more than 5% of the company's shares are issued under the ASIC Class Order 03/184. This cap was set in 1994 to balance the encouragement of staff share offers against the risk that staff plans would be used for fundraising. The cap has for some time presented difficulties for listed companies with a large workforce or strong staff equity alignment principles.

- With the increased regulatory emphasis on delivering remuneration in the form of equity, this very low cap should be increased to ensure the relief offered by Class Order 03/184 is not eroded. Other outstanding technical issues under Class Order 03/184 should also be clarified or resolved through this review.

- ASIC also provides relief from the Corporations Act prohibition against subsidiaries acquiring parent company shares. This relief is critical for funds management businesses which need to acquire shares in their listed parent as part of normal trading by the business' funds (e.g. index funds).

- One of the standard conditions of this relief is that the aggregate interest in shares of a listed company held by its subsidiaries does not exceed 5% of the company's total issued share capital.

- One aspect of all staff share schemes is that they are deemed to give the parent company a "relevant interest" in its own shares through its ability control disposal of shares (e.g. where shares are forfeited). As a result, this cap will increasingly create difficulties for listed companies as they deliver more remuneration in the form of shares. We submit that this cap should be increased with adequate market protection provided through normal substantial holder disclosure disclosures.

Appendix 1

Suggested inclusions in Remuneration Report

- **Executive summary**
- **Remuneration Framework/Policy**
  Description of the remuneration framework, including the key elements, the underlying principles and evolution over time.
- **Remuneration Governance**
  Description of governance framework managing and monitoring executive remuneration, description the Board oversight process, the function and responsibilities of the Board Remuneration Committee, and details of the remuneration approval framework.
- **Remuneration strategy**
  Description of the goals of the remuneration policy and the remuneration arrangements implemented to achieve them.
- **Performance and pay link**
  Description of how performance goals and remuneration strategy are aligned, description of alignment to shareholder goals and discussion of remuneration components and tools used to achieve this. Explanation of how remuneration arrangement are delivering performance outcomes including relevant benchmarking against peers
- **Incentives**
  Discussion of remuneration incentives, structures including
  - fixed remuneration,
  - variable performance based remuneration,
  - delivery and retention of performance based remuneration
  - investment of retained amounts
  - vesting schedules
  - performance hurdles
  - minimum shareholding requirements and
  - significant contractual termination arrangements.
- **Remuneration outcomes**
  Remuneration table for KMPs outlining remuneration *awarded*, including fixed salary, total performance based incentives split by category, for the current and previous year.
- **Non-executive director policy and outcomes**
  Description of the non-executive remuneration policy, details of current and previous year fees and shareholding requirements.

Freehills

Mr John Kluver
Executive Director
CAMAC
Level 16
60 Margaret Street
SYDNEY NSW 2000
john.kluver@camac.gov.au

By email

Submission on Executive Remuneration Information Paper

We have pleasure in submitting Freehills' Head Office Advisory Team's comments on CAMAC's Executive Remuneration Information Paper.

The Head Office Advisory Team (**HOAT**) supports the simplification of remuneration reporting requirements and supports legislative change that would facilitate simpler incentive arrangements and disclosures.

However, we would take care to distinguish between 'simpler laws' to facilitate incentive arrangements and 'simpler incentive arrangements'. We do not support direct regulation of the form, size or structure of incentives. We strongly believe that companies should retain the ability to reward and incentivise their personnel in the way that is most appropriate for their particular circumstances.

1 Identify areas where the Corporations Act and related regulations could be revised to reduce complexity, duplication and more effectively meet the needs of shareholders and companies

The current legislative framework results in undue complexity and duplication of remuneration disclosures and excessive compliance costs for companies (and ultimately their shareholders). We make the following comments and recommendations.

1 Ensure all remuneration reporting obligations are contained in the one piece of legislation. If all obligations are shifted to the Corporations Act, repeal the associated provisions in the Corporations Regulations and expressly state that AASB 124 does not apply to companies who report against the Corporations Act requirements.

2 If sections 300 and 300A of the Corporations Act are retained, ensure that the required disclosures regarding shares, options and rights correspond so that compliance with s 300A will automatically result in compliance with s 300.

3 Allow cross-referencing to earlier reports (other than when comparative information is expressly required). If a company has reported something in

Doc 5896634.2

respect of a prior financial year, it should not be required to report the exact same thing in a future financial year.

4 Limit disclosure 'requirements' to clear, measurable concepts.

5 Allow companies to make voluntary decisions regarding the level of disclosure they make on broader concepts such as 'policy'. Companies are likely to voluntarily elect to make such disclosures, as they need to 'explain' the hard reportable numbers to their stakeholders. Mandating disclosure of 'soft' concepts such as 'policy' tends to result in companies preparing boilerplate answers that provide little insight.

6 Do not create unnecessary overlap by using unnecessarily broad concepts or definitions.

7 A solution may be to redraft s 300A in a "checklist" format.

8 Limit mandatory disclosures (for listed companies) to the following items:

- the "actual" value of remuneration that is paid or becomes "realisable" (i.e. vests) in each financial year (to be valued at the time the remuneration is paid or first becomes realised);
- the conditions and vesting periods of any incentives granted during the year and the value of those incentives at the date of grant;
- whether key management personnel are prohibited from hedging their incentives;
- movement during the year in the number (but **not** the accounting value) of shares, rights and options held by each key management person under an employee incentive scheme;
- a description of any change during the year to the conditions or vesting periods of any unvested incentives or any other change to the arrangements between the company and a key management person that would materially affect remuneration in a future period; and
- termination entitlements.

2 Legislative changes to facilitate simpler incentive arrangements

1 *Ensure the tax legislation facilitates simple best practice arrangements*

- The complexity of current remuneration arrangements is often driven by tax considerations. The need to structure an offer so that it qualifies for tax deferral can result in distorted structures for employee incentive schemes.
- Having said that, taxation is critical to employee incentive schemes - equity can lose its attraction as an "incentive" if employees are taxed before vesting (and before the employee is able to sell a sufficient number of shares to cover any tax liability that arises in respect of them).
- For this reason, cessation of employment should no longer be a "taxing point" for unvested shares granted under an employee share scheme. The current taxing point encourages early vesting on cessation of employment and discourages "best practice"

arrangements (recommended by APRA and the Productivity Commission) whereby unvested shares remain on foot after cessation and only lapse or vest if the original performance conditions are achieved in due course.

2 *Remove unnecessary regulatory "blockers" to straight-forward share-based compensation*

- New offers to the public of securities and other financial products are heavily regulated under the Corporations Act, and for good reason. In essence, those provisions were drafted to protect members of the public from using their own money to purchase stock in "unknown" third party companies who solicited their capital. The relationship between employees and their employer company is obviously quite different, particularly where the financial product being offered is a free "bonus".
- One of the factors complicating current incentive arrangements is the need to comply with the Corporations Act requirements that apply to new offers to the public of securities and other financial products. Freehills acknowledges that there are currently various exemptions provided for under the Corporations Act and in ASIC Class Order 03/184, which allow companies to issue securities under employee incentive schemes to both directors and employees. However, Freehills believes that these exemptions (and ASIC Class Order 03/184) are in need of 'revisiting', as they do not extend to a number of 'ordinary' equity incentive grants and create a number of anomalies.
- Amend the law so that (subject to an overriding requirement that no offer to an employee may be misleading or deceptive) employee incentive schemes are entirely exempted from the following aspects of the Corporations Act:
  - any requirement for a prospectus or other disclosure document to accompany the offer;
  - any requirement for the offeror to hold a financial services licence;
  - any of the managed investment scheme provisions that could arguably be applicable;
  - the hawking laws; and
  - for cash-settled share-based payments, the provisions applicable to derivatives.

  Such an exemption could be limited either by amount (grants to employees worth not more than $X) or size (grants which, in aggregate, do not exceed 5% of the company's issued share capital).

3 *Modify the termination benefits legislation*

- Some anomalies in the new termination benefits legislation have the potential to complicate remuneration arrangements.
- The unfortunate drafting in the new legislation has resulted in confusion over its intended application and unforseen consequences.

- The unintended impact of this legislation has been that corporations are seeking alternative ways to pay 'standard' benefits to departing employees because the new legislation prevents them from doing so. (It is not uncommon for senior executives to have contracts that allow them 12 months base salary, pro rata STI and pro rata LTI if they depart as a good leaver).
- The most obvious example of measures being taken is a move towards increasing base salaries and decreasing grants of equity incentives. This trend is directly contrary to modern concepts of 'good governance' which encourage senior executives having 'at risk' remuneration and 'skin in the game'.
- A particular problem with the new termination benefits legislation is that the new termination benefits cap is relevant for lower-level employees who serve as directors of subsidiaries (for instance, an overseas employee who sits on the board of a foreign incorporated operating subsidiary simply to satisfy a requirement to have at least one locally-resident director), and could unfairly impact "bonus" entitlements paid to long-serving lower-level employees when they retire from positions with only moderate incomes.
- There are other problems with the legislation that could distort remuneration arrangements, including:
  - the cap being calculated by reference to average annual base salary in the three years prior to termination – this means that any employee entitled to a standard 12 month severance payment will exceed the cap if they receive even a nominal salary increase in any of the three years before they cease employment; and
  - the cap being "pro rated" in the first year of service – employees who are terminated without fault in the first year of service have a logical claim to a significant severance payment given the disruption to their professional lives (often in circumstances where they have may have given up other employment to take up the position).
- One simple solution would be simply to increase the statutory cap from "12 months base pay, averaged over the past 3 years" to "12 months total remuneration, calculated at the date of departure". Another might be to expressly limit the application of the provisions to the key management personnel of listed companies.

If you have any queries, please contact Priscilla Bryans on 03 9288 1779 or Garth Riddell on 02 9322 4780.

Yours sincerely

Freehills

Freehills Head Office Advisory Team
13 August 2010

RiskMetrics (Australia) Pty Ltd
Level 4, 190 Queen Street
Melbourne VIC 3000
ABN: 88 081 368 327 AFSL Licence No. 297008

Attention: John Kluver
Executive Remuneration Inquiry
Corporations & Markets Advisory Committee
By email: john.kluver@camac.gov.au

13 August 2010

Thank you for the opportunity to comment on the Corporations & Markets Advisory Committee's (CAMAC) review of executive remuneration disclosure issues. ISS Governance Services, formerly RiskMetrics, is the world's largest governance advisory firm, providing governance research to institutional investors in Australia and around the world.

ISS notes that CAMAC has not put forward any discussion points or potential reform proposals of its own in relation to the disclosure of executive remuneration by Australian listed companies. The information paper released by CAMAC in July 2010 summarises approaches to remuneration disclosure in Australia and other comparable jurisdictions such as the UK and US and also notes reform proposals advanced by various parties in response to the Productivity Commission's inquiry into executive remuneration.

In the absence of specific items calling for a response, this submission has been structured to consider a number of the common complaints directed against remuneration reports apparent from submissions to the Productivity Commission and other public commentary. These responses have been written on the basis of our company's detailed review of more than 1300 remuneration reports at S&P/ASX 300 entities since the introduction of the remuneration report for reporting periods ending on or after 30 June 2005.

1. Remuneration report complexity

The Productivity Commission in its final report notes the views of participants in its inquiry that remuneration reports are overly long and complex.[1] The views of participants cited by the Commission as to report complexity and length were largely those of the management of listed companies.

From ISS' experience of reading remuneration reports prepared by large Australian companies report complexity is driven by company approaches to disclosure and remuneration rather than disclosure requirements, with the exception of share based payment disclosures (see below). Many remuneration schemes now adopted by Australian companies have considerable complexity in terms of the measures against which executive performance is assessed and describing these schemes in a simple fashion is difficult. Telstra Corporation, for example, in its 2007 remuneration report disclosed three different long term incentive schemes all applying for awards in the 2007 financial year: A scheme assessing performance for senior executives with six different performance hurdles overlaid with a 'gateway' hurdle assessed over two to four years;[2] a variation on this scheme applying to the CEO assessing performance over three one year periods[3] and a third plan for the COO paid in cash against unspecified targets.[4]

[1] Productivity Commission, *Executive Remuneration in Australia*, Inquiry Report No. 49, December 2009, p. 47.
[2] Telstra Corporation Limited, *Directors Report For the Year Ended 30 June 2007*, pp. 28-29.
[3] See n. 2, pp. 33-34.

ISS does not support mandating the structure of executive remuneration in Australia and it is clear from submissions to various reviews of executive pay legislation and practice in Australia that there is little support for firm rules on how companies should pay their executives. It is not clear in this environment how remuneration report length and complexity could be addressed without substantially *reducing* the information available to shareholders in these reports given most complexity of disclosure is a function of company remuneration practice.

Complexity is also often a function of a company's disclosure choices: Sonic Healthcare, for example, has since the introduction of the remuneration report disclosed the amortised value of equity incentives granted to its executive directors in a written paragraph below the table summarising cash remuneration.[5]

2. Information overload

Despite the length of remuneration reports, as noted by ISS and other respondents to the Productivity Commission inquiry, there is widespread non-compliance with the existing disclosure requirements. The length of reports is driven in part due to the complexity of company remuneration practice and also by the widespread use by many companies of boilerplate disclosure. It is apparent from reading hundreds of reports that many companies follow similar templates often with identical or near-identical wording. From discussions with listed companies and their advisors it appears these templates are provided by professional advisors such as law firms. This boilerplate discussion, often used for remuneration policy or how fixed pay levels are set, is of minimal use to shareholders and simply adds to the length of reports without providing information. Anecdotal evidence suggests however that over the past two years more listed companies are seeking to take 'ownership' of their remuneration disclosures and are discarding templates.

Remuneration consulting firm Guerdon Associates has estimated that less than 20 percent of ASX 300 listed companies comply with the Corporations Act requirement for listed companies to provide a "detailed summary" of the performance conditions attached to senior executive bonuses.[6] ISS, in its submission to the Commission, made a similar observation (see submission provided to CAMAC, pp. 12-13).[7]

Another area of frequent non-compliance is entitlements on termination under service contracts disclosed under s. 300A(1)(e)(vii) of the Corporations Act. ISS notes companies in disclosing termination payments made to senior executives routinely note that benefits were provided in accordance with contractual terms without these entitlements having been disclosed in prior remuneration reports. In a recent example, Downer EDI disclosed that its departing CEO Geoff Knox had received 243,013 unvested shares on departure as part of his employment contract.[8] Disclosures provided in the 2008 and 2009 remuneration reports on his termination entitlements were silent on any entitlement to unvested equity incentives.[9] More discussion of non-disclosure of termination entitlements is included in ISS' Productivity Commission submission (provided to CAMAC, pp. 11-12).

---

4 See n. 2, p. 35.

5 See, for example, Sonic Healthcare Limited, *Annual Report 2005*, p. 22 and Sonic Healthcare Limited, *Annual Report – 30 June 2009*, pp. 16-18.

6 Guerdon Associates & CGI Glass Lewis, Submission to the Productivity Commission, 5 June 2009, p. 67. The requirement is contained in s. 300A(1)(ba) of the Act.

7 ISS notes that the Australian Institute of Company Directors (AICD) in its reform proposal for remuneration reports has proposed making disclosure of performance conditions attaching to senior executive pay voluntary – see AICD, *Position Paper No. 15: Remuneration Reports*, June 2010, p. 21 . It is not clear why any such reform would be required given the widespread current non-compliance with s. 300A.

8 Downer EDI Limited, 'ASX announcement: Grant Fenn appointed new managing director and chief executive officer', 2 August 2010, p. 7.

9 Downer EDI Limited, *Annual Report 2009*, p. 28; Downer EDI Limited, *Annual Report 2008*, p. 16.

ISS acknowledges however that certain aspects of the formal disclosure regime provide minimal information to shareholders and should be abandoned or modified:

- **s. 300A(1)(c)(iii-iv):** This provision should, in line with the recommendation of the Productivity Commission, be amended to require only the disclosure of the remuneration of members of key management personnel of the group and remove the requirement for the disclosure of the remuneration of the five highest paid group and company executives.
- **s. 300A(1)(e)(iv):** This provision requires the value of options that lapsed during the reporting year held by key management personnel to be disclosed. ISS submits this requirement adds little value as the actual value of options that have not vested (as opposed to the fair value for accounting standard purposes) is zero. This section of the Act should be altered to require the number of options lapsed to be disclosed, and the grant date of the options that lapsed.
- **s. 300A(1)(e)(vi):** The provision requiring disclosure of the percentage of each disclosed executive's remuneration received as options should be removed. Shareholders concerned over the proportion of remuneration delivered as share-based payments will be able to make an assessment based on the information already disclosed.
- **s. 300A(1)(e)(vii):** This provision should be amended to require disclosure of the estimated cash payment and the value of equity incentives a disclosed executive would have received on termination, a change of control, retirement or resignation as at balance date. Companies would then also be free to disclose the contractual terms underpinning these payments on a voluntary basis. The provision should also require disclosure of the contractual basis of any termination payments made to departed executives during the reporting year.
- **s. 300A(1AA-AB):** The provisions requiring the remuneration report to incorporate a specific discussion of the company's performance during the financial year should be removed as they provide little value to shareholders. Section 300A(1)(b) – which requires a discussion of the relationship between remuneration policy and performance - provides adequate statutory guidance without additional proscriptive requirements.
- **Corporations Regulations 2M.3.03(1)(12)(h):** The requirement to disclose the estimated "maximum and minimum possible total value of the bonus or grant (other than option grants)" for future financial years should be removed. The other requirements under item 12 of this section and under the Act itself which require disclosure of unvested outstanding equity incentives as at balance date provide sufficient information to shareholders to determine the potential rewards executives may receive in future years.

3. Share based payment disclosures

Much of the commentary on the problems of remuneration disclosure, including through submissions to the Productivity Commission inquiry, has focused on the disclosed value of share-based payments, especially the amortised value disclosed in the summary remuneration table used to disclose executive pay by nearly all listed companies.[10] It is notable that this criticism has arisen since the onset of the credit crisis at the beginning of 2008 and has grown during a period in which the disclosed fair value of equity incentives has routinely overstated the value received by executives. There was minimal criticism of the current share based

[10] The inclusion of share based payments values in this table is not mandatory but is industry practice. See n.5 for an example of a company that discloses the value of remuneration from share based payments outside of the table; similar approaches were adopted by Qantas in 2008 and Fairfax Media in 2009.

payments disclosure requirements prior to the sharp downturn in equity markets at the commencement of the credit crisis. This may have been because disclosure regimes based around the grant date fair value of equity incentives amortised over the vesting period often significantly understated executive pay during bull markets because the fair value estimates of equity incentives granted are typically significantly lower than the realised vested value of such incentives during periods of high share prices.[11] Even during bear markets the disclosed fair value of equity incentives is often substantially lower than the derived value: As an example, in the 12 months to 30 June 2009, 1 million options with a fair value of $4.315 million were exercised by Sonic Healthcare's CEO with a realised value of $6.44 million.[12]

It is however clear that the estimated fair value of equity incentives granted to senior executives and disclosed in remuneration reports invariably is either much higher or much lower than the actual value received by the executive. This is in part a function of the difficulties in valuing equity based incentives, a difficulty also confronting the many boards that determine the number of equity incentives to be granted to a senior executive based on a dollar value divided by an estimated fair value for a single equity incentive.[13] ISS is unaware of any objections from the issuer community concerning the use of fair values to determine the size of equity grants, a process which invariably leads to larger numbers of equity instruments being granted than if grant sizes were based simply on share prices at the time of grant.

ISS does not consider that remuneration valuation and disclosure requirements should be driven by short term considerations from issuers concerned at 'over-reporting' of remuneration when such concern has been absent during periods when remuneration disclosures have consistently under-reported actual pay. Remuneration disclosures and financial reports generally should also not be driven by the 'lowest common denominator'. There is no obstacle to listed companies providing so-called 'shareholder friendly' concise reports, including simplified remuneration disclosures, in addition to statutory reporting. There is also no obstacle to listed companies providing both realised (ie. cash pay and the value of equity incentives actually vested) and statutory remuneration disclosures, as many have done over the past two years (usually in cases where realised remuneration is lower than statutory remuneration). This practice is akin to the well-accepted use of underlying or pro forma earnings by companies in reporting to investors in addition to statutory profit and as with the use of underlying earnings measures, investors over time will be able to derive information from how companies' preferred measure of remuneration changes over time.

Valuations of share based payments to executives entail costs for shareholders and for this reason are expensed in financial statements. There does not appear any reason, as suggested by some parties, to not disclose the specific costs determined under AASB 2 as they relate to individual senior executive's pay.[14]

There are however several aspects of the current valuation and disclosure regime for share based payments under Australian International Financial Reporting Standards that could be improved. Two shortcomings with the existing requirements are as follows:

- At present, AASB 2 requires companies to value share based payments differently depending on the type of hurdle applying to the equity instruments and whether the instrument is settled using cash or equity. There does not appear any convincing

[11] See research paper provided to CAMAC: ISS, *CEO Pay – It's even higher than you think: Valuation of executive options in Australia*, September 2006.

[12] See n. 5, 2005 report, p. 26; 2009 report, pp. 19, 98.

[13] See, for example, Macquarie Group, *Notice of Annual General Meeting*, 15 June 2010, p. 16.

[14] See n. 7.

rationale for these differential valuation requirements, especially differentiation based on the type of performance hurdle used.[15]

- Companies are also not required to disclose the extent of any discount they apply to equity incentives to take account of the probability of vesting, while other assumptions used in assessing fair value are disclosed. There does not appear to be any compelling reason why the discount applied in determining the fair value should not be disclosed to shareholders, especially if fair values are used to determine the number of equity incentives granted to executives.

In summary, ISS does not consider there is a need for major changes to the remuneration disclosure regime in Australia. Companies remain free to provide supplementary non-statutory disclosure on remuneration to shareholders, as is the case with financial information, in the interests of providing what they consider to be 'better' disclosure.

There is room for relatively minor modifications to existing law but changes designed to substantially simplify remuneration disclosures are unlikely to be successful unless they materially reduce the quality and quantity of information disclosed to investors. This is unlikely to improve the ability of investors to determine whether remuneration policies and outcomes are aligned with their interests.

Please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail. Thank you once again for the opportunity to comment on the issues raised in your Issues Paper.

Yours sincerely

Martin Lawrence
ISS Governance Services
03 9642 2062
martin.lawrence@issgovernance.com

[15] Australian Accounting Standards Board, *AASB 2: Share-based Payment*, 19 October 2009. See paragraphs 19 to 21 for treatment of performance hurdles and paragraph 30 for valuation of equity incentive grants settled with cash.

Level 7, Suite 3,
3 Spring Street,
Sydney NSW 2000
Australia

Tel: 61 2 9270 2900
Fax: 61 2 9270 2999
www.GuerdonAssociates.com
ABN 67 112 483 940 ACN 112 483 940

Guerdon Associates
Equity and Executive Pay

13 August 2010

Mr. John Kluver
Executive Director
Corporations & Markets Advisory Committee

Via email: john.kluver@camac.gov.au

Dear Mr. Kluver,

Re: Executive Remuneration

1. Background

This submission is made in response to a request from CAMAC for assistance in reporting back to the Minister for Financial Services, Superannuation and Corporate Law on the terms of the Minister's reference to CAMAC in relation to executive remuneration dated 12 May 2010.

The submission provides information about Guerdon Associates, and responds to each aspect of the Minister's terms of reference. Attached is a suggested alternative to current legislation.

2. Guerdon Associates

Guerdon Associates is Australia's largest independent[1] executive and board remuneration adviser. It has consulting staff operating from offices in Melbourne and Sydney, and is supported by staff in Chennai, India (remuneration database maintenance) and San Francisco, USA (proprietary technology support).

3. Remuneration reporting

3.1. Reference terms

The Minister has requested CAMAC to:

- Examine the existing reporting requirements contained in section 300A of the *Corporations Act 2001* and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies

- Make recommendations on how best to revise the legislative architecture to reduce the complexity of remuneration reports.

[1] That is, Guerdon Associates is an adviser to boards on executive pay matters, and not a provider of other services that could also be purchased by company management, thereby creating a conflict of interest.

3.2. Section 300A complexity

The essential purposes of s300A have been to:

1. Provide shareholders with the information they need to assess the governance effectiveness of a company's executive remuneration arrangements; and
2. Ensure there is no abuse of power or privilege.

The validity of these purposes and the success of s300A disclosure requirements is supported by research. The research indicates that executive and director remuneration policies as described in s300A and interpreted by at least one governance agency are significantly and consistently correlated with a company's alpha performance.[2]

We suggest that these purposes remain valid and should continue to underpin successive versions of s300A.

We have carefully reviewed the detail of s300A, and *Corporations Regulation 2001* 2M.3.03, with these purposes in mind. We conclude that most of it serves a legitimate purpose and should be retained. Two exceptions are disclosure for the five highest paid employees and the value of options that lapse during the year as if they had not lapsed. These elements and reasons they are superfluous are tabulated below.

Table 1: Superfluous elements of s300A

Element	Reasons
5 highest paid	Pay for those not accountable for pay policy and outcomes, or having a significant influence on policy and outcomes, is superfluous to determining governance. High pay to non-KMP who are not associates of KMP is irrelevant to assessing governance. The Productivity Commission recommended that disclosure be limited to KMP; this recommendation was accepted by the government, which favoured extending it to exclude disclosure for officers of a parent entity
Value of options that lapse during the year as if they had not lapsed	Fails to provide meaningful information for assessing pay governance.

3.3. Section 300A and Regulation 2M.3.03 structure

Currently s300A prescribes details that are to be reported, with Regulation 2M. 3.03 prescribing the details to be disclosed in relation to the remuneration of key management personnel (KMP) and (currently) the five highest paid group and company executives, pursuant to s300A(1)(c). The process of

[2] Alpha performance is that performance over and above (or under and below) the performance that can be attributed to general market movements in share price

understanding and amending the reporting requirements to better meet market requirements would be greatly facilitated by setting out all of the disclosure requirements in a single place. Our suggestion is that this can best be achieved by moving the prescribed elements from s300A to Regulation 2M. 3.03

3.4. The major problem with Section 300A and Regulation 2M.3.03

What is striking about the Australian (and similar UK) reporting requirements, compared to the equivalent North American provisions, is that the tabular breakdown of remuneration components is not related to how companies manage remuneration[3]. This makes it impossible to reconcile Australian companies' explanations of how and why they pay executives in a certain way with the required pay tables. For example, companies discuss their STI and LTI policies. Yet disclosure of the levels of STI and LTI are not distinctly and separately featured in tabular presentations of data under the accounting standard. In addition, the quantum of remuneration reported in these tables includes amortised payments from prior years, whereas companies' discussion of pay policy relates to policy applicable to the financial year just ended.

In Guerdon Associates' view, this is one of the primary reasons why investors and boards are frustrated with the reporting and voting process.

In disclosing the remuneration details prescribed in Regulation 2M.3.03, companies must apply the requirements of Australian accounting standard AASB 124 (refer Regulation 2M.3.03(4)). The disclosures dictated by the accounting standards ascribe costs to the current accounting period. Further, the AASB 124 standard that is used as the basis for executive pay tabular disclosure (i.e. paragraphs Aus25.2 to Aus25.7.2) is a unique Australian accounting impost that is not required to fully comply with the international IAS 24 standard. That is, the accounting standards have requirements additional to the international standards solely to assist in remuneration disclosure, which is, or should be, the purview of corporations' law.

Remuneration is not managed by sole reference to the expense that will be incurred in the current accounting period. Instead, it tends to be managed by reference to present value of total remuneration. This comprises known fixed costs of remuneration, and the expected value of variable remuneration.

The disconnect is evident in directors' discussion of remuneration and the reported levels of remuneration. The reported levels, based on the accounting standards, use the cost attributed to the financial year. So, for example, while the level of equity grants in remuneration policies is typically based on their expected value, the accounting cost reported for an individual is the cost attributed to that year, plus the costs from prior grants attributed to the same year.

This causes problems when trying to assess remuneration packages. For example, making a judgement on whether the pay for a newly appointed

---

[3] Note that the way North American companies manage and discuss remuneration differs from UK and Australian methods, so that their "summary compensation table" is not well suited for adoption in Australia. This does not take away the fact that their "summary compensation table" is better aligned to the way they manage pay, whereas the Australian version is not.

executive is reasonable can be difficult (or impossible), as the pay reported in the first year will show the amortised cost of, say, one third of the expected equity grant value (if a 3-year vesting period applies). Other, longer-serving, executives receiving the same annual grant value will show much higher levels of remuneration because their share-based payments refect the amortised costs of all unvested grants over their entire service period.

The same issues have arisen in both Canada and the US. Both have changed their reporting requirements to more clearly reflect the remuneration policy that applied in the reporting year. For share-based payments this includes showing the fair value of the equity granted in that year on an aggregated, unamortised basis. This share-based payment value is included in the executive's total compensation figure. The fair value method is still consistent with the method in the relevant accounting standard[4], but is unamortised.

Further compounding the inconsistency between policy discussion and reported pay levels is the tabular breakdown of remuneration levels reported. Australian disclosures must show remuneration broken down into accounting expense categories[5]. This categorisation does not reflect how remuneration is managed, i.e. on an actual or expected value basis:

- Fixed remuneration;
- Variable remuneration, typically separated into short-term incentives and long-term incentives; and
- Total remuneration.

Short-term incentives refer to payments contingent on a performance period of 12 months or less, while long-term incentives refer to payments contingent on performance periods of greater than one year.

Equity may be a vehicle for payment within these categories. If it is, its value is based on the unamortised fair (or expected) value.

There is a trend for some short-term incentives to be paid as equity, with receipt deferred and contingent on completion of a continued service period. This is still a short-term incentive, because it is primarily contingent on a performance period of 12 months or less, and will be described as such by a company in the accompanying commentary. The reported value of the deferred equity will, however, be amortised over the service period.

The service period over which fair value expense is amortised using the current accounting treatment is irrelevant and could be misleading for remuneration reporting purposes. For example, one of the positive governance trends to emerge recently in the Northern Hemisphere is the recognition that for long-term, sustainable performance the impact of reward should be maintained beyond an executive's employment. LTIs are tested and

---

[4] AASB 2, which is consistent with IFRS 2. In the US it is FAS 123(R), which is similar.

[5] Short term, with subcategories of cash salary and fees, short term profit sharing or bonuses, non-monetary benefits, other short term benefits; other long term benefits, with amounts for long term incentive plans (where "long term" is on the basis of service period, not performance period) that are not share based payments; termination benefits; share based payments broken down into equity settled with shares and units and options and rights shown separately, cash settled share based payments, all other forms of share based payments.

vested after cessation of employment (providing that the individual terminated is a "good leaver")[6]. The full expected fair value of this payment would be shown at grant date fair value in the suggested reporting of LTI. But under the accounting standards the amount shown would be of little use to anyone in assessing governance and value.

3.5. Deferred reward outcomes

There is currently no requirement to report deferred reward outcomes and the reasons for these outcomes. Currently outstanding unvested equity and equity that vested during the year must be disclosed, but not the reason for vesting, or the realisable value of the reward.

That is, there is no requirement to disclose:

- Non-equity reward components outstanding from prior years;
- Whether there was a service or performance test applicable during the year to any outstanding reward component;
- What the test measure was;
- The results of the test; and
- The extent to which the outstanding reward has vested.

3.6. Realised vs. realisable pay

The Minister suggests it would be useful for shareholders to have realised pay reported in remuneration reports.

In responding to this it may be useful to draw a distinction between realised and realisable pay. Realised pay can be defined as:

- The value obtained through sale of an asset
- The value of an asset obtained through exercise of a right to the asset (e.g. exercise of an option)

Realisable pay, on the other hand, can be defined as the intrinsic value of an asset that has vested. This can be ascertained by the difference between the cost of exercise and the market price of an asset on the day of vesting. It does not rely on the individual exercising his/her right, and realising a gain on the sale of an asset.

The Productivity Commission did not recommend an approach, but suggested that the "realised" value be the taxable value in the year the remuneration vests. This may be workable, given the recent changes to share scheme taxation. Under these changes, the value of an option or right to equity is valued according to "normal market standards", or by reference to a tax table that ascribes a value. Underwater options, for example, will have a tax value under this approach once they have vested.

---

[6] Currently Australian practice is lagging in this regard as a consequence of share scheme taxation levied on unvested equity at cessation of employment. However, as boards become more aware of this limitation the trend to alternative vehicles of payment to achieve good governance outcomes is growing.

The primary disadvantage of this approach is that it is hostage to changes to the taxation treatment of various remuneration vehicles. Reporting realisable pay or intrinsic value overcomes this disadvantage with principle based methods that will result in valuation that is unlikely to change from year to year, all else being equal.

3.7. Realisable pay reporting will aid in understanding pay effectiveness, but may not assist in judging governance

Reporting realised (or realisable) remuneration will not necessarily assist shareholders in making an informed judgement on executive pay. This is because realised (or realisable) remuneration consists of vested remuneration from prior years that:

- Does not reflect the policy that applied in the year of review, as discussed in the remuneration report;
- Was recommended or authorised by directors who may no longer be on either the remuneration committee or full board, respectively;
- Was formulated on the basis of business conditions and strategies that may no longer be applicable;
- May have been part of the payment made to the executive while in a position with different responsibilities and objectives and that the executive no longer occupies; and
- Comprises grants and payments from multiple years.

To makes sense of these payments will require a comprehensive breakdown describing:

- The individual KMP to whom the realised/realisable pay applied;
- The position the person was in at the time the remuneration component was granted;
- The date of grant;
- The payment vehicle (e.g. shares, options, rights, cash, or other) and the amount granted;
- The number of shares, etc that vested;
- The realised/realisable value of the amount vested and the value of the unvested amount;
- The conditions that applied for vesting;
- Whether these conditions had been tested; and
- The result of the test.

Reporting these elements may aid transparency, but will be of little relevance to an assessment of how well the current board directors managed executive pay in the year of review for voting purposes.

3.8. Pay parity disclosures

The newly-passed US "Dodd-Frank Wall Street Reform and Consumer Protection Act", requires companies to disclose (i) the median annual total compensation of all employees, other than the CEO; (ii) the annual total compensation of the CEO; and (iii) the ratio of the median total annual employee compensation to that of the CEO.

The likely unintended consequence of these pay parity disclosures will be the outsourcing of the work done by lower paid employees to external contractors, either locally or offshore.

While the wealth disparity and pay gap in the US may justify such disclosure, there is less need for similar disclosure in Australia, given that:

- Australian executives are not paid highly by global standards[7];
- Australia has a relatively high minimum wage; and
- Australia has low unemployment, and skill shortages, which are likely to continue to underpin employee pay growth in the foreseeable future.

3.9. Transparency, complexity, report length, and enforcing transparency

The perception of complexity in remuneration reports is largely a function of language. The US and Canada have requirements that compensation reports be understandable. The US, in particular, has actively enforced this requirement. A major campaign by the US SEC in 2007 and 2008 was largely successful in ensuring the larger companies simplified language so that compensation reports became more understandable. This did not require less disclosure, only shorter sentences, less use of multi-syllable words, and less jargon[8]. The length of US reports was not reduced.

We would expect the same would happen in Australia. Simplicity and transparency does not necessarily mean a reduction in the length of disclosure or the range of items to be covered. We suspect that many complaints regarding remuneration report complexity have come from commentators who have not had the time and/or inclination to read long remuneration reports, even if these are relatively easy to understand.

While a requirement to ensure reports are understandable would be welcome, it is, in our opinion, unlikely to be enforced, as they have been in the US. To date ASIC has not enforced any remuneration disclosure requirements. So, despite the requirement that reports be subject to audit, most do not comply.[9]

Despite the lack of enforcement, there has been significant improvement in disclosure standards. Largely the credit for this can be attributed to the vigilance and feedback provided by proxy firms and governance agencies. Unfortunately, the Australian stock market is too shallow to support more than a few of these agencies, limiting the range of views of what constitutes good governance. In addition, the lack of resourcing means that sometimes one or

---

[7] Executive Remuneration in Australia, Australian Productivity Commission, No. 49, 19 December 2009, p. 80

[8] "We Don't Speak No English Here - Poor Quality Disclosures Targeted", Guerdon Associates website article, 1/5/2007, http://www.guerdonassociates.com/News-Detail.asp?cid=69&navID=4&NewsID=174, "When it comes to remuneration reports and plain written English, Australian companies could do better", Guerdon Associates website article, 6/8/2007, http://www.guerdonassociates.com/News-Detail.asp?cid=1&navid=1&NewsID=188

[9] For example, the great majority of companies do not disclosure performance requirements for bonus payments. Some proffer the reason that such disclosure is not possible because of commercial sensitivity (which is a reason for non-disclosure that is not recognised in s300A, but is allowable under US regulation). Others companies not disclose a reason.

more of these agencies get it wrong, and with so few of them, this wrong call can have a significant impact on vote outcomes.

3.10. An alternative s300A and Regulation 2M.3.03

Alternative wording for s300A and Regulation 2M.3.03 was put forward in a joint submission to the Productivity Commission by Guerdon Associates with Allens Arthur Robinson, CGI Glass Lewis and Regnan.

The alternative s300A runs for two-thirds of a page (versus 3 pages currently) and the alternative 2M.3.03 is three and a third pages versus the 6 pages currently. They require disclosure of:

- Realisable remuneration
- Fair value remuneration comprising fixed remuneration, short term incentive, long term incentive, termination benefits and total remuneration.

In addition, a plain-English description of remuneration policy is required covering:

(a) *A summary of the key policies used in determining remuneration including, where relevant:*

  (i) *the use of fixed remuneration, short term incentives and long term incentives and how the incentives are used to balance short term performance with the medium to long term performance of the company;*
  (ii) *the use of comparator groups for benchmarking the remuneration of key management personnel and why these comparator groups are appropriate;*
  (iii) *the extent to which incentive pay arrangements were subject to sensitivity analysis to determine the impact of unexpected changes;*
  (iv) *the use of constraints or caps to guard against extreme outcomes from formula based contractual obligations;*

(b) *The persons responsible for setting and those responsible for implementing the remuneration policies;*
(c) *How the remuneration policies are reviewed and evaluated, including a discussion of the objectives and structure of performance based components; and*
(d) *How the remuneration policies align with the risk management framework of the company.*

The full alternative text for s300A and Regulation 2M.3.03 is attached.

In considering this as the basis for an alternative, CAMAC may also wish to incorporate elements in s300A that are not in the suggested version, while retaining our suggested version's less convoluted language style, including:

- An explicit requirement for a discussion of executive pay's relationship with company performance;
- An explanation of why a performance measure was chosen; and

- Executive contract details[10].

Discussion of hedging policy may be omitted given the Government's response to the Productivity Commission's executive pay report on this matter.

4. Executive remuneration framework setting

4.1. Reference terms

The Minister has requested CAMAC to:

- Examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements
- Make recommendations on how best to revise the legislative architecture to simplify the incentive components of executive remuneration arrangements.

These issues are addressed under the subheadings below. Where appropriate, we refer to incentive "transparency", as opposed to "simplification". Transparency refers to the ready understanding of incentive pay outcomes and performance.

4.2. Revising the remuneration setting framework

Board remuneration committees typically manage remuneration setting for executive directors, subject to authorisation by the full board. An executive director typically recommends pay for other executives to the remuneration committee, with final approval either by the committee or full board.

The remuneration committee may seek external advice. Frequently this advice would fail to pass an independence test. For example, the advisers may:

- Be short-listed or chosen by management
- Also be working for management on other matters and receiving fees in excess of those received for advice to the board on executive remuneration.

In its response to the Productivity Commission's recommendations, the government indicated it would address these matters through amendments to the *Corporations Act* disclosure requirements, but the nature and detail of these amendments has not yet been made public. Our view is that disclosure should apply in relation to all advisers on executive remuneration, including lawyers and recruitment consultants. If the remuneration committee/board does not engage external advisers, but relies solely on advice from management, this should also be disclosed.

We understand that the US SEC will shortly be publishing draft regulations on amended disclosures for compensation advisers in response to the Dodd-Frank Act. We suggest that these may be a useful input to CAMAC deliberations.

[10] However, our preference would be the US approach, which requires full disclosure of contracts, but outside of compensation reports.

The remuneration setting process may be further complicated by the requirement (under Listing Rule 10.14) for shareholder approval of grants of new issue equity to directors. Approval is typically sought for each annual grant (under Listing Rule 10.15), but can be sought for grants over a maximum three year period.[11] Shareholder approval is not required for director equity grants sourced from on-market share purchases. However, various stakeholders, such as ACSI, the ASA and ISS, have advocated that even these should require shareholder approval.

Share issues under employee share schemes that have been approved by shareholders are not counted against the 15% cap for equity dilution from all company activities prior to seeking shareholder approval.[12]

Because new issue shares are dilutionary, Guerdon Associates supports continued application of ASX LR 10.14 for director equity grants in these circumstances.

Guerdon Associates does not support introducing a requirement for shareholder approval for director equity grants when equity is sourced from on-market purchases. Payment in equity should be supported because it aligns executives' interests with those of shareholders, and needless and costly administrative barriers to providing this form of payment (which could easily be replaced with cash) should be avoided.

In conclusion, Guerdon Associates does not see any more straightforward remuneration setting processes other than those already in place to streamline administration while ensuring good governance. Our view is that revising the remuneration setting framework does not offer any prospect for simplifying the incentive components of executive remuneration.

4.3. Tax complicates the process to ensure transparent incentives and good governance

Nevertheless, there are legislative aspects that can be amended that would simplify the incentive component of executive remuneration arrangements. These concern the tax on equity plans.

Currently, share scheme taxation requires that unvested equity be taxed on cessation of employment. This encourages short-term thinking and behaviour, as executives, whose tenure is uncertain, will focus on maximising short-term performance for bonuses, rather than equity that, on termination before the end of a performance period, is forfeited to avoid a tax liability arising before the equity vests (which would provide the means to pay the tax). The fact that taxing unvested equity on termination means executives are more attracted to remuneration packages that deliver most of their reward over the short term encourages board directors, who need to contain overall expenses, to agree to packages with more short term elements than they would otherwise prefer in order to attract and retain suitably qualified individuals.

---

[11] ASX LR 10.15A

[12] ASX LR 7.1 and 7.2

Amending share scheme taxation so it applies when the benefit is realisable would resolve this issue, and result in remuneration packages that are more balanced, and in keeping with sustainable shareholder returns.

Not amending share scheme taxation will see a trend to more difficult to understand payment vehicles. These will be constructed to mimic the value of equity, but be paid in cash, in order to remain "alive" post cessation of employment to ensure executives manage the enterprise for the long term and remain aligned with the interests of shareholders. The creation of these shadow options and share vehicles will take more explanation, and contribute to remuneration report complexity.

The Productivity Commission and APRA advocated the removal of cessation of employment as a tax trigger for unvested and unearned equity.

4.4. Revising legislative architecture is not the only avenue for incentive transparency

Incentive components, and hence remuneration more generally, could correlate better with company performance. If they did they would be more transparently explained. That they do not is at least partly explained by the influential guidelines and prescriptions of various governance agencies, and is not a function of the legislative architecture (including the disclosure requirements).

For example, the Australian Shareholders Association (ASA) requires that:

"The base salaries of senior executives need to be and in the great majority of listed companies probably already are, at sufficient levels to provide full and appropriate compensation where performance is adequate but not superior.

Incentive payments in addition to base salaries are acceptable where these reward superior, as against merely satisfactory, performance, which has been proven by the achievement of predetermined and challenging targets.

One component should be clearly aligned with shareholders' interests and based on the achievement of total shareholder return (TSR) above the median for an appropriate comparator group. In this case vesting should commence at a modest level (no more than 10%) only when the company achieves a 51st percentile ranking and should increase progressively to reach full vesting no earlier than at the 75th percentile of the group."[13]

The ASA is not alone in advocating prescriptions along these lines. These and similar prescriptions by other governance agencies essentially limit the extent to which remuneration can vary with performance. For example, remuneration following these guidelines does not decrease with performance that does not meet satisfactory standards (in this case, the 51st percentile). Likewise, performance that is at the 99th percentile is not rewarded more highly than performance at the 75th percentile. The result is that executive remuneration will vary for only a very narrow range of performance.

However, we have witnessed a pleasing evolution of agency governance

---

[13] Executive Remuneration, ASA policy statement, March 2009

guidelines as knowledge of corporate remuneration issues, practices, challenges and opportunities has increased with better disclosure. We expect this evolution to continue as investors and their governance agencies become more sophisticated in these matters.

A change in the legislative framework will not assist this evolution if disclosures are simplified to the extent that this iterative education and improvement process is truncated. Dumbing-down remuneration reports would be counter-productive to the needs and requirements of most institutional investors and governance agencies.

In fact, we expect that many agencies will object to legislative architecture that threatens to either reduce the extent of disclosure, or constrain the way people are paid. Guerdon Associates deals with most of these agencies in the consultative process to ensure executive remuneration meets stakeholder requirements. Many have achieved very sophisticated levels of understanding and are in a position to suggest highly valid solutions to boards that directors may not have considered.

4.5. Running a large company is complex, ergo, so are incentives

Large businesses are complex. To ensure alignment with shareholders and counter agency problems, incentive plans set standards on measures important for shareholder value. Larger companies will, therefore, require their executives to focus on more measures. These may be co-dependent. They may have different risk and therefore return-on-capital requirements. The time horizon to realise returns may differ. Over time, priorities may change. Also, over time, executives may have to change focus to realise an opportunity to achieve a long standing goal at a serendipitous moment in the performance cycle.

Incentive plans are necessary to align interests and reduce agency costs. But, as the factors above indicate, they may need several moving parts that, taken together, work in shareholders' interests. But they are complex, and reflect the nature of the companies shareholders invest in.

Previously, executive remuneration matters were the sole domain of the board and an operational matter that was delegated by shareholders to the board. Disclosure and the non-binding vote on remuneration reports have, to an extent, opened a window on this complexity but do not make the process simpler. Nor will any regulation. But there has been improvement as a result of disclosure, and the engagement of boards with investors and their agents. The process is evolving and dynamic. Further improvement is contingent on retaining the parts of the process that have contributed to this evolution. That is, the autonomy of boards to set pay, the right of shareholders to receive disclosures and express a view on pay, and the freedom of the market to exercise an economic judgement on how each company responds to this governance process.

5. Conclusions

- There is valid research evidence that good remuneration governance is correlated with superior shareholder returns.

- The current pay disclosure requirements are not related to how companies manage pay, resulting in complexity, confusion and the absence of transparency in connecting levels of pay with pay policy.
- Moving away from amortised accounting measures of long term remuneration to a fair value method will go some way to resolve this, as will reporting remuneration levels in terms of fixed remuneration, short term incentives and long term incentives.
- While realisable pay disclosure has positive attributes, it requires a great deal of additional disclosure to understand how the realisable pay was derived. Because realisable pay may stem from past policies, such disclosure may not add materially to an understanding of current pay governance on which a shareholder vote on the remuneration report rests.
- Some complexities in remuneration matters arise from the unintended consequences of equity plan taxation. These contribute to the creation of elaborate shadow equity plans to align executive interests with shareholders. However, if share scheme taxation issues were resolved, these constructions would be unnecessary.
- Incentive payments appear unrelated to performance partly because of requirements that they be disclosed in accord with accounting standards (and also because there can be a significant lag between the performance on which a payment is based and the disclosure of that payment).
- To overcome agency costs, incentives need to be aligned with outcomes that deliver shareholder value. Company complexity increases with size. Hence incentive arrangements become more complex for bigger companies.
- Despite complex incentive arrangements, disclosures can be made more transparent with a requirement that they be described in terms that can be readily understood. However, this would require enforcement to be effective. To date ASIC has not shown any predisposition to enforce compliance on remuneration disclosures but proxy firms, investors and governance groups have been successful in advocating improvement in disclosures and remuneration practices.
- There are no legislative actions that can be taken (apart from simplification of share scheme taxation) that will result in simpler incentive arrangements that are also in the best interests of shareholders.

Yours sincerely,

Michael Robinson

Michael Robinson
Director

6. Attachment: Revised s300A in submission to the Productivity Commission by Allens Arthur Robinson, CGI Glass Lewis, Guerdon Associates and Regnan

Joint Submission to the Productivity Commission's Executive Remuneration Inquiry

Allens Arthur Robinson
CGI Glass Lewis
Guerdon Associates
Regnan

30 November 2009

1. Proposed Amendment to Corporations Act

300A Annual directors' report—specific information to be provided by listed companies

(1) The directors' report for a financial year for a company must include a separate section titled the "Remuneration Report" that includes the following information:

(a) a plain English summary of the remuneration policies for key management personnel that discusses the matters prescribed in the regulations;

(b) the remuneration for each member of key management personnel in the format prescribed by the regulations; and

(c) all other information as is prescribed.

Note: Regulation 2M.3.03 prescribes the information for section 300A.

(2) For the purposes of subsection (1), ***key management personnel*** has the same meaning as in the accounting standards and:

(a) if consolidated financial statements are required, includes – each member of the key management personnel for the consolidated entity; and

(b) if consolidated financial statements are not required, includes – each member of the key management personnel for the company.

(3) This section applies to any disclosing entity that is a company.

(4) This section applies despite anything in the company's constitution.

2. Proposed Amendment to Corporations Regulations

Prescribed details (Act s 300A)

2M.3.03 (1) **Remuneration Policies** For paragraph 300A(1)(a) of the Act, the plain English summary of the remuneration policies for key management personnel must give the reader an informed understanding of those policies and include or discuss the following matters in the following order:

(a) a summary of the key policies used in determining remuneration including where relevant:

(i) the use of fixed remuneration, short term incentives and long term incentives and how the incentives are used to balance short term performance with the medium to long term performance of the company;

(ii) the use of comparator groups for benchmarking the remuneration of key management personnel and why these comparator groups are appropriate;

(iii) the extent to which incentive pay arrangements were subject to sensitivity analysis to determine the impact of unexpected changes;

(iv) the use of constraints or caps to guard against extreme outcomes from formula based contractual obligations;

(b) the persons responsible for setting and those responsible for implementing the remuneration policies;

(c) how the remuneration policies are reviewed and evaluated, including a discussion of the objectives and structure of performance based components; and

(d) how the remuneration policies align with the risk management framework of the company.

(2) Remuneration For paragraph 300A(1)(b) of the Act, for each member of the key management personnel, the company must disclose realisable remuneration and grants received for the financial year and total shareholding in the company in the following format or other format that clearly discloses such remuneration and shareholding:

(a) Realisable Remuneration

Name	Position	Total Amount of Realisable Remuneration

The company must also provide a description of the key components of the total realisable remuneration amount for each member of the key management personnel including:

(A) the amount of remuneration that was granted and realisable during the relevant year;

(B) the amount of remuneration that was granted in prior years but became realisable in the relevant year;

(C) where an amount became realisable due to the fulfilment of a condition or other restriction which applied to that remuneration, a description of that condition or restriction;

(D) the amount that constituted a termination benefit; and

(E) the amount and proportion of realisable remuneration attributable to fixed remuneration and the amount and proportion attributable to each other component of realisable remuneration such as vested incentives or termination benefits.

(b) Grants Received

Name	Position	Fixed Remuneration	Short Term Incentives	Long Term Incentives	Benefits given in connection with a person's termination	Other Benefits	Total Remuneration

(i) Grants received during the relevant year must be presented at fair value.

(ii) The company must also provide a detailed summary of any conditions attaching to remuneration before it becomes realisable or any other restrictions before the remuneration can be realised.

(c) Shareholding

Name	Position	Total Shareholding

Definitions

benefits given in connection with a person's retirement drafting note– benefits given in connection with a person's retirement will have the same meaning as given in section 200A of the *Corporations Act 2001* (as amended by the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* and associated regulations)

fair value means the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction

financial year means the financial year to which the directors' report relates

fixed remuneration means the aggregate of any of the following:

(A) a short term benefit, including cash salary, a short-term compensated absence, a non monetary benefit or other short term employee benefit;

(B) a superannuation contribution;

(C) a share based payment, including a cash settled share based payment and any other form of share based payment (including options and hybrids); or

(D) a liability or prospective liability to pay tax of a fringe benefit taxable under the *Fringe benefit Tax Assessment Act 1986* or the *Fringe Benefits Tax Act 1986* that relates to the provision of a matter specified in paragraphs (A)-(C);

that is:

(i) not dependent on the satisfaction of a performance condition; and

(ii) is paid during the relevant year

benefit drafting note - benefit will have the same meaning as provided in the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* and associated regulations

long term incentive means any remuneration contingent on or subject to performance measured over a period of greater than 12 months

realisable remuneration in respect of a financial year means the fixed remuneration for that year and the fair value of any other incentive, termination or other benefit that vests in the financial year irrespective of when it was granted

short term incentive means any remuneration contingent on or subject to performance measured within a 12 month period

Submission to Corporations and Markets Advisory Committee on

Executive remuneration - Information paper

13 August 2010

Table of Contents

Executive remuneration - Information paper

1. General Comments

We understand that CAMAC's brief is to reduce the complexity of remuneration reporting and put forward proposals to simplify the incentive components of executive remuneration.

The Productivity Commission has proposed an architecture that we believe is simple, practical and effective, but there is a high level of complexity in the current reporting and incentive arrangements, arising from:

- Current regulatory environment
- Accounting standards
- Tax rules
- Wide ranging and often conflicting views about appropriate remuneration arrangements and reporting (as evidenced by the submissions made to the Productivity Commission inquiry[1]).

2. Effectiveness of Current Reporting and Disclosure Framework

2.1 Regulations

It is very important that new regulations are sufficiently clear and definitions are specific enough to ensure companies report the same remuneration items, so that useful comparisons can be made.

Simple disclosures will better enable shareholders to make informed decisions about the remuneration arrangements in an organisation.

2.2 Extent of disclosures

The current level of disclosures is unnecessarily onerous, and in some instances adds very little further information or insight for shareholders. For example, the disclosure of the 5 highest earners either duplicates (key management personnel) KMP disclosures or leads to inconsistent year on year disclosures, allowing for no basis of comparison (a different 5 could be reported in any year).

The requirement to use accounting values to report remuneration is confusing and misleading to shareholders. This results in many organisations trying to "simplify" the same information, but reporting different values to reflect what actually was earned by executives.

2.3 Reducing the complexity of remuneration reporting

The Directors Report and Financial Reports should be treated separately. The Directors Report should be focused on providing a simple outline of company affairs for shareholders, including remuneration, and should not be constrained by accounting standard requirements, which complicate reporting.

---

[1] http://www.pc.gov.au/projects/inquiry/executive-remuneration

The Financial Reports should focus on outlining the accounts and financial information in accordance with accounting standards. If this approach is followed, the remuneration in the financial report would be audited, but there would be no need to require an audit of the Remuneration Report, also reducing compliance costs.

Measures to simplify the Remuneration Report should include:

- Reduction in the mandatory disclosures required and clarification of the rationale of the remaining disclosures.
- Development of a clear consistent and logical structure for the remuneration reports which provides an outline of the company's remuneration arrangements in the context of its business environment and strategy, having appropriate regard to disclosure of commercially sensitive information.
- The use of actual/realised values rather than accounting values. To ensure a consistent approach is taken, guidelines need to be provided on defining terms and values to be used.
- Adoption of a "Plain English" approach to the drafting of the remuneration report, for example, adopting the requirement for a disclosure document that the information be "worded and presented in a clear, concise and effective manner (section 715A). However a separate "Plain English" summary should not be mandated, as this merely duplicates the information and does not address the core issue, being simplification of the remuneration report a whole.
- Removal of the requirement to report the 5 highest paid as well as KMPs (as per the Productivity Commission recommendations).

The proposal by Ernst and Young outlined in section 3.2.6 of the CAMAC Information Paper provides a sensible structure and approach to achieving these objectives.

Some further detail on these matters follows.

2.4 Remuneration disclosure requirements for subsidiary entities

Currently disclosure of remuneration is required for all entities that are required to prepare financial reports under the Corporations Act 2001, specifically these entities are:

- Disclosing entities;
- Public companies;
- Large Proprietary Companies; and
- Registered schemes

These types of entities are further defined in the Corporations Act 2001. For a major bank, this can equate to over 100 entities that meet the disclosure requirement.

The vast majority of directors on these companies are employees of the banking group who do not receive specific fees for their services to the boards of these companies, as directors or KMP.

In order to comply with the requirements, directors and KMP are requested to disclose the proportion of their time they spent on matters relating to the respective company and then this portion of their annual remuneration (which they receive from the banking group) is disclosed in the accounts for the entity. The resulting information does not record any specific remuneration paid for most of the directors and KMP whose details are disclosed for these entities, and would provide limited insight for readers of the disclosures.

It is unclear as to what the intention is behind this requirement. We recommend amending the regulations to exempt entities of a consolidated, listed, company which is already required by law to publish a remuneration report, from producing a separate remuneration disclosure.

2.5 Reporting of actual pay

When setting levels of executive remuneration for a given individual in any given year, Boards generally consider the actual pay awarded in relation to the individual's performance, financial results and other factors.

In some organisations however, particularly financial services organisations, deferrals of bonuses are very common. As a result, actual pay received may include current year fixed and short term performance-based remuneration as well as remuneration deferred from the previous years.

Actual pay awarded can be included in the Remuneration Report, however the definition needs to be defined to ensure all organisations interpret it in the same way.

2.6 Reporting paid vs awarded vs expensed remuneration

Paid remuneration is what the executive actually received during the year. This would include cash and shares received across all remuneration components (fixed, STI and LTI[2] etc components).

Awarded remuneration is what the company allocated to the executive during the year, but from which the executive may not have actually benefited yet (e.g. STI awarded where a portion is deferred to a later date).

Expensed remuneration is essentially what is current recorded in the compulsory remuneration table included in remuneration disclosures.

None of these items will include all the remuneration an executive received for the performance of the company during the reporting period, given the different performance periods that are in play across all remuneration components. Also, STI is the only performance-based component that relates to one year's results.

Other payments, like LTI, relate to multiple periods and there will be times when the vesting of these components does not align with the performance of the

[2] STI = short term incentive; LTI = long term incentive

company due to the timing of payments, not the performance that is being measured (which may be different to the performance for the period that is being reported on).

CAMAC should consider what shareholders are seeking in the disclosures to help them form a view about the organisation they hold shares in. For example, do they want to see how much an executive received, or do they want to understand what they received for the performance that the company achieved?

Intuitively, it would be the latter when assessing the governance and performance of the organisation. Other stakeholders and public commentators may be more interested in the former, but one could question the true value that this brings to the main concern over reward for performance and sharing profits between executives, employees and shareholders.

3. Simplification of Incentive Arrangements

Incentive arrangements and structures are proprietary to an organisation and very difficult to simplify. Each organisation has its own complexities, risks and challenges against which to design incentives. The point of commonality is that any organisation should be able to demonstrate that they have considered all aspects of plan design and that there is a clear alignment to shareholder experience/value.

Incentive arrangements need to be tailored to and aligned with the organisation's environment and objectives. Simplification should focus on the tax, accounting and regulatory framework in which incentive plans operate rather than on prescribing a particular approach or structure for incentive arrangements. A focus on a particular structure or approach may in fact create greater complexity, as any prescribed structure or approach will be unable to take into account the full range of circumstances and factors which Boards are required to consider in setting incentive arrangements.

It is also unlikely, that given the range of views evidenced by the submissions to the Productivity Commission, it would be possible to gain a high level of consensus on what such a structure or approach should look like. Any regulation should be consistent with APRA requirements (which are consistent with the Financial Stability Board principles adopted by the G20), and not create yet another regime, and an additional regulatory overlay for financial institutions.

3.1 Incentive design and disclosure

There are areas where better disclosure of why incentive plans are developed could be implemented, including how the results that flow from them reflect performance. However, given the vast range of business structures, priorities and circumstances, a simple one-size-fits-all approach to incentive design will not deliver positive results in all circumstances and could, in some cases, work against the goals of the company.

There could be regulated principles that guide the design of incentives, but it should be up to the business to apply these in their context and communicate how and why they have done this.

Care will need to be taken to ensure incentive design principles are sensitive to commercial needs in a competitive market. Incentive plans deliver payments on business results, but are also designed to influence behaviours and cultural elements which may be best not discussed in an open forum.

3.2 Board discretion

Boards are in the best position to determine appropriate incentive design, and to ensure the payouts are driving business performance and shareholder value.

Boards are best placed to assess level of remuneration and how that is structured, but need to have flexibility to respond to individual company circumstances and changing market conditions.

4. ASIC relief

Companies that operate employee share schemes can find the disclosures and limitations on ownership difficult. ASIC relief from prospectus and other requirements for an employee share scheme is not available if total shareholding exceeds 5%.

ASIC also provides relief from the Corporations Act prohibition against subsidiaries acquiring parent company shares. This relief is critical for funds management businesses which need to acquire shares in their listed parent as part of normal trading by the business' funds (e.g. index funds). As a result, the 5% cap will increasingly create difficulties for listed companies as they deliver more remuneration in the form of shares.

We submit that the cap could be increased with adequate market protection provided through normal substantial holder disclosures.

5. Tax and other issues

One area which needs particular attention is the current tax, accounting and regulatory framework for equity plans as it is significant factor contributing to the complexity of these arrangements. Areas requiring particular attention are:

- The cessation of employment taxing point
- The tax treatment of option plans (tax on vesting rather than exercise)
- The impact of the 75% rule.

The taxation of equity upon cessation is contrary to the intent of aligning performance with shareholder experience. This taxing point encourages some organisations to vest in part or full, equity that is still subject to assurance tests, so that departing employees can meet tax obligations. This can result in an employee receiving value inconsistent with shareholder expectations.

The taxing point issue needs to be resolved to ensure organisations are designing incentive arrangements to align with the shareholder experience, and not to circumvent taxing points or incorporate onerous and often difficult to enforce forfeiture conditions.

We support deferred incentives to be in the form of equity, however the taxing of options at vesting, even if they are "under water", has meant that this reward option has become less attractive - yet it is arguably the instrument that best aligns employee and shareholder interests.

6. Proxy-Advisor and the two strike rule

With the introduction of the two strike rule, the importance of well informed shareholder base is of significantly increased importance.

Quite often the largest shareholder groups are influenced by proxy advisors. It is therefore of paramount importance that disclosure requirements are consistent with the requirements of proxy advisors and other influential shareholder groups so that such groups can accurately assess the disclosures against their marking criteria. Inaccurate marking by proxy-advisors could lead to a spill of the Board.

While it would not be practical to have disclosure to cover the requirements of all such groups, the key ones should be covered.

Disclosures should match as closely as possible proxy advisor criteria and there needs to be a Government-led communication campaign for this group of stakeholders to ensure consistency of approach.

Group Reward & Recognition

BHP Billiton Limited
BHP Billiton Centre 180 Lonsdale St
Melbourne Victoria 3000 Australia
GPO Box 86
Melbourne Victoria 3001 Australia
Tel +61 3 9609 2246 Fax 9609 2042
bhpbilliton.com

13 August 2010

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

email: john.kluver@camac.gov.au

Dear John

Please find attached a submission from BHP Billiton in relation to your current review of executive remuneration in Australia.

BHP Billiton welcome the opportunity to provide this submission, and trust you will find our comments of assistance in your deliberations.

Yours sincerely

Richard Doody
Vice President Group Reward & Recognition

Attach.

Submission from BHP Billiton Limited (BHP Billiton) to the Corporations & Markets Advisory Committee (CAMAC) in relation to their review of executive remuneration.

We have a number of comments, as set out below, in regard to the Minister's request to CAMAC to review the disclosure of executive remuneration under s300A of the Corporations Act (and related regulations), particularly in relation to:

1) More effectively meeting the needs of shareholders and companies;

2) Reducing the complexity of reporting requirements; and

3) Simplifying incentive components of remuneration.

1) More effectively meeting the needs of shareholders and companies

The most oft-cited shareholder need not being met by current requirements is disclosure of the amount of actual pay realised by executives. The equivalent for the company is the desire to show remuneration values in the context of the Remuneration Committee's deliberations, that is, what has been provided, why, and what value the company and the recipient ascribe to the benefit at the time that it is provided.

These gaps primarily arise from the focus on the estimated fair value methodology prescribed under accounting standards for including share-based payments within the remuneration analysis. Although the accounting methodology is largely successful in enabling like with like comparisons across different organisations, it also ascribes values to share-based payments which do not relate to the actual benefits experienced by the executives (including to securities that never vest).

The amortisation of amounts across a number of accounting periods is often not simple and transparent to shareholders, and combines a portion of the value of a number of successive years' awards together – clouding the link between actual performance and remuneration outcomes. This does not assist the organisation in expressing the decisions that have led to the setting of remuneration packages for its management team during the current year, and as a result of performance over the financial period which is the focus of the rest of the annual report.

BHP Billiton believes that there is a role for more than one perspective on 'actual remuneration' to be presented and that the requirements for doing so could be reasonably straight forward, as described below.

a) **Actual remuneration as realised by executives**: The disclosure of actual pay as realised by executives would, in its simplest form, require the adding together of the fixed remuneration components (as already disclosed) with the actual value delivered from awards that have vested during the year (from grants provided in prior years). The value on the vesting date would be a proxy for the actual amounts received by individual executives at the different times that they choose to exercise, or sell, their awards over the post-vesting period – as these events may occur a number of years after vesting, and potentially a significant time after the individual's cessation of employment with the company (when they are out of scope for disclosure).

   The current disclosure requirements provide all of the components for this equation – as the number and value of awards that have vested during the year is already required. It is the addition of these components together, with relevant commentary and explanation, which is not currently a requirement.

b) **Actual remuneration as provided by the company**: The risk with presenting only the above perspective of actual remuneration is that it would naturally tend to place less weight on those circumstances where awards do not vest (because performance hurdles are not met) or where share price depreciation delivers modest rewards to executives, and rather, focuses the eye on those circumstances where performance and share price combine to deliver rewards significantly in excess of the allocation value.

   The range of potential outcomes from the awards is, however, of key consideration to the company in determining the number and nature of equity awards to provide to executives. Disclosure and commentary in regard to the expected future value of the remuneration would, we believe, give the shareholder a valuable perspective on the Remuneration Committee's deliberations and rationale.

   Companies use the accounting fair value of the awards (or an equivalent or proxy for it) to determine the appropriate number of securities to provide, in order to deliver a future remuneration value which takes this range of potential outcomes into account. Leaving to one side for present purposes the complexity introduced by amortisation, the current disclosure requirements again provide all of the components for this actual remuneration equation – which would sum the fixed remuneration (already disclosed) with the fair value of the awards that have been provided during the year, or as a result of the year's performance. It is the addition of these components together (without amortisation of equity grants from prior years) which is not currently a requirement.

Reducing the complexity of reporting requirements

Great strides have been taken along this path in recent years, in particular with the consolidation of previously separate requirements under the Australian Accounting Standards and the Corporations Act. This was a significant step forward in simplifying disclosure requirements.

The elimination of reporting for Top 5 executives (as recommended by the Productivity Commission) and restriction of disclosures to Key Management Personnel would be a further significant and welcome improvement in simplifying remuneration reports and providing meaningful disclosure for shareholders.

There is an inherent value in maintaining consistency of requirements across a number of reporting periods, both for shareholders and companies, in terms of the increased level of understanding that comes from familiarity with the disclosures, and enabling the company and the shareholder to make transparent year on year comparisons. BHP Billiton therefore does not advocate change for change's sake, and we have therefore limited our comments to those areas which we feel would most benefit from simplification:

a) Due to the UK listing of BHP Billiton Plc, BHP Billiton has the benefit of dealing with disclosure requirements in both the Australian and United Kingdom jurisdictions. The UK requirements in regard to disclosure of current shareholdings of each KMP require all holdings as a result of share plan participation to be disclosed, including any activity during the year such as grants, vesting, exercises, and lapses. The Australian legislation also requires disclosure of these activities, but where there is no activity during the year in relation to a particular holding, the holding does not need to be mentioned or listed within the remuneration report. While the UK legislation therefore requires more detail to be provided,

b) Australian legislation requires the disclosure of “estimates of the *maximum* and *minimum* possible total value of the bonus or grant for subsequent financial years, measured in accordance with applicable accounting standards” for performance bonuses and share-based payments, in addition to the requirement to include the estimated fair value of these payments in remuneration. This additional requirement is often nonsensical, with the minimum potential value being nil (in the event that the employee forfeits the award or a performance hurdle is not achieved) and the maximum value being difficult to calculate (being largely dependent on future share prices of the company) to the point that its best proxy is the estimated fair value already included in remuneration.

c) In addition to the value of options/rights that form part of remuneration during the year, Australian legislation also requires disclosure of “the percentage values of remuneration that consist of options/rights”. The rationale for this additional requirement and the value that it is intended to provide to shareholders is not clear.

Simplifying incentive components of remuneration

BHP Billiton notes that CAMAC have been requested to “examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying incentive components of executive remuneration arrangements”.

Appropriate incentive arrangements will be particular to the organisation, the time and circumstances, and that “simplification” is neither required or in the interests of shareholders. Rather, such an approach would be more likely to limit the organisation’s ability to drive and reward desired outcomes and behaviours through incentives.

Different organisations will implement different short-term and long-term incentive arrangements, designed to support that organisation’s current business strategy, with the goal of driving sustained shareholder wealth creation. The appropriate incentive arrangements will therefore be those that support the desired corporate behaviours and values, and drive the outcomes that are relevant to that business at that time, reflecting potentially complex business structures, external environments and the needs of multiple stakeholders. Such arrangements will be under constant review to ensure ongoing relevance for the organisation in the prevailing market circumstances.

Mandating, for example, that all organisations have a long-term incentive plan that employs a TSR hurdle, or commences vesting at the median (or above the median) in order to make these arrangements simpler for shareholders to understand will simply produce a ‘sameness’ in arrangements that may not suit some companies, and will not drive the outcomes relevant for that business.

A very significant driver of complicated incentive arrangements in Australia is in fact the current tax structure in relation to employee equity. The impacts for Australian employees vary significantly from those in other major jurisdictions, complicating the equity programs for global companies and, as a result, the related disclosures. Key points of difference, and therefore complication, have been well publicised, but include the taxation upon cessation of employment, tax upon vesting (rather than exercise) for options, and the 75% rule to enable tax deferral for share grants.

16 August 2010

Mr John Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email to john.kluver@camac.gov.au

Dear Mr Kluver,

Submission in relation to the Executive Remuneration Information Paper

I have pleasure in forwarding the following comments on the Information Paper which have been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia (**Committee**). These comments have been endorsed by the Business Law Section. Owing to time constraints, the comments have not been considered by the Directors of the Law Council of Australia Limited.

General

The Committee supports the simplification of remuneration reporting requirements as outlined below. The Committee supports legislative change that would facilitate simpler incentive arrangements and disclosures, but does not support direct regulation of the form, size or structure of incentives.

The legislative framework for remuneration disclosures

The current legislative framework results in undue complexity and duplication of remuneration disclosures and excessive compliance costs for companies (and ultimately their shareholders).

The Committee suggests that the mandatory disclosures to be included in a listed company's remuneration report should be limited to disclosure of the following items in relation to each key management person:

- the "actual" value of remuneration that is paid or becomes "realisable" (i.e. vests) in each financial year (to be valued at the time the remuneration is paid or first becomes realised);
- the conditions and vesting periods of any incentives granted during the year and the value of those incentives at the date of grant;
- whether key management personnel are prohibited from hedging their incentives;
- movement during the year in the number (but **not** the accounting value) of shares, rights and options held by each key management person under an employee incentive scheme;

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

- a description of any change during the year to the conditions or vesting periods of any unvested incentives or any other change to the arrangements between the company and a key management person that would materially affect remuneration in a future period; and
- termination entitlements.

If, as foreshadowed, the government introduces laws prohibiting the hedging of unvested incentives or vested incentives that remain subject to trading restrictions, no separate disclosure in relation to a company's hedging policy would be required.

The Committee submits that the disclosures listed above will provide shareholders with a true and fair view of the remuneration arrangements of the key management personnel of a listed company, and as such these disclosures should be mandated by law. Companies would of course be free to voluntarily disclose any additional information they felt was relevant to a shareholders' consideration of the information contained in the mandatory disclosures, such as a plain English summary, a description of the company's remuneration policy, or discussion of the link between remuneration and performance. The Committee does not support making these or any other additional disclosures mandatory.

For consistency of reporting obligations, any changes to s 300A of the Corporations Act must be accompanied by complementary amendments to the Corporations Regulations and the Accounting Standards.

In the alternative, if the AASB takes the view that the Accounting Standard disclosures should not be amended to complement the revised provisions in the Corporations Act and Corporations Regulations, the Corporations Act should make it clear that any additional accounting standard disclosures may appear in the accounts, but need not appear in the remuneration report.

Legislative changes to facilitate simpler incentive arrangements

As stated above, we do not support direct regulation of the form, size or structure of incentives. In the Committee's opinion, it is critical that companies retain the ability to reward and incentivise their personnel in the way that is most appropriate for their particular circumstances. One size does **not** fit all.

However, there are other legislative provisions that constrain the effective setting on incentive arrangements, as discussed below.

Ensure the tax legislation facilitates simple best practice arrangements

The complexity of current remuneration arrangements is often driven by tax considerations. For instance, a number of "structural" conditions must be met before shares granted under an employee incentive scheme can qualify for tax deferral. This distorts the structure of employee incentive schemes because equity can lose its attraction as an "incentive" if employees are taxed on them before they vest (and before the employee is able to sell a sufficient number of shares to cover any tax liability that arises in respect of them).

For the same reason, cessation of employment should no longer be a "taxing point" for unvested shares granted under an employee share scheme. The current taxing point encourages early vesting on cessation of employment and discourages "best practice" arrangements (recommended by APRA and the Productivity Commission) whereby unvested shares remain on foot after cessation and only lapse or vest if the original performance conditions are achieved in due course.

Remove unnecessary regulatory "blockers" to straight-forward share-based compensation

New offers to the public of securities and other financial products are heavily regulated under the Corporations Act, and for good reason. In essence, those provisions were drafted to protect members of the public from using their own money to purchase stock in "unknown" third party companies who solicited their capital. The relationship between employees and their employer company is obviously quite different, particularly where the financial product being offered is a free "bonus".

One of the factors complicating current incentive arrangements is the need to comply with the Corporations Act requirements that apply to new offers to the public of securities and other financial products. The Committee acknowledges that there are currently various exemptions provided for under the Corporations Act and in ASIC Class Order 03/184, which allow companies to issue securities under employee incentive schemes to both directors and employees. However, the Committee believes that these exemptions (and ASIC Class Order 03/184) are in need of 'revisiting', as they do not extend to a number of 'ordinary' equity incentive grants and create a number of anomalies.

The following example illustrates the point. An equity incentive grant to employees of a de-merged listed entity cannot rely on the scheme booklet as an exemption to the prospectus disclosure requirement (if the de-merger takes place through a scheme of arrangement) and the exemptions in ASIC Class Order 03/184 cannot be relied on because the new entity will not have been listed for 12 months.

Modify the termination benefits legislation

Some anomalies in the new termination benefits legislation have the potential to complicate remuneration arrangements.

The Committee has previously made a submission on this legislation, and reiterates its concerns. The unintended impact of this legislation has been that corporations are seeking alternative ways to pay 'standard' benefits to departing employees because the new legislation prevents them from doing so. (It is not uncommon for senior executives to be offered 12 months base salary, pro rata STI and pro rata LTI if they depart as a "good" leaver).

The most obvious example of measures being taken is a move towards increasing base salaries and decreasing grants of equity incentives. This trend is directly contrary to modern concepts of 'good governance' which encourage senior executives having 'at risk' remuneration and 'skin in the game'.

A particular problem with the new termination benefits legislation is that its intended application is unclear and currently a number of differing views exist as to how it should be interpreted. The Committee submits that legislation (particularly legislation that could result in a strict liability offence for both companies and individuals) should be clear on its face.

For example, on one interpretation of the legislation, the new termination benefits cap applies to lower-level employees who serve as directors of subsidiaries (for instance, an overseas employee who sits on the board of a foreign incorporated operating subsidiary simply to satisfy a requirement to have at least one locally-resident director), and could unfairly impact "bonus" entitlements paid to long-serving lower-level employees when they retire from positions with only moderate incomes.

There are other problems with the legislation that could distort remuneration arrangements, including:

- the cap being calculated by reference to average annual base salary in the three years prior to termination – this means that any employee entitled to a standard 12 month severance payment will exceed the cap if they receive even a nominal salary increase in any of the three years before they cease employment;
- the cap being calculated by reference to average annual base salary in the three years prior to termination discriminates against employees who have, in the 3 years before ceasing employment, taken maternity or other unpaid leave; and
- the cap being "pro rated" in the first year of service – employees who are terminated without fault in the first year of service have a logical claim to a significant severance payment given the disruption to their professional lives (often in circumstances where they have may have given up other employment to take up the position).

One simple solution would be simply to increase the statutory cap from "12 months base pay, averaged over the past 3 years" to "12 months total remuneration, calculated at the date of departure".

Additional matters affecting Executive remuneration

Do not introduce the "two strikes" rule

Many of today's complex remuneration arrangements are driven by the desire of some companies to comply with perceived "best practice" structures. This can result, for instance, in incentives with complex or multiple performance conditions, deferral arrangements and "unusual" post-vesting disposal restrictions. While these measures typically result in a closer alignment between executive and shareholder interests, they can often be confusing or misunderstood by shareholders (particularly when many different "best practice" features are combined in one incentive).

Introducing a "two strikes" rule will result in greater pressure for companies to comply with "best practice" structures recommended or expected by proxy advisers and other corporate governance bodies, regardless of whether these structures are the "best fit" for the company or are appropriate given their business and operating environment.

In essence – the real concern is that the "two strikes" rule will effectively shift the responsibility for decision making in relation to staff rewards and incentives from the company (through its board and management) to shareholders. This contradicts the fundamental principles of how corporations operate.

If you have any queries, in the first instance please contact the Committee Chairman, Mr Guy Alexander, on 02 9230 4000.

Yours sincerely

W Grant

Bill Grant
Secretary General

Australian Shareholders' Association
STANDING UP FOR SHAREHOLDERS

Level 7, North Tower
1-5 Railway Street
Chatswood NSW 2067
PO Box 519
Chatswood NSW 2057

ABN 40 000 625 669
Telephone 1300 368 448
or (02) 9411 1505
Fax (02) 9411 6663
Email share@asa.asn.au
Web www.asa.asn.au

ASA Submission: CAMAC - Executive remuneration

Tuesday 17 August 2010

The Australian Shareholders' Association (ASA) has long been critical of the levels of remuneration paid to executives of listed Australian companies. Through its policy program, company monitoring and proxy voting activities the ASA seeks to improve the outcomes in relation to executive remuneration to benefit the owners of listed companies.

About the ASA

The ASA is a not-for-profit organisation formed to represent, protect and promote the interests of investors in shares, managed investments, superannuation and other financial investments.

The ASA company monitoring program monitors the performance and corporate governance of most of the ASX 200 companies in Australia. In addition the ASA accepts appointments as proxy at the meetings of those companies it monitors. In 2009 the ASA held proxies for approximately $4.3 billion worth of shares.

As a holder of open proxies the ASA decides how to vote those proxies on the resolution to approve of the remuneration report. The ASA decides how to vote those open proxies in accordance with its policy, *Executive Remuneration* (see *Appendix A*).

ASA participation in the Productivity Commission inquiry into Executive Remuneration

The ASA made two written submissions to the Productivity Commission (PC) inquiry and appeared at both the initial hearing and the hearing in response to the Commission's discussion draft.
Complexity of remuneration reports stems from the inherent complexity of the remuneration structures, but also from a lack of commitment to ensuring that the report is a

document to communicate with shareholders rather than simply to comply with the legislation. As a result retail shareholders, in particular, find the reports impenetrable.

The narrative section of the reports are frequently difficult to read without a level of expert understanding, whilst the tables generally contain information which is only understood by experts and is not explained in plain English. Rarely do the reports actually appear designed to communicate with shareholders.

Section 300A and related regulation

Reducing the number of items of disclosure required by section 300A may have the effect of simplifying reports by reducing length. This however will not automatically lead to better reports. Removing disclosure which is complex and replacing it with no information will not be an improvement for shareholders.

The consultation paper refers to submissions made to the Productivity Commission by Ernst and Young (EY) and jointly by Allans Arthur Robison, Guerdon Associates, CGI Glass Lewis and Regnan specifically with regard to the simplification of section 300A.[1]

Both of these submissions suggested requiring companies to report actual, or realisable remuneration, instead of accounting values. The approach of providing accounting values of equity based remuneration can confuse shareholders who want to understand what remuneration has been actually paid to executives during the year. This suggestion was a final recommendation of the PC and is supported by the ASA.

Both of the submissions referred to offer suggestions for streamlining the information provided in the remuneration report. The ASA has approached section 300A in a similar manner, suggesting below areas of which could be improved, included and removed.

Improve:

- **Information about comparators**

Section 300A requires that where a performance measures are comparative, that the identity of comparator companies is identified[2]. This requirement needs to be retained. The use of relative measurements can only assist shareholders when the details are transparent and appropriateness of comparators can be assessed.

Remuneration reports frequently refer to benchmarking against comparator companies in order to determine fixed remuneration, without providing any information about those comparators. Where relying upon benchmarking to justify fixed remuneration, reporting entities should identify those comparators in order for shareholders to assess whether they are appropriate.

- **Compare performance and remuneration**

Reporting entities are currently required to discuss company performance, where remuneration is performance based. Section 300A currently requires that:

"(1AA) Without limiting paragraph (1)(b), the discussion under that paragraph of the company's performance must specifically deal with:

(a) the company's earnings; and

(b) the consequences of the company's performance on shareholder wealth;

in the financial year to which the report relates and in the previous 4 financial years." [3]

Subsection 1AB goes on to note that regard should be had to dividends, the changes in share price over the reporting period and any return of capital. There is no requirement that the information provided is consistent over the five years. The reporting entity is able to choose which metrics it uses to discuss company earnings and the consequences for shareholder wealth.

Shareholders would be more likely to receive a genuine reflection of performance if all reports set out the same measure of performance, in a graph, which also set out CEO total remuneration for the same period. In order to avoid the risk that by prescribing the information, the true picture might be lost in some limited circumstances, the narrative would provide an opportunity to discuss any anomalies and provide further information. The ASA would favour a graph setting out total shareholder return and CEO total remuneration over a period of five years.

- **Details of performance conditions**

Section 300A currently requires the following information to be provided with regard to performance conditions:

"(i) a detailed summary of the performance condition; and

(ii) an explanation of why the performance condition was chosen; and

(iii) a summary of the methods used in assessing whether the performance condition is satisfied and an explanation of why those methods were chosen;" [4]

Share holders are particularly interested in how the incentive plan is designed to:

- Align the time horizons of executives with those of investors in the company, with the long term and short term strategies of the company
- Encourages sustainable long-term earnings.

Whilst remuneration reports frequently state that the various incentive plans employed are designed to achieve these ends, detailed discussion is generally absent. Amending section 300A to require reporting entities to address these issues could both:

- Focus remuneration committees, consultants and others on the shareholder focussed outcomes which plans should be designed to achieve
- Allow shareholders to decide whether the company has genuinely designed any such plans with outcomes for shareholders as the primary motivation.

Include:

- **Risk**

Performance based remuneration comes with inherent risks. The risks which should be addressed include the risk that excessive payments could be made and that awards may vest for performance which is not able to be sustained. The remuneration report should include information about the potential risks of the particular incentive schemes employed by the company, as well as the measures taken to address/ reduce those risks.

- **Non-executive director fees**

The report should include with regard to the remuneration of non-executive directors:
Information relating to the maximum aggregate non-executive director amount (NED fee pool), including:

- The total NED fee pool
- Changes to the NED fee pool in the past 5 years
- Total NED fees paid in the reporting period.

The NED fee pool is approved by shareholders. Shareholders should be able to easily access the history of these payments, without needing to read several years of remuneration reports. This information is easily aggregated in a table and would not add to the complexity or length of the remuneration report.

Remove:

Remove the accounting valuations of grants of equity made during the year (but not vested). This information should be made available within the financial statements.

Detailed descriptions of incentive plans which relate to grants made in previous years could be incorporated by reference to an easily accessed source, such the company website.

***Enforce**:*

There is currently no enforcement procedures related to failure to comply with section 300A. CAMAC should consider whether civil penalties for failure to comply, or some lesser form of enforcement, such as audit and report by ASIC might assist in ensuring that the section is complied with.

Simplifying the incentive components of executive remuneration

The CAMAC information paper sets out the numerous guidelines of industry bodies in relation to executive remuneration, including the ASA policy *Executive Remuneration.* These guidelines provide broad boundaries with regard to incentive based remuneration. The ASA policy is probably the most prescriptive guideline.

Although care has been taken by the ASA to leave room for flexibility, few listed companies will comply with the policy in 2010, which is the first year it will be applied. The ASA acknowledges that the policy sets a higher standard than its previous policies with regard to executive remuneration, with the expectation that it may take several years before there is a significant level of compliance.

The ASA policy experience illustrates the difficulty in attempting to simplify the incentive components of executive remuneration arrangements by the use of regulation. In the view of the ASA it would be extremely difficult to do and would be likely to have unforeseen consequences.

The answer is not in regulating the contents of incentive plans, but rather in providing shareholders with the opportunity to send a clear message, which cannot be ignored, to the board that the structures are: not aligned with their interests, indecipherable or simply not working. The PC "two strikes" recommendation which has been accepted by the Government will allow shareholders the opportunity to protest in a way that boards will not be able to ignore.

APPENDIX A: ASA Policy – *Executive Remuneration*

Executive Remuneration

ASA Policy Statement: 23 March 2009

Background

Rates of increase in executive remuneration have accelerated over the past decade to such an extent that multi-million dollar packages have become commonplace in larger listed companies. The gaps between the pay of Australian CEOs and senior executives on the one hand, and other employees and the workforce in general on the other, have become huge and are the subject of increasing levels of valid criticism.

Retail shareholders have long been sceptical of the need for Australian CEOs to be remunerated with such increasing largesse. They have questioned the necessity, often claimed by boards, of having to meet international standards set by the two highest paying regimes of USA and UK. They view with suspicion the advice of "independent" remuneration consultants contracted by, and accountable to, those same boards. Retail shareholders have widely condemned the large termination payments granted to CEOs and others who have left their positions on retirement, resignation or sometimes following unsatisfactory performance. There is also increasing concern about high levels of short-term incentive payments and the potential for executives to focus on achieving short-term goals to the detriment of the longer-term interests of shareholders.

The structures of those components of remuneration packages which are classified as long-term and short-term incentive payments, often described as "at risk", have been challenged with some success and it is now the norm for payments to require preset performance hurdles to be met. Nevertheless, progress here has been modest and there remains a widespread view that incentive payments are too easily given for performance which is satisfactory only and by no means superior, and that these payments are neither earned nor well aligned with returns generated for shareholders.

Recent and current global financial turmoil and the accompanying massive diminution in shareholder wealth have reinforced the view that senior executive remuneration levels are excessive. Equally disturbing, in too many cases they have provided support to shareholders' conclusions that incentives embedded within remuneration structures are not well aligned with the interests of shareholders and encourage activities that conflict with long term wealth creation. The Australian Shareholders' Association (ASA) does not support statutory restrictions on remuneration levels and believes it is the responsibility of the boards of companies to deal with the problem. Nevertheless, ASA recognises an increasing risk of intervention by the Australian Government if the corporate sector fails to act. Consequently, ASA has prepared this updated policy paper for the guidance of listed companies. This updated policy position represents a hardening of ASA's position to one that is more reflective of the attitudes of retail shareholders towards remuneration issues.

The ASA Position

1. The structure and disclosure of executive remuneration should be concise, easily understood and transparent to investors.

2. The base salaries of senior executives need to be and in the great majority of listed companies probably already are, at sufficient levels to provide full and appropriate compensation where performance is adequate but not superior.

3. Incentive payments in addition to base salaries are acceptable where these reward superior, as against merely satisfactory, performance, which has been proven by the achievement of predetermined and challenging targets.

4. It is appropriate for the remuneration package of a CEO to include a substantial "at risk" element. As a broad indication only, intended as a guideline for any board which is planning the structures of its CEO's remuneration package, an incentive award equal to the amount of the base salary package is acceptable for a CEO who has achieved significantly superior performance. Payments which are significantly above this level, other than on an exceptional basis, are excessive and are unacceptable to retail shareholders.

5. Long-term incentive (LTI) arrangements based on preset performance hurdles and properly aligned with the interests of shareholders are the appropriate means for providing CEOs, and possibly other senior executives, with motivation and reward for demonstrated superior levels of performance. Recommended guidelines for achieving this alignment are set out below.

6. Short term incentives (STIs) are questionable as incentives for CEOs. They should be used only where the performance targets support and are entirely consistent with the company's long-term goals. STI arrangements may be appropriate for other senior executives, providing these awards are conditional upon achieving pre-set performance targets that are clearly disclosed to shareholders.

7. Boards must not permit executives to enter into arrangements (such as hedging) which reduce the risk elements essential to effective incentive schemes.

8. Termination payments to failed executives which are above statutory entitlements or that include additional amounts in lieu of notice are unacceptable to retail shareholders. Boards should consider this when negotiating departure conditions in employment contracts or subsequently.

9. Golden parachutes are totally unacceptable to shareholders. Other lump sum payments additional to the agreed annual remuneration package, for example, executive retention payments, and compensation for "benefits foregone at previous employers" are also in principle unacceptable to shareholders. Any exceptions need to be very clearly described and strongly justified as being in the company's best interests in the remuneration report.

10. Where there has been a significant, for example 20%, vote against a Remuneration Report by independent shareholders and the board concerned has failed to take appropriate corrective action, the ASA intends to vote undirected proxies against the re-election of any of the directors at the next AGM of that company.

Guidelines

Long-term Incentives

1. ASA views long term incentives as a means of (i) rewarding executives for creating shareholder value and (ii) providing incentives to create further value. There is no single test that adequately meets the requirements of both objectives. Consequently, LTIs should be based on two components, each subject to achieving company performance above a hurdle threshold, with all details clearly set out for shareholders at the time of adoption:
    a. One component should be clearly aligned with shareholders' interests and based on the achievement of total shareholder return (TSR) above the median for an appropriate comparator group. In this case vesting should commence at a modest level (no more than 10%) only when the company achieves a 51^{st} percentile ranking and should increase progressively to reach full vesting no earlier than at the 75th percentile of the group.
    b. The second component should provide an incentive to achieve long-term improvement in company performance, typically the achievement of a hurdle that is based on a pre-set and superior level of increase in company earnings. This can be measured by, for example, growth in earnings per share, return on funds employed or another verifiable metric that the board considers best reflects long-term progress across the cycle.

2. LTI awards should be made in equity.

3. LTI performance should be assessed over a fixed period of no less than four consecutive years, with vesting at completion of the full assessment period.

4. The share prices used within the calculation of the TSR, i.e. those at the start and end dates of the vesting period, may be subject to short-term smoothing in order to avoid the unintended effects of price volatility, (for example, averaging over the three month period around the start and ending dates of the vesting period). However in such cases the formula used must be specified within the LTI scheme at the outset.

5. Should TSR be negative over the vesting assessment period there should be no award for that component, irrespective of relative performance against the comparator group.

6. There should be no retesting of performance against LTI hurdles. The need for retesting is eliminated if the vesting period is adequate and short-term smoothing is adopted.

7. In order to promote and support management succession and other strategic long-term objectives, CEOs' equity-based plans should provide that a meaningful portion of any equity

awards shall not be made available to the CEO for at least two years after vesting. This restriction should apply irrespective of whether the CEO remains in the position.

8. There should be no company loans associated with LTIs as this decouples any alignment with shareholders' interests that might otherwise have existed and is an inappropriate use of shareholders' funds.

Short-Term Incentives

1. Around 50% of STI awards should be based on verifiable financial performance metrics at the company level and/or of the area of responsibility of the individual executive.

2. The remainder of any award should be based on quantifiable performance indicators that are set at the start of the period.

3. In the interests of transparency, the performance indicators used to determine STI awards should be disclosed to shareholders. Disclosure may be retrospective if necessary to avoid disclosing commercially sensitive information.

4. Disclosure of STI amounts paid to senior executives should be supported by details of the maximum and minimum amounts available to be earned under the scheme.

5. A proportion of STI awards (ASA recommends at least 50%) should be in the form of equity. This equity must not be made available to the executive for at least two years after the end of the relevant performance period, irrespective of whether the executive remains in the position.

End Notes

[1] CAMAC, Executive Remuneration- Information Paper, July 2010, pp 23 - 25

[2] Section 300A (1) (BA) (iv) (B)

[3] Section 300A (1AA)

[4] Section 300A (1)(ba)

Submission

Executive Remuneration Issues Paper

Corporations and Markets Advisory Committee

August 2010

Kym Sheehan
Ross Parsons Centre of Commercial Corporate & Taxation Law
Sydney Law School
The University of Sydney
Email: kym.sheehan@sydney.edu.au

This submission addresses the following issues

1 Policy goals
2 Existing remuneration practice requirements
3 Revisions to the legislative architecture: remuneration practice.
4 Existing remuneration reporting requirements
5 Revisions to the legislative architecture: remuneration reporting.

1 Policy goals behind the introduction of the remuneration report and advisory vote

[1.1] It is important to revisit the policy goals that underpinned the introduction of the remuneration report and advisory vote as part of the CLERP 9 reforms in 2004 before examining the existing requirements and any proposals for reform. The five reform actions identified in the 2009 Productivity Commission report[1] and the policy rationale for government action[2] are largely unchanged.

[1.2] The primary goal behind these initiatives was to ***improve the accountability of boards of directors* (and remuneration committees) *of listed companies for the remuneration decisions they make*,** with the stated goals in the CLERP 9 report of promoting transparency, accountability and shareholder activism. The remuneration report and advisory vote were 'designed to enhance transparency and accountability in relation to decisions surrounding director and executive remuneration.'[3] Achieving the framework principles of remunerating responsibly and fairly[4] through these legislative measures[5] requires shareholders have sufficient information to monitor company remuneration (disclosure) and engage with remuneration committees to translate this broad principle into appropriate, company specific practices.

[1.3] While the Productivity Commission argues that disclosure makes boards more accountable,[6] the advisory vote is the legislative mechanism for achieving improved board accountability, because

---

[1] The policy actions for reform are board capacities, conflicts of interest, remuneration principles, disclosure and shareholder engagement: Productivity Commission, *Executive Remuneration in Australia*, Productivity Commission Inquiry Report No. 49 (2009), 357.

[2] Need to maintain public confidence in the corporate sector to facilitate the raising of equity capital and allocation of investment funds: Ibid, 359;

[3] Corporations Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth), Explanatory Memorandum, 166, (*CLERP 9 EM).*

[4] ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (March 2003), 51 (*ASX CG Principles 2003*). This was the statement extant at the time of the CLERP 9 reforms. This was substantially reworded in the second edition to recommend a clear relationship between remuneration levels and composition (structure) and performance: ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (2007), 35 (*ASX CG Principles 2007*).

[5] Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, Executive Remuneration, Continuous Disclosure, Shareholder Participation and Related Matters* (2004) (*CLERP 9 Report Part 1*), 33.

[6] Productivity Commission (2009), above n 1, 241.

it sends a signal to the board of shareholder views. Given the signal is blunt ('adopt the report' or 'do not adopt the report'), shareholders engaging with boards of directors (and vice versa in terms of who might initiate the dialogue) is where the opportunities for intelligent accountability occur. Given the government is committed to introducing the 'two-strikes' rule recommended by the Productivity Commission,[7] it clearly is of the view that this accountability needs to be strengthened.

[1.4] However, accountability is not an end in itself. In this context, ***improving board accountability is ultimately about improving remuneration practices within listed companies.*** Indeed the triggers for legislative amendments to remuneration disclosures have typically been concerns about the quantum of remuneration and the link between quantum and company performance. Without having some picture of what the outcomes of good remuneration decisions look like, it is difficult to create a legislative framework to support shareholders in holding directors to account for their remuneration decisions. *Best practice* is a guide on how to structure remuneration payments, but is not determinative of this issue, because ultimately the best remuneration for a particular company is that which ensures the company achieves its business goals and does not cost the company too much. There is some upper limit on what the quantum of executive remuneration is, even if it is only identifiable when it is breached.

[1.5] There are ***very different views both within the business community and outside of it, as to what amount of remuneration is reasonable.*** While these views are unlikely to ever be reconciled, perceptions of excesses and inappropriate practices will again, in time, create further political momentum for the inquiry and law reform processes of the last two years. I suggest that the Minister's referral in respect of remuneration reports ('more effectively meet the needs of shareholders and companies') should be broadened to 'more effectively meet the needs of shareholders, companies *and stakeholders'* to reflect the interests of others who may not technically qualify as a 'shareholder' but who are interested in ensuring that public confidence is maintained in the corporate sector. Such a view is also consistent with corporate governance principles such as Principle 3 'Promote ethical and responsible decision-making', which exhorts companies to

> *also consider the reasonable expectations of their* ***stakeholders, including shareholders, employees, customers, suppliers, creditors, consumers and the broader community*** *in which they operate.*[8]

[1.6] The other important policy goal for remuneration practice that was cited in the CLERP 9 reforms was to ***improve the link between company performance and pay.*** As the reference from the Minister suggests, this requires thinking about reforms not only to disclosure but also to remuneration practices.

[1.7] Regulated remuneration cycle: I have previously outlined a model of the regulatory framework for executive remuneration in Australia (that is also applicable to the UK). The regulated remuneration cycle is a regulatory space within which various rules exist about four separate activities that occur in an annual cycle

- Remuneration *practice*
- Remuneration *disclosure*

[7] Ibid, xl (Recommendation 13).

[8] *ASX CG Principles 2007*, 21.

- *Engagement* on remuneration
- *Voting* on remuneration.

[1.8] This is represented below in **Figure 1: the regulated remuneration cycle**. The advantage of thinking of the regulatory framework in this manner, as opposed to the 'silo' approach in the Productivity Commission's Report (Figure 5.1, p 127) is that the regulated remuneration cycle looks at the rules holistically in terms of the activities, rather than an approach of 'who does what'. 'Who does what' is also relevant, but as my submission to the inquiry demonstrated[9] and as CAMAC notes in its Issues Paper, a variety of different people make rules about each of the four activities. Viewing the activity holistically can allow for easier identification of the current rules, who makes that rule and thus the legal status of the rule.

[1.9] Appended to this submission are the 'sets' of rules for two of the activities relevant to this CAMAC inquiry: practice and disclosure. What these rules confirm is that firstly, there are a lot of rules that address remuneration practice; secondly that most of these rules do not have the force of law; and finally, that there is a lot of overlap where any one topic is addressed by multiple rule-makers.

[1.10] Just because a rule on remuneration practice lacks legal status does not mean that it cannot be effectively enforced by shareholders. That is the advantage of the regulated remuneration cycle because executive remuneration is not regulated in a hierarchical manner: law has little role in regulating remuneration practice, yet this is the activity where governments hope to see improvements. If there is a need to address an emerging practice issue, this model allows easy identification of who is best placed to make the relevant rule. A number of these rule-makers are not able to be 'directed' to make rules by the Minister. *This is not necessarily a problem because the motivation to rule-make will also drive the motivation to monitor.* This aspect of the regulation of executive remuneration should not be impeded by unnecessary government regulation.

[1.11] While amending the remuneration reporting requirements (disclosure) will hopefully provide clearer information on remuneration practices, it cannot change these practices directly. At best, it may have *an indirect effect* on practices: by requiring companies to disclose their practices on particular matters, it forces companies to address aspects of their remuneration practices that may have been absent or poor. Typically the thrust for changes to remuneration practices comes from remuneration consultants or from shareholders associations or proxy advisors.

[1.12] One example of this in practice relates to the disclosures surrounding company policy on hedging share-based payments. Based on a sample of 109 companies from the ASX 200 for the period 2005/06-2007/08 (3 years), the number of companies disclosing a policy on hedging (where the company's policy prevented hedging of unvested share-based payments) went from 5 companies in the first year to 35 companies in the second year and 52 companies in the third year. The largest change was in the period 2006/07 (30 companies). The Australian Council of Super

[9] The regulated remuneration cycle is explained further in (2009) 31 *Sydney Law Review* 273.

Investors' guidance has been against such hedging since 2003,[10] with IFSA's guidance adopting this stance in 2007, in line with the ASX Corporate Governance Principles as amended in that year. In other words, the change was driven by factors other than legislation and other than an amendment to the ASX Corporate Governance Principles. A change in shareholder expectations of practice led to companies voluntarily disclosing their practices (and it would be a reasonable inference that some companies changed their practices prior to disclosure).

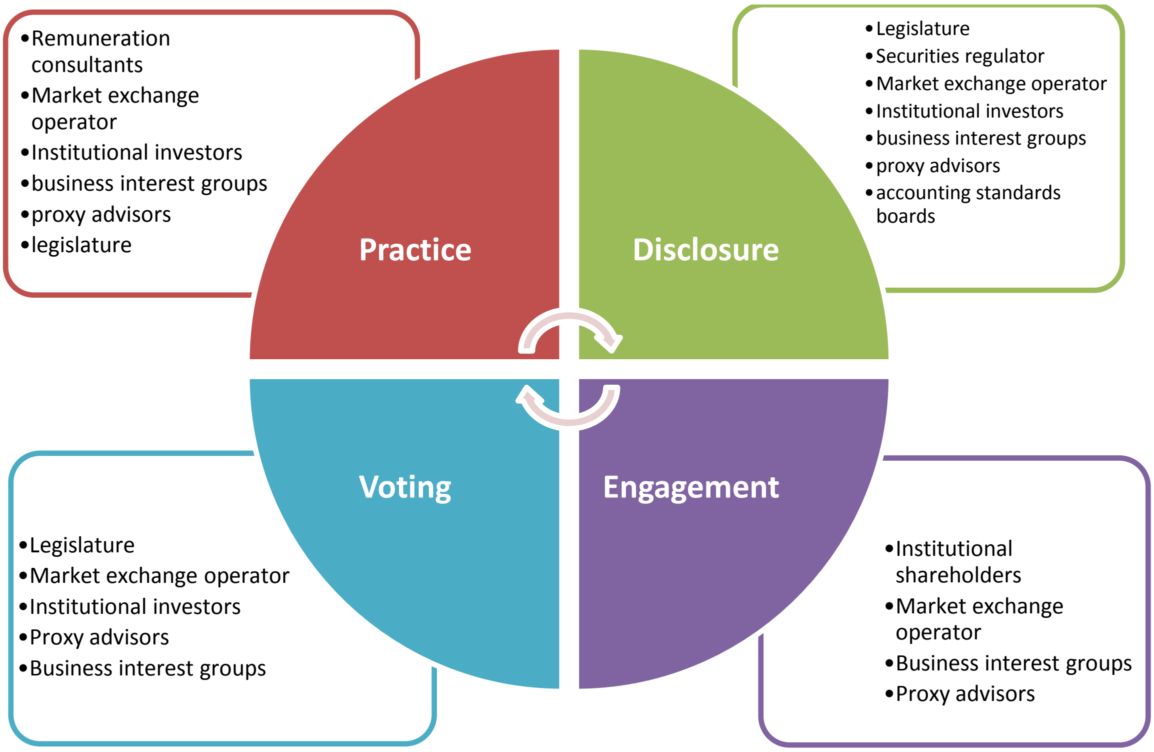


Figure 1: The regulated remuneration cycle

[1.13] In view of the regulated remuneration cycle, I will first examine the remuneration setting framework, before examining the remuneration reporting framework.

2 Existing remuneration setting framework

[2.1] As noted in the Issues Paper and as demonstrated by table 1 below, most of the rules that shape the remuneration setting framework lie outside legislation. An examination of where the existing remuneration setting framework could be revised, with a goal of simplifying the incentive components of executive remuneration arrangements, needs to focus on the rules as they relate to incentive schemes and how they are presented to remuneration committees. What drives this complexity appears to be firstly, the difficulties associated with defining company and executive performance and translating that into metrics that can be assessed; and secondly the technical aspects or fine detail of remuneration design.

[10] Australian Council of Super Investors Inc, Corporate Governance Guidelines for Superannuation Fund Trustees and Corporations (2003), 8 (guideline 11). This is now found in *Corporate Governance Guidelines: A Guide for Superannuation Trustees to Monitor Listed Australian Corporations* (2009), 13 (guideline 10.1(g)).

[2.2] **Defining performance:** Evidence reported in the Productivity Commission's 2009 report of a standard suite of approaches to performance measures for long-term incentives,[11] with greater diversity of performance measures observed for short-term incentives.[12] Observed disclosures of short-term performance measures tend to be in general terms and fail to disclose a specific link between measured performance outcomes and the incentive payments made, whereas long-term incentive payments were clearly disclosed.[13] If shareholders are dissatisfied with the lack of a clear link between remuneration payments and 'performance', then they should use the advisory vote on the remuneration report to say so by voting against its adoption. Companies who are sensitive to shareholders' views will seek to improve the disclosure of this link. If the complexity of the design means that it cannot be clearly disclosed, shareholders might reasonably ask why is the design so complex?

[2.3] **Fine details:** The financial accounting for share-based payments, the taxation implications for executives of particular forms of remuneration, the detailed provisions required in incentive scheme plans to deal with foreseeable consequences and the details required in executive service agreements, not to mention the details of the company's strategy and financial reports, together with the details of the regulatory framework, are all factors that contribute to the complexity of the task. However, the remuneration committee and the board are able to access professional advisors to assist with this task. It may be a timing matter for a committee of part-time, non-executive directors. That is something for companies to be cognisant of and manage accordingly. A number of these factors are well within the control of companies: having a simple remuneration policy that is applied consistently can remove the need to deal with exception upon exception.

[2.4] **Remuneration consultants:** As noted in my initial submission to the Productivity Commission, I believe there is merit in developing a remuneration consulting standard. While the Remuneration Consultants Code in the UK offers principles for engagement letters and presentations of reports, the standard I propose will address the 'how to' aspects of incentive design. For example: what is a valid comparator group for the purposes of benchmarking remuneration? How are sensitivity analyses for remuneration payments performed? What are the assumptions that relate to the analysis and on what basis are they valid? What are the advantages and disadvantages of different measures of company performance? When is it valid to include non-financial performance measures and in what proportion? What is a valid risk analysis?

3 Revisions to legislative architecture: remuneration setting

[3.1] The existing legislative architecture for remuneration setting should be maintained.

[3.2] Remuneration consultants should be encouraged to develop a remuneration consulting standard by forming a broad consultative group with representatives from the remuneration consultancies, and, to represent their client base, the group could draw upon the Chartered Secretaries of Australia (as the company secretary will be secretary to this committee and have views on information needs of remuneration committee members), the Australian Institute of Company Directors and with senior HR managers of Australia's listed companies.

[11] Productivity Commission (2009), above n 1, 201-203, 206-207.
[12] Ibid, 204-205.
[13] Ibid, 208-209.

4 Existing remuneration reporting framework

[4.1] The existing framework for 'disclosure' as an activity is set out below in table 2.

[4.2] In essence a remuneration report consists of both narrative disclosures and financial disclosures, with both sets of disclosures subject to audit. There are several amendment proposals in the Issues Paper, but I have restricted my submission to those noted in [3.2.5], [3.2.6] and [6.1.2].

[4.3] I note the ideal remuneration report suggested by Ernst and Young.[14] While I agree with a number of the details, I believe a more intuitive sequence for the ideal report is to work through governance, strategy, company performance, outcomes, and pay-performance link in that order.

[4.4] Remuneration committee membership and process (including numbers of meetings): this is currently reported in the ASX Listing Rules 4.10.3 disclosures, but arguably should be set out in the remuneration report and incorporated by reference into the listing rule disclosures, as suggested by the Guide to reporting on Principle 8 in the ASX CG Principles 2007 (as updated in 2010). Disclosure of remuneration committee process should be more than disclosure of the number of meetings attended: it needs to provide information on how the committee goes about its task. For example: what resources does the committee access (both internal and external); who else attends the meetings, how does the committee verify the information it is provided with?

[4.5] Remuneration strategy: the remuneration policy should both explain the policy in place for the financial year reported on, together with the policy intentions for the financial year ahead. Remuneration committees with good processes in place should be able to ensure that this policy is signed off in time to enable it to be included in the remuneration report. I appreciate that the remuneration committee cycle is linked to the budgeting cycle.

[4.6] Many of the items listed under 'overview/summary' in the EY model are aspects of strategy. Thus I believe the remuneration strategy section should cover:

- Coverage (KMP, who else?) and comments on any oversight of remuneration throughout the company
- Remuneration objectives
- Components of remuneration and relative mix
- Benchmarking fixed pay and total remuneration including incentives
- Gender equality issues (per the ASX CG Principles updated in 2010)
- Pay relativities with general workforce within the company
- Contractual arrangements including
    - Policy on new hires and sign-on bonuses
    - Policy on terminations
    - Policy on change of control
    - Policy on share holdings, share-trading and hedging
    - Summary table of key contractual provisions for existing KMP.

[14] Cited in the Issues Paper at [3.2.6].

[4.7] Company performance: I am constantly surprised to find little reference in remuneration reports to the ss 299 and 299A disclosures on the review of company operations, the results and its future strategies. The remuneration report could draw upon the earlier more detailed disclosures in these parts of the report by way of **summary** at this point. The company may use KPIs or some other metric/ measurement approach to track its progress against strategy. In reporting historic results (which is what the figures shown in the remuneration report largely are), it seems odd that the company cannot disclose what its performance was against these benchmarks.

[4.8] Remuneration outcomes: These are largely financial disclosures. One approach is to have a ***summary of the remuneration outcomes in the remuneration report*** with the ***details contained in the financial statements and the notes to the financial statements***. Subject to the discussion below on reporting actual remuneration received, I believe the current approach of reporting in accordance with the accounting standards be maintained.

[4.9] Reporting actual remuneration received: I understand the debate on disclosure of actual remuneration received. However, this is not so easy to resolve. It is difficult to report actual remuneration received in a way that makes the link with company performance clear. An executive might be paid in the financial year to 30 June 2010 an amount of annual salary, together with an annual bonus for *the previous 12 months*, superannuation and other benefits. If the KMP exercised share-based payments during the previous 12 months, there is some 'gain' that currently escapes the definition of 'remuneration' in AASB 124 (and hence 'remuneration' in s 9 CA 2001) yet is clearly material to the benefit received by the KMP from their employment.

[4.10] If the basis on which share-based payments are reported as 'actual remuneration received' is that the executive becomes unconditionally entitled to them in the financial year, there is the unanswered question of how to value these to show as a figure. Companies should be aware that the failure to attach a value to this particular aspect of remuneration will not deter users of financial statements from using their own method to do so. Given that retesting of performance hurdles is accepted practice, more than one long-term incentive scheme grant may vest in a particular year. Say, for example, that two schemes' worth of share-based payments (100,000 options) vested in the financial year to 30 June 2010. The options in scheme 1 were issued with an exercise price of $1.00 and the average weighted share price of the company in the three months to 30 June 2010 was $2.00 (hence a paper gain of $100,000).The options in scheme 2 were issued with an exercise price of $0.80c (hence a paper gain of $120,000). If just the numbers of options are disclosed without any further information, it fails to convey the benefit gained by the executive from his or her employment.

[4.11] As this approach is contrary to the valuation approach adopted in the accounting standards, companies will have some flexibility as to how these matters are reported. There is likely to be quite a bit of variation in approaches to disclosure of actual remuneration received and this may make comparisons between companies more difficult. In other words, the 'real picture' that executives and remuneration committees are so keen to convey may be undermined by this approach. It is also difficult, although not impossible, for these figures to be audited, as the basis of the conclusions contradicts accounting practice.

[4.12] Unless these issues can be resolved, mandatory disclosure of actual remuneration is premature. If companies believe there is merit in doing so, they should disclose it on a voluntary basis. If the feedback from shareholders supports the disclosures, then reforms can be mandated at a later time.

[4.13] Link between company performance and remuneration outcomes: This part of the remuneration report needs to be clear.

[4.14] The elements discussed above and where they should be located is summarised below in Figure 2.

[4.15] **Boiler-plating:** While companies may express a preference for principles-based approaches, this approach can be undermined if it appears that a certain 'magic phrase' is one that shareholders will accept. The risk of providing detailed rules on disclosure by way of the Act or Regulations is that companies will follow these to the letter. Companies will also potentially adopt phrases from the ASX CG Principles 2007 or from shareholders' own guidance. Such boiler-plating may not be a bad practice *if* it gives a true and fair view of what the company's remuneration practices actually are. It is poor practice when it is essentially meaningless. The task for companies is to ensure that they describe their remuneration policies meaningfully.

[4.16] **Legal sanctions:** Currently there are no specific legal sanctions that can be imposed in relation to the remuneration report. There is no sense from the Productivity Commission's report of any particular issues that required a different sanction that can be imposed via the advisory vote and ultimately via the 'two strikes' initiative.

[4.17] **Non-executive directors' remuneration:** This should be included within the remuneration report and the elements noted above and summarised in figure 2.

Figure 2: Remuneration disclosures: proposed allocation across the annual report

(DR = directors' report; RR = remuneration report; FR = financial report or the financial statements and notes to the financial statements)

	Remuneration reporting aspects	Remuneration reporting location			
		Narrative or financial	DR	RR	FR
Remuneration committee membership and process (or Board process for setting executive remuneration)	• membership of committee • committee charter exists and is available on website • meeting cycle/ number of meetings attended and by whom • use of advisors (eg who prepares the remuneration report?) • where decisions are made: by remuneration committee or by the board and for whom. • Policies developed by the committee (see below under remuneration strategy) • areas where committee has the right to exercise discretions re terms of policies and any broad parameters for doing so/ process • stress testing and risk considerations	narrative	DR has cross reference from RR to satisfy ASX LR 4.10.3	RR	
Remuneration strategy	• Coverage (KMP, who else?) and comments on any oversight of remuneration throughout the company • Remuneration objectives • Components of remuneration and relative mix • Benchmarking fixed pay and total remuneration including incentives o Gender equality issues (per the ASX CG Principles updated in 2010) o Pay relativities with general workforce within the company • Process for determining fixed pay and policy on benefits • Selection of performance criteria for STIs and LTIs • How each is linked with company performance as measured by the company • Risk considerations and tolerances • Contractual arrangements including o Policy on new hires and sign-on bonuses o Policy on terminations o Policy on change of control o Policy on share holdings, share-trading and hedging o Availability of policies on website	narrative		RR	

	Remuneration reporting aspects	Remuneration reporting location			
		Narrative or financial	DR	RR	FR
	o Summary table of key contractual provisions for existing KMP. • Planned changes to policy/ reviews				
Company performance	• Company performance as is pertinent to enable readers to understand what the company's performance was, whether that performance is viewed by management as 'good' or otherwise, so that the remuneration outcomes can be understood. Cross-referencing could be used as necessary to other parts of the report. • However, the remuneration report should contain sufficient information on company performance in summary form, to enable readers to have a clear view of what the performance was and secondly, what management's view of that performance was (because this is what influences the remuneration outcomes).	narrative and financial narrative and financial financial	DR	summary in RR	FR
Remuneration outcomes	Remuneration awarded during year in accordance with the accounting standards. A set tabular format could be prescribed in reg 2M.3.03. Two tables ideally (1) remuneration awarded during year plus comparison with previous year (Fixed rem, benefits taken as part of fixed rem, superannuation, short term incentives, long term incentives termination payments, other) with non-executive directors disclosed in the same table but in a separate section of the table. (2) numbers of share-based payments issued during year and previous year; number vested. ***If*** CAMAC recommends that actual remuneration received be reported, then the company must make clear disclosures of the basis on which they report this information: eg do the payments reflect performance of the financial year reported on (or a previous year)? This could be reflected in a third table (3) remuneration actually received during the year. Details of fair value accounting for share-based payments should be reported in	some narrative and summary financial detailed financial		RR	FR

	Remuneration reporting aspects	Remuneration reporting location			
		Narrative or financial	DR	RR	FR
	the notes to the financial statements				
Link between company performance and remuneration outcomes	Given the discussion of company performance enables the reader to see whether management viewed the performance as 'good' or otherwise', the links here should be easier to state and might include: • A clear statement on whether the performance overall of the company met management's expectations • Percentage of bonus awarded and forfeited • Discretionary adjustments to bonuses awarded for factors outside executive's control (or note if none) • Percentage of shares lapsed in LTIs • Total shareholdings and changes over year	narrative and financial		RR	
Signature	Remuneration report should be signed and dated by the remuneration committee members, although this signature is on behalf of the board of directors.	Narrative		RR	
Audit opinion	Remuneration report should be specifically mentioned in the audit opinion.	Narrative			

5 Revisions to legislative architecture: remuneration reporting

In light of the above comments and the recommendations noted in the Issues Paper, I believe that the following revisions should be made to the legislative architecture for remuneration reporting:

[5.1] Legislative architecture: there will always be a relationship between the *Corporations Act 2001* (Cth), *Corporations Regulations 2001* (Cth) and the *Accounting Standards* because there is a need for a mix of legal rules and accounting principles to regulate this activity. In particular, any rules that relate to issues of valuation should be consistent with the overarching approach to accounting outlined in the accounting standards. That said, the specifics of the remuneration reports for listed companies should ideally be contained in the *Corporations Regulations 2001* (Cth) (currently reg 2M.3.03), with AASB 124 as support for any valuation matters. While companies want a move towards a principles-based approach, I suggest that, without some content that is easily comparable (such as by way of mandatory tables), companies run the risk of shareholders extrapolating to fill the gap.

[5.2] Amendments to s 300A: The requirement to prepare a remuneration report should be retained in s 300A of the Act. However that section should be amended such that the detailed requirements for the report are moved to reg 2M.3.03.

> **A new sub-section of s 300A** be introduced that states principles to be adopted in preparing the remuneration report are to inform the users of the financial statements about the company's remuneration setting processes and the outcomes of those processes in a way that presents a true and fair view of the process, policy, outcomes and link between company performance and remuneration received.
>
> **Narrative disclosures:** CAMAC may be interested in the **International Accounting Standards' Board Exposure Draft ED/2009/6 on *Management Commentary*.** Much of the remuneration report is narrative disclosure, as is the case with management commentary (the management discussion and analysis section of the annual report). The approach adopted there is not to specify the actual disclosures, but rather to specify **'content elements'** that should appear in the commentary (BC41-43). This may be one way of addressing concerns that s 300A is overly prescriptive while still setting out some framework content to be included. *The headings shown in the first column of figure 2 could be content elements within such an approach.*
>
> Five characteristics suggested in that document for the qualitative disclosures that could be adopted as a guiding principle for the remuneration report are:
>
>> **The remuneration disclosures are *relevant*, *easy to understand*, *supportable* by the financial results, present a *balanced view* and allow for users to <u>*compare*</u> *the policy and outcomes over time*.**
>
> **Reg 2M.3.03** should be amended to include mandatory tables for use in the remuneration report and to note the relationship between the financial reporting requirements of the accounting standards with respect to remuneration. The advantage of having the details in

the regulation is that it is able to be amended more readily than the Act itself. Thus any changes in the accounting standards can be accommodated more readily within Reg 2M.3.03.

Definition of 'remuneration' in section 9 should remain unchanged.

Consideration of legacy schemes: reducing the length of the remuneration report where there are legacy share-based incentive schemes might be achieved by allowing reference to the full terms of the legacy scheme (available on company's website) and a brief summary of the key elements.

[5.3] Plain English: should be the approach adopted throughout the remuneration report and not just in the summary foreshadowed as an amendment ([2.7], p 14). If there is a need to set some standards for the overall readability of remuneration reports, maybe amend s 300A to include something about readability etc, along the lines suggested by the case law for notices of meeting: fully and fairly inform readers about remuneration policies and outcomes, are able to be read and understood by an ordinary man or woman of commerce and, like the financial statements, present a true and fair view of remuneration practices.

[5.4] A summary of remuneration policy: if the summary can present the remuneration policy in a way that does not mislead, then reg 2.M3.03 could be amended to require such a summary. My personal view is that it is not necessary. The need for a summary might be diminished if a format can be devised and reporting is clear.

[5.5] Actual levels of remuneration received: This is not an easy figure to report in a way that makes the link with company performance clear. As noted above, one of the policy goals underlying the introduction of the remuneration report and advisory vote was to improve the link between company performance and executive remuneration. A member of the key management personnel (KMP) might be paid in the financial year to 30 June 2010 the following remuneration: annual salary, annual bonus for the *previous* 12 months, superannuation and other benefits. If the KMP exercised share-based payments during the previous 12 months, there is some 'gain' that currently escapes the definition of 'remuneration' in AASB 124 (and hence 'remuneration' in s 9 CA 2001) yet is clearly material to the benefit received by the KMP from their employment.

[5.6] Disclosure of pay relativities within the company: If the widening gap between executives' remuneration and the wages of ordinary workers is a concern, one way to address this issue is to require that companies disclose this gap. Section 300A could be amended to require disclosure along the lines proposed by the Private Members' Bill initiated in the House of Lords, the Companies' Remuneration Reports Bill 2008 (UK), set out briefly below in Figure 3.

[5.7] Disclosure of pay relativities by gender: The ASX CG Principles 2007 as amended in 2010 require companies to disclose this information. In light of my preference for the narrative remuneration disclosures to be contained in the one report that shareholders vote on, companies should be encouraged to report this item in the remuneration report and to cross-reference that report in the ASX LR 4.10.3 disclosures.

[5.8] Mandatory tables for remuneration disclosure: These could be specified in reg 2M.3.03. The suggested format provided by the Investment & Financial Services Association in its *Blue Book'* seems a good model.

[5.9] Guide to remuneration disclosure: Consideration should also be given to producing a 'guide' to the annual reporting provisions within the Corporations Act and Regulations, with references to any pertinent ASIC guidance. Ideally this would include reference to the accounting standards. It could be an initiative voluntary undertaken by a number of interested parties, given ASIC might view policy on remuneration reports as a low regulatory priority.

Figure 3: An example of wording for disclosure of pay relativities

After section 430 (quoted companies: annual accounts and reports to be made

available on website) insert—

"430A Annual accounts and report: public quoted companies

(1) Every public quoted company, as defined …***shall publish on the first page of the chairman's statement, chief executive's statement, or directors' report, whichever comes first in the annual accounts and report, the ratio between the total annual remuneration of the highest paid director or executive and the total annual average remuneration of the lowest paid ten per cent of the workforce.***

(2) The ratio referred to in subsection (1) shall appear in bold type on the first page of the chairman's statement, chief executive's statement or directors' report.

(3) The total annual remuneration of the highest paid director or executive and the total annual average remuneration of the lowest paid ten per cent of the workforce shall also appear in bold type in the text of the annual accounts.

…

(5) In this section, "the lowest paid ten per cent of the workforce" means the ten per cent of people who have been on the company's payroll during the previous financial year and received the lowest annual remuneration.

(6) The remuneration of any person employed on a part-time basis, or not employed for the full year, shall be calculated on a pro-rata basis.

(7) The requirement to publish the ratio, as stated in subsection (1), applies equally to electronic versions

Keys to tables

Australian tables

AASB	Australian Accounting Standards Board
ASIC	Australian Investments and Securities Commission
AuSB	Auditing and Assurance Standards Board
CG code	ASX Corporate Governance Council*, Corporate governance principles and recommendations,* 2nd edition (2007)
INWN	If not, why not (compliance with the guideline is voluntary but the company must disclose whether it complies or else explain why it does not comply)
M	Mandatory
Practice guidance	Shareholder practice guidance (for example, that issued by the Australian Council of Super Investors Inc, or by the Investment and Financial Services Association)
Practice statement	Business interest group practice statement (issued by the Australian Institute of Company Directors, the Business Council of Australia, or the Chartered Secretaries Association)
SR guidance	Securities regulator guidance (guidance on how the securities regulator interprets the relevant laws and regulations, together with information on enforcement)
V	Voluntary
Voting guidance	Proxy advisor voting guidance (for example, that issued by RiskMetrics (Australia) Pty Ltd

Table 1 – Regulatory framework for executive remuneration practice

Aspect of practice	Regulator					
	Legislature	**Securities regulator (ASIC)**	**Market exchange operator (ASX)**	**Business interest groups**	**Institutional investors**	**Proxy advisors**
REMUNERATION DECISION PROCESS RULES						
Have a remuneration committee[1]			CG code (INWN)[2]	Practice statement (V)[3]	Practice guidance (V)[4]	
Structure of the committee			CG code (INWN)[5]	Practice statement (V)[6]	Practice guidance (V)[7]	Voting guidance (V)[8]
Its tasks or activities			CG code (INWN)[9]	Practice statement (V)[10]	Practice guidance (V)[11]	
Use of remuneration consultants			CG code (INWN)[12]	Practice statement (V)[13]	Practice guidance (V)[14]	
Content of the remuneration policy			CG code (INWN)[15]	Practice statement (V)[16]	Practice guidance (V)[17]	Voting guidance (V)[18]
REMUNERATION CONTRACT CONTENT RULES						
Remuneration contract	Common law			Practice statement (V)[19]	Practice guidance (V)[20]	
Base pay			CG code (INWN)[21]		Practice guidance (V)[22]	
Annual bonus/ short term incentives			CG code (INWN)[23]		Practice guidance (V)[24]	
Long term incentive schemes			CG code (INWN)[25]		Practice guidance (V)[26]	Voting guidance (V)[27] Practice guidance (V)[28]
Share-based remuneration			CG code (INWN)[29] Listing Rules (M)[30]	Practice statement (V)[31]	Practice guidance (V)[32]	Voting guidance (V)[33] Practice guidance (V)[34]
Performance criteria			CG code (INWN)[35]	Practice statement (V)[36]	Practice guidance (V)[37]	Practice guidance (V)[38]
Superannuation	Superannuation laws (M)[39] Taxation laws (M)[40]					
Termination provisions	Company law (M)[41]		CG code (INWN)[42] Listing rules (M)[43]	Practice statement (V)[44]	Practice guidance (V)[45]	
Share holdings					Practice guidance (V)	
Share transactions			CG code (INWN)[46]			
Loans	Company law (M)[47]			Practice statement (V)[48]	Practice guidance (V)[49]	Practice guidance (V)[50]
Margin loans			CG code (INWN)[51]		Practice guidance (V)[52]	

Aspect of practice	Regulator					
	Legislature	Securities regulator (ASIC)	Market exchange operator (ASX)	Business interest groups	Institutional investors	Proxy advisors
Hedging positions			CG code (INWN)[53]		Practice guidance (V)[54]	

Table 2: Regulatory framework for remuneration disclosure

Aspect of disclosure	Regulator						
	Legislature	Securities regulator (ASIC)	Market exchange operator (ASX)	Accounting standards setter (AASB) Auditing standards setter (AuSB)	Business interest group	Institutional investors	Proxy advisors
Definition of remuneration	Corporations law (M)[55]			Accounting standard (M)[56]			
Whose pay to be disclosed	Corporations law (M)[57]			Accounting standard (M)[58]		Practice guidance (V)[59]	
Frequency of disclosure	Corporations law (M)[60]		Listing rules (M)[61] CG Code (INWN)[62]				
Remuneration report	Corporations law (M)[63]						
Remuneration policy	Corporations law (M)[64]		Listing rules (M)[65] CG Code (INWN)[66]			Practice guidance (V)[67]	
Remuneration committee membership	Corporations law (M)[68]		Listing rules (M)[69] CG Code (INWN)[70]			Practice guidance (V)[71]	
Remuneration committee activities	Corporations law (M)[72]		Listing rules (M)[73] CG Code (INWN)[74]			Practice guidance (V)[75]	
Material advisors to remuneration committee							
Contractual terms	Corporations law (M)[76]	Regulations (M)[77]				Practice guidance (V)[78]	
Remuneration payments	Corporations law (M)[79]	Regulations (M)[80]		Accounting standard (M)[81]		Practice guidance (V)[82]	
Superannuation		Regulations (M)[83]		Accounting standards (M)[84]			

Aspect of disclosure	Regulator						
	Legislature	**Securities regulator (ASIC)**	**Market exchange operator (ASX)**	**Accounting standards setter (AASB)** **Auditing standards setter (AuSB)**	**Business interest group**	**Institutional investors**	**Proxy advisors**
Loans				Accounting standards (M)[85]			
Options and other SBPs	Corporations law (M)[86]	Regulations (M)[87]		Accounting standards (M)[88]		Practice guidance (V)[89]	Voting guidance (V)[90]
Shareholdings	Corporations law (M)[91]		Listing rules (M)[92]				
Share trading	Corporations law (M)[93]	SR Guidance (V)[94] Class order (M)[95]	Listing rules (M)[96] Guidance (V)[97]				
Termination payments		Regulations (M)[98]		Accounting standard (M)[99]		Practice guidance (V)[100]	
Tabular disclosure format						Practice guidance (V)[101]	
Performance graph						Practice guidance (V)[102]	
Performance criteria	Corporations Law (M)[103]	Regulations (M)[104]				Practice guidance (V)[105]	Voting guidance (V)[106] Practice guidance (V)[107]
Valuations	Corporations law (M)[108]	Regulations (M)[109]		Accounting standard (M)[110]		Practice guidance (V)[111]	Voting guidance (V)[112] Practice guidance (V)[113]
Sign-off within company	Corporations law (M)[114]					Practice guidance (V)[115]	
Audit certification	Corporations law (M)[116]			Accounting standards (M)[117] Auditing standards (M)[118]			
Other directorships	Corporations law (M)[119]					Practice guidance (V)[120]	
Compliance with CG codes			Listing rules (M)[121] CG Code (INWN)[122]			Practice guidance (V)[123]	

[1] *Corporations Act 2001* (Cth), s 198D(1)(a) allows the directors to delegate any of their powers to a committee of directors unless the company's constitution provides otherwise. As all listed companies must have a constitution (ASX Listing Rules, rule 1.1, Condition 1A), the company's constitution should be reviewed to confirm if any limits exist to this power of delegation. Typically the constitution will allow delegation so as to not limit s 198D, as well as provide for the rules of procedure to be followed. See, for example, AMP Ltd, *Constitution of AMP Ltd* (ACN 079 354 519) amended 19 May 2005, article 77.

[2] ASX Corporate Governance Council, *Principles of Corporate Governance and Recommendations* (2007), 35 (recommendation 8.1) (*ASX CG Council Principles*).

[3] Australian Institute of Company Directors, *Executive Remuneration: Guidelines for Listed Company Boards* (2009), 9.

[4] Australian Council of Super Investors, *Corporate Governance Guidelines: A Guide for Superannuation Trustees to Monitor Listed Australian Companies* (2009), 14 (guideline 10.3(a)) (*ACSI CG Guidelines*); Investment & Financial Services Association (IFSA), Corporate Governance: A Guide for Fund Managers and Corporations, 6th edition (2009), 20 (Guideline 7, 11.8) (*IFSA Blue Book*).

[5] *ASX CG Council Principles*, above n 2, 35 (commentary to recommendation 8.1). This was revised in 2010 – *Marked-Up Amendments dated 30 June 2010 to the Second Edition August 2007 of the Corporate Governance Principles and Recommendations*, 16 (Recommendation 8.2) (*ASX CG 2010 Amends*)

[6] Australian Institute of Company Directors, above n 3.

[7] *ACSI CG Guidelines*, above n 4, 13 (guideline 10.1(g)); *IFSA Blue Book*, above n 4, 21 (11.8.3).

[8] RiskMetrics (Australia) Pty Ltd, *2008 Australia Voting Guidelines* (2008), 12.

[9] *ASX CG Council Principles*, above n 2, 35 (commentary to recommendation 8.1). This was revised in 2010 to include remuneration by gender, *ASX CG 2010 Amends*, 15.

[10] Australian Institute of Company Directors, *Executive Equity Plan Guidelines, Position Paper No. 2* (2007), 5 (guideline 4.1).

[11] *ACSI CG Guidelines*, above n 4, 14-15 (guidelines 10.3(a)-(g)); *IFSA Blue Book*, above n 4, 21 (11.8.3).

[12] *ASX CG Council Principles*, above n 2, 35 (commentary to recommendation 8.1).

[13] Australian Institute of Company Directors, above n 3, 9, 10-11, 12, 14.

[14] *ACSI CG Guidelines*, above n 4, 15 (guideline 10.3(f)).

[15] *ASX CG Council Principles*, above n 2, 35-36 (commentary to recommendation 8.1).

[16] Australian Institute of Company Directors, above n 3, 16-25.

[17] *ACSI CG Guidelines*, above n 4, 12 (guidelines 16.1(h)

[18] RiskMetrics (Australia) Pty Ltd, above n 8, 12.

[19] AICD, above n 3, 19-20-22.

[20] *ACSI CG Guidelines*, above n 4, 18-19 (guidelines 16.2(a),(b),(d),(e),(f),(g),(h).

[21] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 1).

[22] *ACSI CG Guidelines*, above n 4, 20 (guidelines 16.4(a)-(c)).

[23] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 2).

[24] *ACSI CG Guidelines*, above n 4, 20 (guideline 16.4(a),(b).

[25] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 2).

[26] *ACSI CG Guidelines*, above n 4, 20 (guideline 16.4(a),(b)), 21-23; guideline 16.6).

[27] RiskMetrics (Australia) Pty Ltd, above n 8, 18.

[28] Ibid, 15-18.

[29] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 2, 3).

[30] ASX, *Listing Rules*, rule 10.14.

[31] Australian Institute of Company Directors, above n 10, 4-6 (guidelines 3.1-4.7), 9 (guidelines 7.1-7.4).

[32] *ACSI CG Guidelines*, above n 4, 22-23 (guideline 16.9), 24 (guidelines 16.10, 16.11).

[33] RiskMetrics (Australia) Pty Ltd, above n 8, 18.

[34] Ibid, 15-18.

[35] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 2).

[36] Australian Institute of Company Directors, above n 10, 6-8 (guidelines 5.1-5.7).

[37] *ACSI CG Guidelines*, above n 4, 21 (guideline 16.8).

[38] RiskMetrics (Australia) Pty Ltd, above n 8, 16-17.

[39] *Superannuation Guarantee (Administration) Act 1992* (Cth), *Superannuation (Excess Concessional Contributions Tax) Act 2007* (Cth), *Superannuation (Excess Non-concessional Contributions Tax) Act 2007* (Cth), together with provisions in the *Income Tax Assessment Act 1997* (Cth).

[40] *Income Tax Assessment Act 1936* (Cth), *Income Tax Assessment Act 1997* (Cth).

[41] *Corporations Act 2001* (Cth), ss 200A-200G.

[42] *ASX CG Council Principles*, above n 2, 36 (Box 8.1, 4).

[43] ASX, *Listing Rules*, rules 10.18 and 10.19.

[44] AICD, above n 3, 22-23. Also Australian Institute of Company Directors, *Executive Termination Payments, Position Paper No. 13* (October 2008).

[45] *ACSI CG Guidelines*, above n 4, 18-19 (guideline 16.2).

[46] *ASX CG Council Principles*, above n 2, 23 (box 3.2, 3, 4, 6, 7).

[47] *Corporations Act 2001* (Cth), s 208(1) if the loan is on less than commercial terms *cf* s 210; a loan given by way of financial assistance to acquire shares in the company would trigger the prohibition contained in ss 260A(1)(a),(b), (c) unless the loan is given under an employee share scheme approved by shareholders in general meeting: s 260C(4)(a).

[48] Australian Institute of Company Directors, *Non-recourse Loans Provided to Executives*, Position Paper No. 8 (May 2008).

[49] IFSA Blue Book, above n 4, 21 (11.8.3). 26 (guideline 11.15.1); *ACSI CG Guidelines*, above n 4, 24 (guideline 16.13 (c)). ACSI does not take as strong a position on non-recourse loans as does IFSA who opposes non-recourse loans. Rather ACSI wants the loans to be on a commercial basis and, where the loan is non-recourse or limited recourse, to have a provision in the share plan which allows the company to sell on market the shares forfeited by the executive to recoup part of the cost. Neither NAPF nor ABI deal with non-recourse loans in their guidelines.

[50] Regnan, *Position Paper – Director and Executive Security Trading* (2008). Regnan undertakes engagement on behalf of a number of industry super funds and hence its policy statements can be said to be the policy positions of those investors. However, it is coded under ‘proxy advisors’ because it formulates its own views on these issues.

[51] *ASX CG Council Principles*, above n 2, 23 (box 3.2, 7).

[52] ACSI and IFSA, *Joint Statement by IFSA and ACSI on Market Integrity and Efficiency* (28 March 2008), 2.

[53] *ASX CG Council Principles*, above n 2, 23 (box 3.2, 8).

[54] *ACSI CG Guidelines*, above n 4, 24 (guideline 16.14).

[55] *Corporations Act 2001* (Cth), s 9.

[56] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005) paragraphs 9, Aus 9.1, Aus 9.1.1.

[57] *Corporations Act 2001* (Cth), s 300A(1AAA) defines ‘key management personnel’ by reference to the definition in the applicable accounting standard, which is *AASB 124 Related Party Disclosures* (2005). It defines ‘key management personnel’ in clause 9 as ‘those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.’

[58] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005) paragraphs 9, 16.

[59] *ACSI CG Guidelines*, above n 4, 17 (guideline 16.1(d) and 25 (guideline 16.15(a)); *IFSA Blue Book,* above n 49, 25 (guideline 14).

[60] *Corporations Act 2001* (Cth), s 300A(1A); s 674(2) (continuous disclosure obligations).

[61] *ASX Listing Rules*, rule 3.1, rule 3.16 (where there is a change in a chief executive officer or equivalent); ASX, *Continuous Disclosure and Chief Executive Officer Remuneration* (2003), 1-2.

[62] *ASX CG Council Principles*, above n 2, 29 (eliminating surprise about executive payments).

[63] *Corporations Act 2001* (Cth), s 300A (1A).

[64] *Corporations Act 2001* (Cth), ss 300A(1)(b),(ba).

[65] ASX, *Listing Rules*, rule 4.10.3.

[66] *ASX CG Council Principles*, above n 2, 37 (guide to reporting on principle 8).

[67] *ACSI CG Guidelines*, above n 4, 23 (guideline 16.1(f); *IFSA Blue Book*, above n 4, 25-26 (guideline 14).

[68] *Corporations Act 2001* (Cth), s 300(11).

[69] ASX, *Listing Rules*, rule 4.10.3.

[70] *ASX CG Council Principles*, above n 2, 37 (guide to reporting on principle 8).

[71] *ACSI CG Guidelines*, above n 4, 31 (guideline 22); *IFSA Blue Book*, above n 4, 16-17 (guideline 1).

[72] *Corporations Act 2001* (Cth), s 300(11).

[73] ASX, *Listing Rules*, rule 4.10.3.

[74] *ASX CG Council Principles*, above n 2, 37 (guide to reporting on principle 8).

[75] *ACSI CG Guidelines*, above n 4, 31 (guideline 22); *IFSA Blue Book*, above n 4, 16-17 (guideline 1).

[76] *Corporations Act 2001* (Cth), s 300A(1)(e)(vii).

[77] *Corporations Regulations 2001* (Cth), reg 2M.03(1), item 13.

[78] *ACSI CG Guidelines*, above n 4, 18 (guideline 16.2(a).

[79] *Corporations Act 2001* (Cth), s 300A(1)(c).

[80] *Corporations Regulations 2001* (Cth), reg 2M.03(1), items 6, 7, 8, 9 and 11.

[81] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), paragraph 16.

[82] *ACSI CG Guidelines*, above n 4, 19 (guideline 16.3); *IFSA Blue Book*, above n 4, 25-26 (guideline 14).

[83] *Corporations Regulations 2001* (Cth), reg 2.M.3.03(1), item 7.

[84] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), paragraph 16(b); *AASB 119 Employee Benefits* (2006), paragraphs 29-30, 39, 44-47.

[85] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), paragraphs Aus 25.8, Aus 25.8.1 but loans involved in transactions that are essentially options, including non-recourse loans in such transactions, are excluded from the requirement to disclose under Aus 25.8.2.

[86] *Corporations Act 2001* (Cth), s 300(1)(d), ss 300(3),(5),(6),s 300A(1)(ba).

[87] *Corporations Regulations 2001* (Cth), reg 2M.03(1), item 11.

[88] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), paragraphs Aus 25.7.3-Aus 25.7.5; *AASB 2 Share-based payments* (2007), paragraphs 7-8, 10-12, 16-25, 30-31, 34-40, 44-52, appendix B.

[89] *ACSI CG Guidelines*, above n 4, 23 (guideline 16.9(f)); Investment and Financial Services Association, *Executive Equity Plan Guidelines* (2007), 10-11 (guidelines 8.1, 8.2, 8.3, 8.7) (*IFSA Equity Guidelines*).

[90] RiskMetrics (Australia) Pty Ltd, above n 8, 18.

[91] *Corporations Act 2001* (Cth), ss 300(11)(a)-(c).

[92] ASX Listing Rules, rule 4.10.4.

[93] *Corporations Act 2001* (Cth), s 205G. Board policy on hedging of share-based payments is required under s 300A(1)(da), with effect from 28 June 2007.

[94] Australian Securities and Investments Commission, *Notification of Directors' Interests in Securities – Listed Companies, Regulatory Guide 193* (2008).

[95] Australian Securities and Investments Commission, *Class Order 01/1519 Disclosure of Directors' Interests*.

[96] ASX, *ASX Listing Rules*, rule 3.19A.

[97] ASX, *Disclosure of Directors' Share Trading*, Guidance Note 22 (2002).

[98] *Corporations Regulations 2001* (Cth), reg 2M.03(1), item 9.

[99] Australian Accounting Standards Board, *AASB 124 Related Party Disclosures* (2005), paragraph 16; *AASB 119 Employee benefits* (2006), paragraphs 133-140, 143.

[100] *ACSI CG Guidelines*, above n 4, 18 (guideline 16.2(a)).

[101] *IFSA Blue Book*, above n 4, 31-32 (Appendix A).

[102] *IFSA Equity Guidelines*, above n 89, 10 (guidelines 8.2).

[103] *Corporations Act 2001* (Cth), ss 300A(1)(b),(ba), (1AA), (1AB).

[104] *Corporations Regulations 2001* (Cth), reg 2M.3.03(1), items 12(c), (d), item 14 (c)(iii), item 15 (b)(vi).

[105] *ACSI CG Guidelines*, above n 4, 20 (guideline 16.6 – short-term incentive schemes) and 23 (guideline 16.9(f) *IFSA Equity Guidelines*, above n 89, 10 (guideline 8.2).

[106] RiskMetrics (Australia) Pty Ltd, *Assessing Remuneration Reports for ASX-listed Companies* (2008), 1-2.

[107] RiskMetrics (Australia) Pty Ltd, above n 8, 17.

[108] *Corporations Act 2001* (Cth), s 300A(1C)(a).

[109] *Corporations Regulations 2001* (Cth), reg 2M.3.03(1), items 10(a), item 14(e), item 15(b), regs 2M.3.03(2), (4)

[110] Various accounting standards give guidance on valuations, including Australian Accounting Standards Board, *AASB 2 Share-based Payment* (2007), *AASB 101 Presentation of Financial Statements* (2007), *AASB 119 Employee Benefits* (2006).

[111] *ACSI CG Guidelines*, above n 4, 19 (guideline 16.3) and 23 (guideline 16.9(g)); *IFSA Equity Guidelines*, above n 89, 11 (guideline 8.7).

[112] RiskMetrics (Australia) Pty Ltd, above n 106, 1-2.

[113] RiskMetrics (Australia) Pty Ltd, above n 8, 17.

[114] *Corporations Act 2001* (Cth), s 298(2)(c) as the remuneration report forms part of the directors' report.

[115] *ACSI CG Guidelines*, above n 4, 15 (guideline 10.3(g)).

[116] *Corporations Act 2001* (Cth) s 308(3C) requires the auditor to state whether in the auditor's opinion, the remuneration report complies with s 300A. This section only applies from 28 June 2007; prior to this date, the remuneration report was not required to be audited, although disclosures made in the financial reports, including the notes to the financial reports, would be audited under s 307.

[117] Australian Accounting Standards Board, *AASB 101 Presentation of Financial Statements* (2007), paragraphs AUS 138.2.

[118] Various auditing standards impact upon the audit certification, including Auditing and Assurance Standards Board, *Auditing standard ASA 200 Objective and General Principles Governing an Audit of a Financial Report* (2006), paragraphs 7, 9, 14-15, 18, 20-21, 24; *Auditing Standard ASA 545 Auditing Fair Value Measurements and Disclosures* (2006), paragraphs 23-34, 40, 47, 64, 68-69; *Auditing Standard ASA 550 Related Parties* (2006), paragraphs 13, 18, 21, 23, 37-38; *Auditing Standard ASA 580 Management Representations* (2006), paragraphs 9, 12, 22; Auditing Standard ASA 720 Other Information in Documents Containing Audited Financial Reports (2006), paragraphs 14-16, 20, 22-23, 29; *Guidance Statement GS 008 The Auditor's Report on a Remuneration Report Pursuant to Section 300A of the Corporations Act 2001* (2008).

[119] *Corporations Act 2001* (Cth), s 300(11)(e).

[120] *ACSI CG Guidelines*, above n 4, 31 (guideline 22).

[121] ASX, *Listing Rules*, rule 4.10.3.

[122] *ASX CG Council Principles*, above n 2, 5.

[123] *ACSI CG Guidelines*, above n 4, 6 (guideline 1(c)).

Australian Government
Corporations and Markets Advisory Committee
Submission on Executive Remuneration

By

Max Underhill

Director

Maxumise Consulting Pty Limited

2A Beaconsfield Road

Chatswood NSW 2067

Tel: +612 9884 9256

Email: max@maxumise.com

Purpose:

To provide an input into Executive Remuneration by outlining the impact of modern and quantifiable human capital management (HCM) approaches on the valuation of roles.

> *While it was recognised by the Productivity Commission that remuneration design could be applied as a "science" through a quantification of the process of remuneration design, this was avoided in the report and recommendations which focussed more on the subjective approaches that provide more scope for flexible interpretation and avoids the hard quantifiable accountability.*

Submission:

Human Capital Management has developed over the past few years to a point where Human Resources/Assets can be quantified and valued allowing them to be managed as well, if not better than other organisational assets whether Financial, Plant and Equipment, Inventory etc. The value of the HR asset can be established and placed on the balance sheet if accounting standards would allow. There are a number of features that allow human assets to be better managed than other assets, for example a HR asset appreciates while physical assets like plant depreciate. Furthermore in HCM the asset is valued on its contribution to the organisation and any deviation from the specification can also be assessed and taken into the measures, this is not the case for other physical assets like vehicles, motors etc. HR assets are purchased and must be maintained to ensure value is obtained.

This submission presents that in any organisation:

1. Roles (defined contribution points in a structure) can be sized and valued based on the defined contribution to the organisation (specification of requirements) and
2. The incumbent can also be sized and valued against the designed role (shortfalls against the specification).

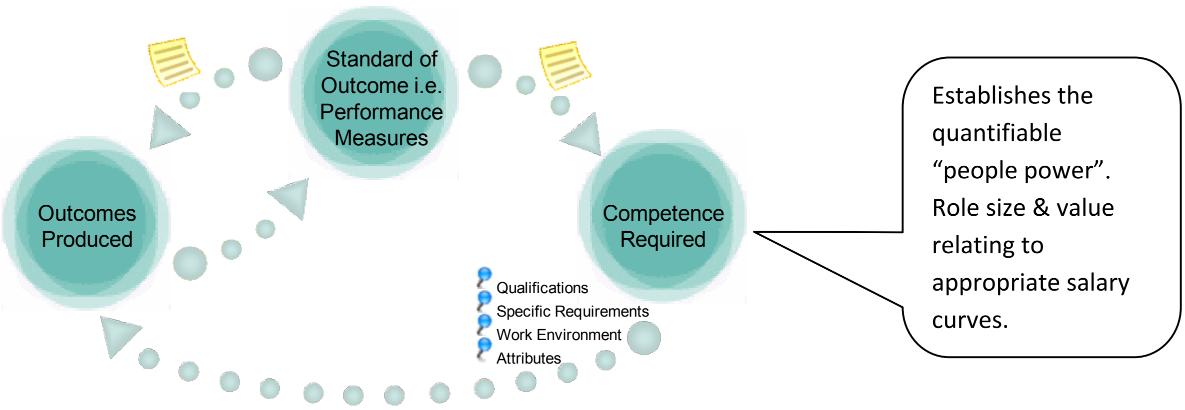
The designed role can be applied across a national or global structure as its size remains constant while the value is related to the relevant currency and salary curve positioning. This provides for responsive and appropriate decision making including international equity and competitiveness.

This quantitative sizing and valuation of the roles within a current (or even future) structure allows HR assets to be placed on the balance sheet (if accounting standards would allow it) and a new series of performance measures could be introduced including:

1. Ratio of Employment Cost (total or department) to HR Asset value
2. Return on HR Assets

The HR Asset balance sheet value is determined through a logic and robust approach which is as sound as say plant and equipment valuation. The logic and robustness is derived from the checks and balance that can be applied:

1. Outcomes produced by the role as designed;
2. Performance measures or standard of the outcomes, and then
3. The competence required to produce the outcome at the standard required.

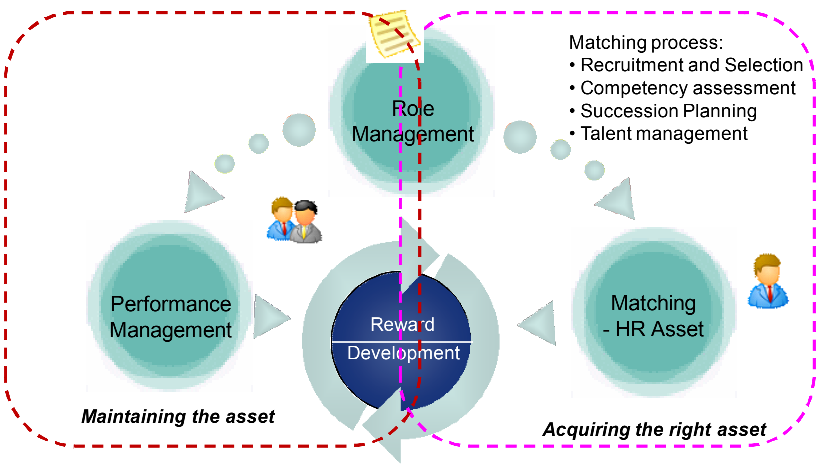


The HR Asset value is the "Base Salary" value from which the package is developed including any adjustments required in the "cash amount". The base salary and performance payment are the variable components of the package and what Board and shareholders are interested in. If the performance pay is calculated as a percentage or other relative proportion base salary (this is a measure of relative contribution) then base salary becomes the key driver in determining total package.

Similarly when an individual is appointed to a position (specific role), they are sized and valued on the same basis as the role. The appointment of the employee may be an external recruitment, internal promotion/movement or an assessment for succession planning, role changes etc. The individual assessments not only ensure the individual is remunerated correctly (contribution against this role) the gaps and development planning can be put in place prior to appointment.

Salary curves have been used within sectors and organisations for many years providing approximate "job" worth in very generic terms. These salary curves can now be produced much more accurately utilising the same role sizing methodology described above (reverse engineer of the existing role design). While these curves exists and can be enhanced, it is in recent years that the value of the contribution at the top 2 to 4 levels has become distorted in some organisations. This distortion has largely been the result of a combination of the role contribution value (base salary) with the perceived "Market Adjustment" within the package. Protocols or guides for establishing "upper" points have been proposed and adopted throughout the world for many years. An example is the article in the Financial Review 1st June 2009 which proposed 10x the average as the maximum. While existing contribution curves can be enhanced significantly, they have operated with reasonable effectiveness for the majority of the hierarchy in organisations for many years. The extension of this contribution curve, as a mathematical formula, to the upper levels involves a combination of commercial reality and acceptability just like managing any other asset. There will always be "*Holden*" organisations and "*Mercedes*" organisations but this has been, and will continue to be, catered for in the statistical distribution 1st Quartile, Median and 3rd Quartile (percentiles). The systems in use for many years have to establish salary curves have in principle been relatively effective but lacked methodology and quantitative rigour which is now available.

While the acquisition of the HR asset is normally a one-off (diagram RHS), the maintenance is an on-going process and can be addressed through a quantitative performance management system shown in the following diagram (LHS). A true performance management system is definitive and the employee knows themself how they are performing and can utilise the system for performance management and reporting (exception and interventions actioning).



Conclusion

It is possible utilising modern human capital management to size and value human assets and manage these as well as, if not better, than other assets whether financial, plant and equipment, inventory, buildings.

The question of Base Salary value is a factor of determining the role size and relating this to the appropriate salary curve which determined by location including currency and competitive market positioning (not adjustments).

Salary curves have been in use for many years and while the principle is sound it has been the lack of quantitative rigour that is now available through HCM methodology. This includes extending the contribution curves to the upper "Executive" levels.

Base Salary or contribution value forms the basis for developing the package including the "Performance Pay".

Structures and role are not static and change over time. A strategic approach to HCM will address both current and future structures. Human asset must be maintained to ensure they:

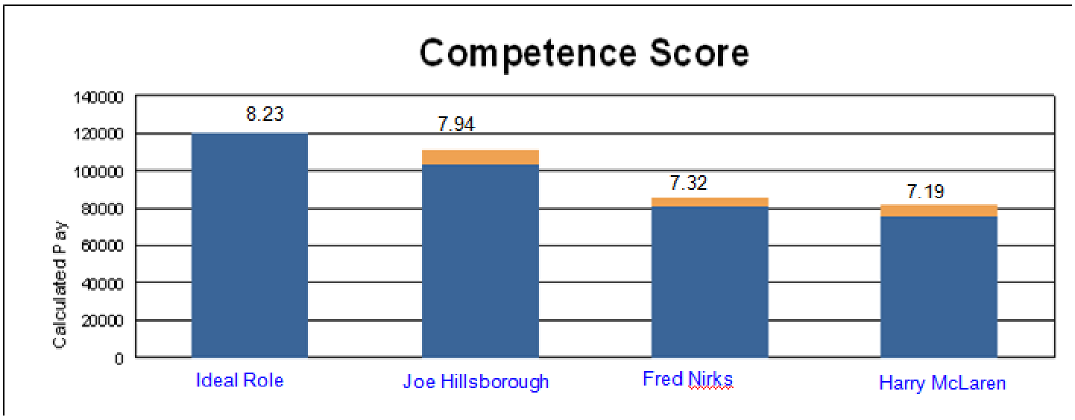
1. Appreciate and develop in the current role (which will be dynamic)
2. Contribute in a measurable way and within a predetermined envelope of performance
3. Are developed for new and future roles where economically viable (succession planning – assets available for existing role in current structure as well as future roles).

Salary differential would firstly be determined by the size or contribution to the organisation. Secondly it would be driven by the competitive components in the package, variable performance pay being a significant contributor to this.

Appendix A – Examples of Executive Officer Recruitment – Size and Dollar Differential

The following graph and table shows an example three (3) applicants who were interviewed (not real names) for a senior position. One applicant was clearly the more competent applicant. However while relative to the other applicants Joe was outstanding he did have significant shortfalls in competence. In fact 3.65% under in size (approx half a band) and if he had been paid the full salary (which was the initial tendency) he would have been over paid by 12.26%. Also he would have been appointed not knowing his own shortfalls or have a personal development plan in place to correct these.

Calculated Pay $120,513 **Band Size** 8.23



	Band	Salary	*Diff Band*	*Diff $'s*
Ideal	**8.33**	**$120,513**	*"Power"*	*"Value"*
Joe Hillsborough	7.94	$107,353	*-3.65%*	*-12.26%*
Fred Nirks	7.32	$83,229	*-12.43%*	*-44.80%*
Harry McLaren	7.19	$78,743	*-14.46%*	*-53.05%*

The gap between the designed Role and Applicant in Hierarchical terms is shown in this diagram:

Band	Behaviours	Overall Objective
8	Organisational Leader • Leader • Change Driver • Performance Oriented • Visionary	• Organisational Strategic Focus • Long-term perspective • Performance control • Policy direction • Business direction
7	Functional Leader • Leader and Manager • Performance Driver • Influencer • Achiever • Innovator	• Functional strategic focus • Policy formulation • Change implementation • standard formulation
6	Regional Manager/Technical Leader/Coordinator • Technical Excellence/Manager • Performance driven • Implementer • Challenger • Initiator	• Policy implementation • Technical adviser • Results management • Performance monitoring / reporting • Predictions & recommendations • Departmental leadership • Standard setting

8.33

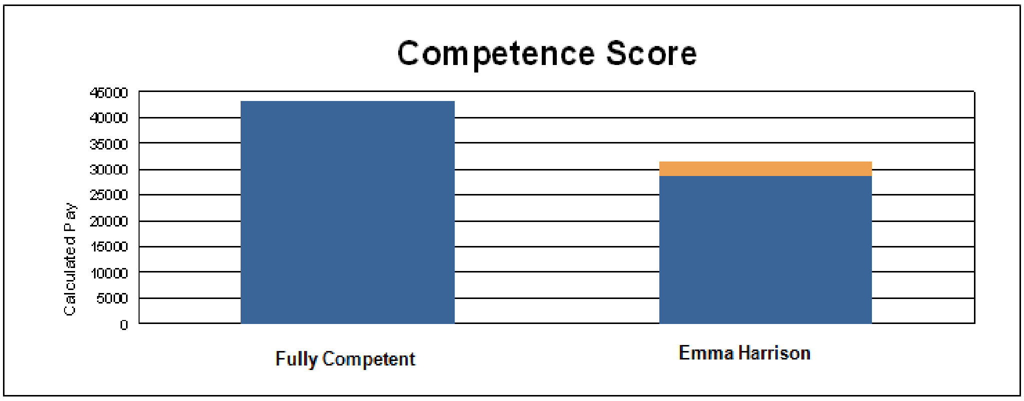
7.94 – 8.33

Appendix B – Examples of Assessment of an Incumbent against a Role

This assessment could have been for: 1 x applicant recruitment; assessment against a current role or assessment against a future role (succession planning). The graph and first table show the gap from a size and value perspective. The second table Competency Profile shows the gap between designed or ideal and actual competence.

Regional Retail Operations Manager

Calculated Pay $43,320 **Band Size** 5.71



Role	Role Design	Incumbent Emma H.	Difference
Size	5.71	4.72	-21.0%
Salary	$43,320	$31,341	-38.2%

Competence Profile – Required/designed vs Assessed

Emma Harrison		Required Level	Assessment Score
Applicants Calculated Pay		$43,320	$31,341
Applicants Band Size			4.72
A 2	Business Performance	D	B
A 3	Risk Management	D	B
A 5	Planning	D	C
A 6	Resource Management	D	D
A 7	Systems and Procedures	C	B
A10	Communication	D	C
B 1	Customer Commitment	D	B
B 3	Commercial Focus	C	B
C 1	Leadership	C	B
C 3	Facilitation	C	C
D 7	Technology Application	D	B
E 3	Health and Safety	D	B

Comparison with Other Asset Management

It is unlikely management would accept the above differential in other asset management such as equipment/plant or financial management. The following diagram shows the 21% size and 38% value differential applied to a physical asset, say a motor, and Return on Investment or margin:

	Specification/ Requirements	Delivered
Power (hp)	35	27.65
RoI (%)	20%	12%

Tax
147 Collins Street
Melbourne Vic 3000

GPO Box 2291U
Melbourne Vic 3001
Australia

ABN: 51 194 660 183
Telephone: +61 3 9288 5555
Facsimile: +61 3 9288 6666
DX: 30824 Melbourne
www.kpmg.com.au

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Our ref Admin_13853561_1.DOC

23 August 2010

Dear John

Executive Remuneration

We appreciate the opportunity to make this submission to the Corporations and Markets Advisory Committee ("CAMAC") regarding the Executive Remuneration issues referred to CAMAC.

Specifically, CAMAC has been requested to:

- examine the existing reporting requirements contained in section 300A of the Corporations Act and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies;

- examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements; and

- make recommendations on how best to revise the legislative architecture to reduce the complexity of remuneration reports and simplify the incentive components of executive remuneration arrangements.

We have set out our submission in the attached two appendices by making several recommendations in respect of:

Appendix A: Remuneration arrangements

Appendix B: Remuneration reporting

If you have any queries, please feel free to contact me on 03 9838 4600 or Andy Hutt on 02 9335 8655.

Yours sincerely

Martin Morrow
Partner
Equity Based Compensation & Executive Remuneration

Andy Hutt
Partner
Equity Based Compensation & Executive Remuneration

Appendix A

Remuneration arrangements

The Committee has been asked to examine where the existing remuneration setting framework could be revised to enable it to provide advice on simplifying the incentive components of executive remuneration arrangements.

KPMG considers the current remuneration setting framework should not be revised as it is appropriately structured.

The taxation of employee share scheme should, however, be revised to remove some of the complexity and inequity that arises under those arrangements. Such measures would work to simplify the incentive components of executive remuneration arrangements.

We have set out our reasons for these recommendations below.

Role of the Board

The ultimate decision on remuneration structure and performance hurdles for the organisation should be left in the hands of the Board. It is the Board that is in the best position to determine what is appropriate in the company's circumstances, and it is the Board that should be, and will be held accountable over time.

Boards have the responsibility of setting the strategic direction of a company and are privy to significant confidential information about the company, its future direction and specific key milestones that need to be achieved. Equally relevant is that the Board is required to know and deal with the company's most senior executives and to compensate them for the performance of their employment duties. This means that it is, and should be the Board's responsibility to:

- determine the composition and quantum of remuneration packages;
- set the performance hurdles and vesting period of short-term incentives ("STI") and long-term incentives ("LTI");
- assess the performance of executives against the objectives set for them; and
- communicate the remuneration package to shareholders – including guidance on the quantum of compensation that can be earned.

It is the directors of the Board who are in the best position to have a sufficient knowledge of the company's business strategies, objectives, its people and the markets in which it operates to conclude that the performance hurdles, for example, are appropriate.

Importantly, the Board should also be accountable for appropriately weighing up the company's risk horizons and setting the vesting period for variable pay accordingly. To prescribe that companies operating complex businesses should "simplify" their executive remuneration arrangements would be directly at odds with the standards for risk-adjusted variable pay that regulators such as APRA now require.

Both internal and external remuneration advisors seek to understand the requirements of the relevant position, the requirements of the organisation and the responsibilities of the employee to determine the most appropriate way in which to compensate the employee.

It is the responsibility of Board Remuneration Committees to understand the remuneration structure that is appropriate for their organisation. To achieve the necessary level of understanding, directors will seek to understand the merits of different structures that are used by other organisations.

Through this knowledge and experience, it is the directors of the Board who can best determine the appropriate and the most suitable mix of fixed remuneration, short term incentive and long term incentive.

It would not be appropriate to regulate the type of performance hurdles that can be used in remuneration arrangements as the key features, direction and drivers of each business are different. Regulation in this regard would undermine the ability of a company to compensate executives for achieving the key outcomes considered to drive the creation of shareholder wealth for each specific business, something that cannot be regulated. Regulation would limit the ability of the Board to recruit and retain the executive(s) who it considers is the best person to drive performance that will ultimately reward shareholders. If the Board fails in this responsibility, the shareholders have the ability to hold the directors accountable.

Difficulty and risk in simplification

The diversity and varying circumstances of companies and executives are such that it would not be appropriate to simplify and standardise incentive components. As companies grow and increase in complexity in all aspects, so too do the incentive components of their executive remuneration arrangements. As the global economy is developing at a fast pace and is increasing in complexity, it would be unsuitable to simplify executive remuneration in this environment. Institutional investors in complex businesses recognise that there will be some difficulty in determining whether a Board has set the correct and most appropriate amounts, forms and types of executive remuneration.

At the same time, Boards are seeking to better inform retail investors of the way in which they have structured the company's remuneration arrangements and their reasons for doing so.

There is no one right, or wrong way in which to compensate employees. It is necessary to have regard to all aspects of an employee's role to properly compensate them. While there continues to be calls for remuneration to be simplified it is the experience of many organisations that over-simplified remuneration arrangements lead to poor outcomes and inequities between employees. Simple remuneration arrangements will not necessarily align executive compensation with shareholder interests.

Non-financial performance hurdles

The Australian Prudential Regulation Authority ("APRA") executive remuneration standards and guidelines have gone a long way in regulating non-financial measures as part of performance-based remuneration. APRA requires financial institutions to have regard for such non-financial measures as management of staff and adherence to corporate values and displaying acceptable corporate citizenship.

As these requirements are part of a multitude of requirements companies must comply with, it will become even more difficult to regulate non-numeric/financial components of executive remuneration schemes.

Implications of deferred components

While we support the use of equity and deferred components of variable short-term and long-term incentives, we do not support a requirement or regulation for rules determining the percentages that variable pay should consist of these components.

Although the notion that prescribed amounts or percentages may assist with simplicity of incentive components, there is not one particular amount which can be applied fairly across all industries and all companies and will work effectively in Australia.

The European Union now requires that at regulated financial institutions, set percentages of an executive's variable remuneration be paid as deferred compensation. Such regulations should not be necessary in Australia, as Australia already has sound corporate governance principles and a robust regulatory framework. Australia does not need strict provisions in an attempt to discourage excessive risk-taking.

The risk with increasing the component of variable compensation that is deferred, and concurrently extending deferral periods, is that employees do not place any value on the deferred compensation. It therefore ceases to influence their behaviour, and can also give them more incentive to negotiate a higher fixed base remuneration. This will weaken the correlation between the interests of company executives and the interests of its shareholders.

As well as there not being a need for strict percentage requirements, such a move would undermine the power and influence the shareholders currently have in relation to remunerating their Board and executives. All remuneration increases for key management personnel must be voted on by shareholders and there is no evidence to suggest that this is a practice Australia should be moving away from.

Taxation

A contributing factor to the complexity of executive remuneration requirements comes in relation to the taxation of incentive components of variable remuneration.

Australia is the only country that taxes rights to acquire shares (or options) at the time of vesting rather than at the time of exercise of the rights. This has created many issues for start-up as well as larger companies that seek to construct the most appropriate equity compensation arrangements for the organisation.

Similarly, Australia is unique in taxing unvested equity awards at the time of termination of employment rather than on exercise or vesting at the end of the performance period.

These two aspects alone mean companies need to create arrangements that do not result in individuals being adversely and inequitably taxed. In this respect, taxation rules are leading to remuneration arrangements that are not reflective of good governance practices.

Recommendations

- **The remuneration setting framework should not be revised as a company's Board is best placed to appropriately determine remuneration levels and structures.**
- **There should be no regulation or legislation to simplify the incentive components of executive compensation arrangements. To do so would hamper Boards in setting arrangements that were suitably aligned to business performance and risks.**
- **The taxation of employee share schemes should be revised so that:**
    - **rights to acquire shares are taxed at the time they are exercised, and not at vesting;**
    - **termination of employment is not a taxing point.**

Appendix B

Remuneration reporting

We consider the most effective way to improve the readability of the remuneration report is to consolidate the multitude of statutory, regulatory and other requirements that must currently be taken into account by Boards in the preparation of the report.

Reporting entities in Australia that are compiling remuneration reports are required to prepare their remuneration reports in accordance with:

- the statutory requirements of the *Corporations Act 2001*; and
- Australian Accounting Standards set by the Australian Accounting Standards Board ("AASB") which follow from, and add to, International Financial Reporting Standards ("IFRS") set by the International Accounting Standards Board ("IASB").

The ASX Corporate Governance Principles, various investor association guidelines, proxy advisor guidelines and similar are neither statutory nor obligatory but, nevertheless, are sought to be followed by reporting entities.

KPMG considers that CAMAC should recommend there should only be one statutory set of requirements governing remuneration reports. The AASB should also be directed to remove any specific remuneration disclosures from Australian accounting standards, as this type of disclosure should be a public policy decision.

Current status of section 300A of the Corporations Act

KPMG considers that CAMAC should initiate a complete re-write of section 300A of the *Corporations Act 2001*. The disclosure requirement should be principles-based, with the objective of disclosing to shareholders the principles and policies followed by the entity in setting remuneration for key management personnel, and the nature and extent of remuneration transactions that have occurred in the reporting period.

The starting point for such a re-write should be the principles in AASB 124 and should involve the input of Treasury, the ASX Corporate Governance Council and investor associations. This would enable there to be one comprehensive set of requirements that fulfil the information needs of users so they can make appropriate investment decisions.

This would ensure that the myriad of overlapping recommendations and requirements directors must have regard for when preparing remuneration reports are distilled into a clear and concise set of principles-based requirements. This is likely to make remuneration reports more concise and more useful for the end user, as well as reduce the administrative effort of producing the report.

We believe that the overlapping and sometimes conflicting requirements of regulators and current legislation combine to generate inefficiency and complexity in the reporting process. This detracts from the policy intention of providing information which investors can readily understand. Having uniform, prescriptive rule-based requirements will not reduce the reporting complexity but, rather, lead to a potentially misleading view of remuneration structures.

Increasing the current requirement to satisfy the various ASX Corporate Governance Principles, *Corporations Act 2001* obligations and the Australian Accounting Standards along with the new APRA guidelines and the addition of the Productivity Commission recommendations will increase the length and complexity of the remuneration report, add to the cost of producing the report, and yet probably detract from its ability to be readily understood by investors. This would not occur if all information was consolidated and reported in simple terms.

Reporting in simple terms

We recommend that reporting entities should disclose the monetary value of remuneration components (eg fixed base, short-term, long-term and share-based payments) only for the individual directors (including executive directors and the CEO). Disclosing the monetary value does not necessarily mean that only actual values, or only amortised values should be disclosed, but just the values in simple terms that are relevant for shareholders.

Companies should inform shareholders about the extent to which the pay of senior executives is fixed or variable based on short-term or long-term performance. The company should be required to disclose the make-up of these individuals' pay by describing the percentage that is fixed, short-term variable or long-term variable (including the performance criteria that apply to variable pay elements).

How to disclose the value of incentive components

The outcome of attempting to satisfy all of the myriad of principles governing disclosure is often a remuneration report consisting of what can be 20 pages or more detailing all components of the remuneration framework of the company. This information can be difficult to interpret and in many cases seems repetitive.

What further complicates matters is the value ascribed to the non-cash elements of remuneration detailed in the remuneration report.

Section 300A of the Act requires the details of each remuneration element paid or payable for services rendered be discussed in the prescribed format. This means that the cash salary paid to the executive is often disclosed in the same table as the proportion of the value of LTI previously granted to the executive but attributable to the relevant year. The actual value of salary and annual cash bonus is easy to determine, while the actual value of the STI and LTI often cannot be known with certainty until the instrument has vested (and if relevant, disposal restrictions have lapsed). This detail is neither useful nor necessary for the shareholder.

As a result of these existing disclosure requirements, it is common for this estimate of LTI value to be misunderstood by investors and commentators as being the actual value received by the executive. These arduous and strict provisions do not make remuneration reports easier or simpler for shareholders to read and interpret.

The issues around disclosing "actual" pay

Many commentators have suggested that remuneration reports would be easier to understand if they disclosed *"actual"* pay, or pay that was *"realised"* during the year. While this may appear to give a clearer picture than annual amortisation of deferred values, it will become increasingly the case that the pay *realised* during a year is the product of service and performance over varying periods covering more than just that particular year. Such *'actual'* disclosure may, therefore, be equally prone to misinterpretation.

The Remuneration Report could instead simply cease to include values for share based payments because such values rarely represent what, if anything, is ultimately received by the executive. Rather, the Remuneration Report could disclose the number of securities the entity has granted and subsequently allowed to vest for each relevant individual, and a description of the performance hurdles governing them. Investors and analysts could then form their own view of the potential value of the instruments from time to time during the performance period, without the distraction of either the accounting expense for the share-based payment which would often have its basis in the grant date value, or of the share value at vesting which would not be reflective of factors that were known at the time of the grant.

KPMG supports the principle of having Remuneration Reports that are readily understood by investors and clearly articulate the policies applied by a Board in determining how to remunerate, and the nature and extent of remuneration provided to executives.

Non-binding shareholder vote on the Remuneration Report

The Productivity Commission has recommended that the accountability of the Board to shareholders on executive pay matters can become stronger where there is a mandatory vote on directors being required to stand for re-election if there is a significant vote against the Remuneration Report in consecutive years.

If the Federal Government acts on this recommendation, it will become very important for Remuneration Reports to clearly identify those elements of remuneration that are the result of decisions that the Board has made during or immediately after the reporting period.

It is these elements that shareholders should focus on when considering whether they should vote in favour of the report. Other disclosed elements of compensation (such as actual payment of deferred bonuses, or amortisation thereof) are the result of decisions that the Board has made in previous years, *and which the shareholders have already had the opportunity to vote on.*

It would not be a correct reflection of the Productivity Commission's recommendations if shareholders were to vote on the content of a Remuneration Report that contains the deferred elements of pay that was granted two years earlier and voted on by the shareholders at that time.

Recommendations

- **There should be one unified statutory set of requirements (in s 300A of the Corporations Act) governing remuneration reports.**
- **These requirements should not be so prescriptive as to dictate exactly what amounts should be included, other than mandating reporting in simple terms for the benefit of the shareholders.**
- **There should be a requirement for the Board's pay decisions taken during or immediately after the reporting period to be identified separately from elements of disclosed pay that are a consequence of deferred or multi-year remuneration granted in previous years, and on which the shareholders have already had the opportunity to vote at the time of grant.**

UniSuper

23 August 2010

Mr John Kluver

BY EMAIL: john.kluver@camac.gov.au

Dear John

CAMAC Inquiry – Executive Remuneration

UniSuper is one of Australia's largest and longest-standing industry superannuation funds and is dedicated to those who work in Australia's higher education and research sector. UniSuper represents more than 435,000 members Australia-wide and has assets under management of approximately $26 billion (as at 30 June 2010).

UniSuper is committed to being an active shareowner and has voted its proxies since 2004. In addition, we seek to actively engage with investee companies. Relevantly, issues pertaining to executive remuneration are of key importance to UniSuper as an institutional investor and as a fiduciary acting in our members' best interests.

We endorse the submission that is being made to CAMAC by the Australian Council of Superannuation Investors. However, there are four items that UniSuper would like to specifically highlight for consideration by CAMAC:

1. We believe there needs to be greater clarity regarding short term incentives (STI). However, we do not believe that a company should be required to provide an exhaustive list of all STI performance conditions, the satisfaction of which will result in payment of 100% of the STI. This is because it could lead to CEOs and other senior executives 'gaming the system'. In our view, it would be useful if a statement was made in the remuneration report to the effect that *"A number of matters were taken into account, and these include x, y and z, among others"*. That is, some specific targets and requirements should be disclosed (beyond the generic statements many companies make) but not all of them. Thus, a fine balance needs to be struck in ensuring greater transparency whilst avoiding a moral hazard.

2. At times, there can be a lack of clarity regarding precisely what an executive must do to achieve 100% of their long term incentive (LTI). We believe it would be useful if companies were required to clearly and precisely disclose what it was that an executive had to do to achieve 100% of their LTI.

3. We believe it would be useful if termination arrangements were clearly disclosed *ex-ante*. Thus, if a termination does occur, investors can then compare what the payment actually was against what was initially proposed.

Fund: UniSuper
ABN 91 385 943 850

Trustee: UniSuper Limited
ABN 54 006 027 121

Administrator: UniSuper Management Pty Ltd
ABN 91 006 961 799
Australian Financial Services Licence No. 235907

Head Office
Level 37, 385 Bourke Street
Melbourne VIC 3000

Telephone 03 9910 6100
Facsimile 03 9910 6141

www.unisuper.com.au

4. We are supportive of efforts to provide a 'plain English' overview of remuneration practices. However, it is important to ensure that remuneration reports are not unduly simplified. We do not support efforts to reduce complexity that would result in the removal of important details (albeit complex) from remuneration reports.

We appreciate the opportunity to make this submission and hope that it is of assistance. Please do not hesitate to contact me should you have any questions or wish to discuss this further.

Yours sincerely

Talieh Bentley
Manager, Governance and Sustainable Investment

24 August 2010

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

CAMAC REVIEW - EXECUTIVE REMUNERATION (SIMPLIFICATION OF REPORTING AND OF INCENTIVE STRUCTURES)

On behalf of the Board of Directors of Origin Energy I welcome the opportunity to provide a submission to the review on executive remuneration matters that your Committee is undertaking at the request of the Minister for Financial Services, Superannuation and Corporate Law.

The Minister has requested CAMAC to advise on two separate matters:

(1) Appropriate changes that would reduce the regulatory complexity applying to remuneration reporting and to make that reporting more effective in meeting stakeholder requirements; and

(2) Legislative changes that would simplify the incentive components of executive remuneration.

Our submission will address the matters in that order.

However, by way of preface, we refer to the final report of the Productivity Commission's 2009 Inquiry into Executive Remuneration (as identified in your July 2010 Information Paper). This landmark review concluded that it was a key function of Boards to set appropriate executive remuneration for their corporations and noted that, in a global context, Australian boards and Australian corporations have managed executive remuneration relatively well.

The Commission's Recommendation 8, which has led to the Minister's first reference above, identified the need for an expert panel to formulate guidelines for the simplification of remuneration reporting.

The Commission, soundly, did not make a recommendation for legislation to simplify or regulate incentive structures themselves. For the reasons provided below, we have significant concern that regulation in this area will be counterproductive and will hamper boards from devising appropriate remuneration for their particular circumstances and time. We do, however, see some areas in which the Corporations Act and related regulation should be amended so that incentive structures can be simpler and more effective and lead to greater linkage between pay and performance, in turn making reporting of that remuneration more meaningful.

Also by way of preface, a key principle underpinning our submission is that different industries, different sectors, companies with different levels of complexity, and companies at different points in their evolution, all have different requirements to exact from their remuneration systems and strategies. There are risks to Australian productivity and competitiveness if companies are to be constrained by excessive regulation into a "one-size-fits-all" approach to remuneration. This could result, for example, if regulatory thrusts are designed around features observed in the finance sector, and then applied to other sectors without an understanding of their different operational and strategic circumstances and requirements.

1 Reducing remuneration reporting complexity and making it more effective

The guiding principles around the disclosure arrangements for remuneration reports should be:

- Disclosures are designed to enable stakeholders to assess the remuneration strategy and outcome in the context of the company's operational situation and its performance. Rather than a goal of simplification for its own sake, the goals should be defined in terms of three fundamental aims - relevance, understandability and transparency (a "true and fair view").

- The disclosures be regulated from one source (Corporations Act) rather than the multiplicity of accounting standards regulations that currently affect it.

- Given that the government has accepted the Productivity Commission's Recommendation 15 (boards will ultimately stand or fall on the voting of their Remuneration Reports) a guiding principle should be that boards should have sufficient flexibility to present their reports in the manner that allows them to best explain the way they have designed and managed remuneration arrangements and linked them to strategy. There is a need to reduce the current level of rigidity and prescription applying to Remuneration Reports.

It is important to note that remuneration matters are complex and that reporting of them has been subject to increasingly overlapping and complex regulation over time. The starting point for simplification should be the removal of irrelevant and overlapping regulation, including the removal of remuneration data based on accounting standards (such data should be in the Financial Statements rather than the Remuneration Report). In particular:

- We note that the Productivity Commission's Recommendation 9 (removing the requirement for 'Top 5' disclosure) has commenced this process. The 'Top 5' is an example of duplicative and unnecessary reporting and the Recommendation should be implemented.

- The tabular requirements for detailed disclosure of Key Management Personnel should be made more flexible so that the disclosures relate to the way the company manages remuneration. Current requirements create a disconnect between the data presented and with the aims of the report itself (which are to explain the connection between remuneration and performance). For example, the current framework leads to companies separating out post employment benefits such as superannuation, or specific components such as employee benefits, when many companies in fact manage their remuneration on a fixed package basis (where the executive can adjust components such as superannuation, cash or benefits provided that the total cost to the company remains the same). The remuneration table is currently needlessly complicated because it reflects changing decisions that individuals have made within their packages rather than focusing on the total that is being managed.

- Incentive payments may be unrelated to the performance period being reported because of the requirement to use accounting standards. The use of accounting standards mask the lags between the performance that created the reward and the deferred receipt thereof. In response to the desire to report "actual" remuneration, the challenge is to recognise that the actual payment received in one financial year from equity plans may include deferred remuneration from prior years. The best way of presenting the board's award of remuneration to an executive during a year is to disclose the value of all pay **awarded** that year. For equity this means the fair value of allocated value in that year. This is the number by which both the board and the executive value annual remuneration. Any disclosure of the "full picture" of delivered results from deferred pay arrangements over multi-year periods, if disclosed at all, should be separately tabulated to make it clear that it includes deferred remuneration from prior years and that it may represent double-counting with the annual disclosure described above. The value reported to the ATO on vesting is the obvious choice to disclose in the "vested value and deferred remuneration" context, though our submission is that the annual award value is the only necessary disclosure.

- The requirement to provide a section on corporate performance within the remuneration report itself is duplicative and unnecessary. The requirements to discuss the relationship between corporate performance and the remuneration policy are sufficient.

By way of concluding comments on the Reporting issue, it is important that the desire to strive for brief and "plain English" does not leads to a "plain vanilla" approach to remuneration. This could lead to ever greater homogeneity of executive pay, and less willingness by boards to adopt innovative approaches to create the best arrangements to suit the individual organization. Boards must be and feel free to manage remuneration without fear of having to conform to short term fashion or trends, or without fear of experimentation with new approaches that may take more than one cycle to demonstrate value.

While some organisations may find it helpful to produce short or concise versions of their remuneration reports, designed perhaps for retail investors, and keep the fuller versions for reference to suit institutional investors, such separation should not be mandated. It is again a matter for what suits the organisation best, and a judgement of the board as to how to make communications with shareholders most effective.

2 Simplifying incentive arrangements through legislative change

In approaching the issue of whether legislative changes are appropriate in terms of regulating incentive arrangements themselves, the concluding comments above are repeated. It is important that regulatory constraint does not prevent boards from designing arrangements that best suit the circumstances of their corporations.

There is a distinct risk that over-regulation of remuneration simply puts pressure on replacing incentive or variable pay with fixed or guaranteed pay, and pressure on replacing deferred pay with advance or up-front pay. Both trends are counter to the direction of remuneration governance.

We are already seeing these trends emerge in response to the 2009 changes by the government on employee equity schemes and termination payments legislation.

In a short-skilled competitive market, especially where corporations need to look overseas for specialist talent, prospective candidates are less inclined to accept variable pay arrangements because of the additional risks they now carry. Increasingly they seek to substitute variable or deferred pay with lower-risk fixed or up-front pay. There is less willingness to have 'skin in the game' and the pressures serve to escalate (fixed) salaries generally. The fixed cost of employment rises and the ability of corporations to incentivate is diminished.

Direct regulation around the incentive arrangements reduces the capacity for boards to design remuneration that is tailored to their industry and circumstances. It inevitably leads to a one-size-fits-all approach. Boards will become increasingly risk-averse to experimentation to find solutions that work best to align their remuneration strategy with their corporate strategy.

In terms of regulation, there is also a risk that those entities governed by the regulation will be disadvantaged in the highly competitive international market by the adoption of standardised remuneration policies developed to meet the requirements of minority and unsophisticated shareholders rather than developed to create value through alignment with the corporations's strategic direction and requirements. Working for a large listed Australian company should not require employees to accept disadvantage or sacrifice compared to comparable positions with unlisted, overseas or private competitors. It is not in the interests of the Australian investor base or the economy as a whole for listed employers to be handicapped in attracting and retaining talent.

It is important to acknowledge that the complexity of incentive arrangements is partly a response to the complexity of the taxation arrangements that govern them. Genuine reform and simplification of incentive arrangements requires that the taxation arrangements be simplified.

For example, the Productivity Commission's Recommendation 13 was to remove cessation of employment as a taxing point for equities or rights that qualify for tax deferral and are subject to risk of forfeiture. This recommendation should be implemented as a matter of priority. In its initial response to this recommendation the government advocated addressing the problems associated with this provision by accelerated or partial vesting or other special compensation in Plan Rules. The result of this approach is to encourage short-term behaviours and short-term focus, which is at odds with the direction of corporate governance. Further, it drives complexity in incentive structures and it diminishes the attractiveness of them to executives. It is another feature of the regulatory framework that puts additional pressure on the provision of guaranteed or fixed pay. The government's suggestion of using partial or accelerated vesting to address a widely acknowledged problem is inconsistent with the punitive stance it has taken on accelerated vesting in the Termination Payments legislation that it introduced during 2009.

The Australian Prudential and Supervision Authority has made similar recommendations concerning the removal of cessation of employment as a taxing point.

Action on Recommendation 13 is the single most important reform that should be made in order to simplify and make incentive arrangements more effective.

Another area for priority is the current Termination Payments legislation. In particular the limit of one times base salary, excluding variable pay altogether, is so low that it acts as a powerful driver in pushing up the level of fixed pay and complicating the structure of overall remuneration arrangements. The limit should be raised and it should take into account the annual remuneration amount rather than the fixed base salary component.

Conclusion

The focus of review on legislative arrangements affecting executive remuneration should be to remove constraints (such as cessation of employment as a taxing point, and the excessively low cap in Termination Payments legislation) and to remove duplication, rather than to attempt to regulate the arrangements themselves.

Increased or prescriptive regulation of incentive arrangements is likely to continue the trends that are already occurring to increasing pressure on fixed pay at the expense of deferred pay, and it will reduce the flexibility of boards to determine the remuneration arrangements that would maximise their corporations' performance. The risks created and unintended consequences that flow from excessive regulation have the potential to diminish not just the performance of individual corporations, but the Australian economy and its productivity overall.

Please do not hesitate to contact me if you wish to discuss any of these matters in more detail.

Trevor Bourne
Chairman
Remuneration Committee
(02) 8345 5435

31 August 2010

Attention: Mr John Kluver
Executive Director
Corporate and Markets Advisory Committee

By Email: john.kluver@camac.gov.au

Executive Remuneration Review

The Australian Council of Superannuation Investors (ACSI) is pleased to provide the following submission to the Corporations and Markets Advisory Committee (CAMAC) following the request from the Hon. Minister Chris Bowen MP for CAMAC to examine the reporting requirements contained in section 300A of the Corporations Act and related regulations. We note that CAMAC has been specifically requested to:

- Examine the existing reporting requirements contained in section 300A of the Corporations Act and related regulations and identify areas where the legislation could be revised in order to reduce its complexity and more effectively meet the needs of shareholders and companies;
- Make recommendations on how best to revise the legislative architecture to simplify the incentive components of executive remuneration arrangements;
- Examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements; and
- Make recommendations on how best to revise the legislative architecture to simplify the incentive components of executive remuneration arrangements.

ACSI represents the interests of 39 superannuation funds who collectively manage over $250 billion in retirement savings. ACSI provides its members with advice and information on the impact of corporate governance, environmental and social issues on the long term performance of investee companies. On behalf of its members, ACSI discusses these issues with Australia's largest listed companies.

The work ACSI undertakes on behalf of its member funds includes:

- Providing advice to members on the governance practices of listed companies;
- Proxy voting services to assist super funds to exercise their voting rights effectively;
- Engagement with listed companies to improve governance practices;
- Commissioning and producing research on key governance issues; and
- Publicly advocating for improved governance practices, including the promotion of effective legislative and regulatory regimes.

ACSI's interest in the remuneration of directors and CEO's and other Key Management Personnel (KMP's) in listed companies arises from:

- A desire to ensure that boards have in place adequate remuneration mechanisms to motivate CEO's and KMP's to achieve desired behaviours and performance outcomes in the interests of shareholders.
- The view that remuneration provides one of the few visible proxies for shareholders to gain insight into whether boards are exercising effective control and monitoring company executives.
- Recognition of the contribution of non-executive directors for their governance oversight responsibilities.
- The fact that CEO's and senior executives influence the direction of companies, which ultimately affects shareholder returns over the long-term.
- The view that in some cases, poorly designed remuneration structures can contribute to short-termism or excessive risk taking by company executives.

The detail and substance of what is disclosed in a remuneration report is essential for investors to review a company's governance practices, to engage with companies in an informed manner and to determine their vote on a remuneration report. ACSI believes that the introduction of the non-binding vote on remuneration reports in 2005 has been conducive to fostering improved engagement between companies and shareholders on remuneration and corporate governance issues.

Over the past 9 years ACSI has had extensive experience engaging with S&P/ASX200 company boards, and providing advice to its members, on executive remuneration issues. More particularly, ACSI has advised its members on the non-binding remuneration report vote since its introduction in 2005. This experience has meant that we have read, interpreted, engaged on and made recommendations on the contents of a countless number of remuneration reports. Drawing on this experience, ACSI welcomes the opportunity to make the following observations to CAMAC on how current legislative requirements could be revised to reduce complexity and more effectively meet the needs of shareholders:

1. The perceived 'complexity' of remuneration reports is not a product of current reporting requirements. Perceived complexity is often reflective of complex remuneration arrangements designed by listed company boards. ACSI supports the preparation of concise or 'plain English' summaries of remuneration policies, however, efforts to reduce complexity should not result in the removal of important detail from remuneration reports.

2. In ACSI's experience, the majority of listed companies do not meet the requirement of s300A (1)(ba)(i) of the Corporations Act to provide a 'detailed summary' of performance conditions when reporting short term incentives. Clarifying, enforcing and improving compliance with this legislative requirement would significantly improve the quality of remuneration disclosures.

3. ACSI notes that institutional investors understand the difference between fair value estimates of share-based remuneration and the realised value of remuneration received by company executives. ACSI therefore recommends that no change be made to current reporting requirements relating to the disclosure of share-based payments to company executives. Reporting the realised or actual value of share-based payments received by company executives, or total realisable remuneration, is consistent with current legislative reporting requirements. Including aggregate 'realisable remuneration' or 'actual values' of share-based payments received in remuneration reports may be useful when reporting summary remuneration outcomes but should not replace current reporting requirements.

4. ACSI notes that there is often a discrepancy between contractual termination entitlements disclosed under s300A(1)(e)(vii) and the payments actually received by executives. ACSI therefore supports the introduction of a requirement for companies to report the maximum value of termination pay on an *ex ante* basis which would allow investors to compare estimated termination benefits with actual termination benefits received. ACSI also recommends that companies be required to disclose the contractual provisions that gave rise to the relevant termination or retirement payment, at the time the payment is made, as another way in which s300A could be amended to more effectively meet the needs of shareholders.

5. ACSI recommends CAMAC reject submissions calling for an increase in the threshold requiring companies to seek shareholder approval for executive termination payments included in ss200AA-J of the Corporations Act.

6. Simplifying the incentive components of executive remuneration arrangements through the 'legislative architecture' is difficult without imposing prescriptive requirements. ACSI believes that company boards are best placed to create remuneration structures which may be simple or complex depending on the objectives of the company. ACSI is therefore opposed to the introduction of prescriptive legal or regulatory arrangements aimed at simplifying the components of executive remuneration.

7. If it is thought that the 'remuneration setting framework' should provide more guidance on remuneration practices, outside of prescriptive legal requirements, ACSI suggests that guidance and 'if not, why not' recommendations could be produced by the ASX Corporate Governance Council to indicate what is considered 'good practice'.

1. Reducing complexity in remuneration reports

ACSI contends that a 'dual method' of presenting information contained in a remuneration report is one way to reduce perceptions of complexity. A 'dual method' of reporting would include the preparation of a concise or 'plain English' summary of remuneration practices coupled with the more detailed presentation of relevant details required by the Corporations Act and relevant regulations.

A threshold question is – for what audience are remuneration reports prepared? The perception of complexity for institutional investors may be very different to a reader with low financial literacy. ACSI notes that perceptions of complexity in reporting are often reflective of the complex remuneration arrangements designed by listed company boards rather than legislative reporting requirements. The financial statements of a listed company would appear complex to the average reader but few would recommend that complex financial details be removed from company reports simply to improve readability. ACSI does not support efforts to reduce complexity which would result in the removal of important detail from remuneration reports.

ACSI notes that 'plain English' summaries of remuneration practices may reduce the perception of complexity amongst some investors. ACSI is supportive of the efforts of companies to provide a 'plain English' overview of remuneration practises, such an approach may include:

- Remuneration objectives, in particular the link between incentives and company strategy and performance objectives;
- Explanation on the alignment of remuneration arrangements with shareholder interests;
- Rationale for fixed pay levels complemented with explanations for movements in fixed pay for executives;
- A detailed summary of performance requirements for short term and long term incentives; and
- Termination payment arrangements which are applicable.

Since the introduction of the non-binding vote on remuneration reports in 2005, ACSI has encouraged listed companies to improve their narrative approach to reporting by striking a balance between meeting legislative reporting requirements and providing explanations for why specific remuneration arrangements have been employed. We note that a narrative approach to reporting, and the preparation of a 'plain English' summary of remuneration practices, are not precluded by the existing provisions of s300A of the Corporations Act.

As noted in detail below, ACSI supports current reporting requirements and the provision of detailed information in remuneration reports. ACSI also notes that some remuneration reports are complex, but such complexity largely reflects the nature of the remuneration arrangements endorsed by company boards that are considered appropriate depending on the objectives of the company.

Recommendation:
ACSI supports the disclosure of concise or 'plain English' summaries of remuneration practices where they are complemented by the provision of a more detailed account of remuneration arrangements. The disclosure of detailed remuneration arrangements is an essential requirement for institutional shareholders to evaluate remuneration reports.

2. Short term incentive ('STI') disclosures

In examining the existing reporting requirements contained in section 300A of the Corporations Act, ACSI recommends that CAMAC consider the requirements of ss300A(1)(ba)(i-iii) for listed companies to provide information on performance conditions where an element of executive remuneration is performance based. ACSI notes that the disclosures provided by a significant number of companies do not meet the requirements of ss300A(1)(ba). Where an element of the remuneration of a member of the key management personnel is dependent on the satisfaction of a performance condition, companies must disclose:

- a detailed summary of the performance condition[1];
- an explanation of why the performance condition was chosen[2];
- a summary of the methods used in assessing whether the performance condition is satisfied and an explanation of why those methods were chosen[3]; and
- if the performance condition involves a comparison with factors external to the company, a summary of the factors used in making the comparison including relevant comparator group of companies if relevant[4].

We note that among the submissions made to the Productivity Commission's inquiry, several groups noted widespread non-compliance with the requirement for companies to provide a 'detailed summary' of performance conditions under s300A.[5] The Productivity Commission's own research demonstrated that 'in 2007-08, only one of the top 20 companies disclosed the actual performance hurdle for payment of (some) short-term incentives[6]' and remuneration reports 'provide little, if any, information about short-term incentive hurdles, which are more likely to relate to internal and, therefore, commercially sensitive, indicators'[7].

Recent research conducted by ACSI into the reporting of short term incentives in S&P/ASX50 companies indicates that only 21% of the remuneration reports prepared by S&P/ASX50 companies in 2009 appear to

---

[1]Corporations Act, s300A(1)(ba)(i).
[2]Ibid, s300A(1)(ba)(ii).
[3]Ibid, s300A(1)(ba)(iii).
[4]Ibid, s300A(1)(ba)(iv)(A).
[5] See, for example, ACSI, Submission No 71 to Productivity Commission, *Executive Remuneration Inquiry*, 6 June 2009, p8;
Egan Associates, Submission No 105 to Productivity Commission, *Executive Remuneration Inquiry*, 14 September 2009, p19;
RiskMetrics, Submission No 58 to Productivity Commission, *Executive Remuneration Inquiry*, 25 September 2009, p12; and
Guerdon Associates and CGI Glass Lewis, Submission 80 to Productivity Commission, *Executive Remuneration Inquiry*, 10 June 2009, p8.
[6]Productivity Commission, *Executive Remuneration in Australia, Final report No.49* (2009), Table 7.4, p204.
[7]Ibid, p375.

comply with statutory requirements to disclose a 'detailed summary' of performance conditions where remuneration is performance based. These findings are in line with research provided by remuneration consultancy firm Guerdon Associates which indicates that fewer than 20% of ASX 300 companies comply with s300A reporting requirements.[8] Proof that non-compliance with these standards is not a new phenomenon; Guerdon Associates' best estimates are partly based on research into the reporting practices of the S&P/ASX50 for the 2006 year.[9]

Commercially Sensitive Information

ACSI is aware of concerns around the disclosure of commercially sensitive performance hurdles, specifically where companies would have to disclose commercially sensitive forward-looking profit or earnings targets. While we acknowledge the issue of commercial sensitivity, this does not appear to be an impediment for two reasons. Firstly, the reporting requirements included in ss300A(1)(ba)(i-iii) are retrospective and the remuneration reports of listed companies reflect performance over the previous financial year. Secondly, the requirements ss300A(1)(ba)(i-iii) do not appear to require disclosure of specific forward-looking performance hurdles or targets, or the minutiae of STI results for each senior executive. We also note that the current wording of s300A appears to provide what the Productivity Commission defined as 'ample scope[10]' for companies to summarise performance requirements without disclosing commercially sensitive details.

Current STI Reporting Practices

ACSI notes that a significant proportion of companies provide STI disclosures which include general statements such as 'short term incentives were determined with regard to a range of financial and non-financial measures determined by the board'. Another defining feature of many remuneration reports is the lack of STI performance metrics or 'detailed summaries' of performance conditions. Often disclosures provide a grab-bag of general performance areas without an indication of any performance measures used, or the proportion of STI attributable to each performance measure or outcome. Two examples of this type of disclosure are:

> 'At the commencement of each financial year the Board approves the Managing Director's performance objectives and ensures that they are consistent with Board approved corporate objectives… Performance objectives include a blend of financial, corporate and individual objectives and typically include targets in relation to contribution to earnings, the successful implementation of strategic initiatives, management of operating expenses, customer service, risk management, market share and portfolio management[11]'

And;

> A range of Company performance measures is used in order to drive balanced business performance. These measures include lagging indicators to assess the Company's past performance, as well as forward-looking indicators to ensure the Company is positioning itself effectively for future growth. The areas covered by the measures include reserve growth, reserve replacement cost, production, margin, new growth options, shareholder value creation, people, environment, health and safety, and continuous improvement[12].

These examples demonstrate the difficulty for shareholders in assessing how STI bonus outcomes are arrived at based on the information disclosed in remuneration reports. ACSI's view is that providing an exhaustive list of performance conditions (which may or may not have a connection to STI outcomes) does not meet the needs of shareholders and contributes to 'complexity' in remuneration reports. Simple, retrospective disclose of short term incentive conditions would reduce complexity in remuneration reports and improve the level of detail provided to shareholders.

Options for reform and policy implications

ACSI notes that despite having been put in place six years ago, regulators and policymakers have not clarified the requirements of s300A(1)(ba). A simple action which would improve compliance with this provision would be to have ASIC clarify and produce guidance for listed companies on these disclosure requirements. It has been noted elsewhere that having ASIC clarify and enforce remuneration reporting requirements is not without precedent.[13] One example occurred in 2004, where ASIC provided guidelines on valuing options in annual directors' reports which where later integrated in the *Corporations Act*[14]. Research undertaken elsewhere with

---

[8]Guerdon Associates and CGI Glass Lewis, Submission 80 to Productivity Commission, *Executive Remuneration Inquiry*, 10 June 2009, p58.
[9]Guerdon Associates, *Disclosures and Compliance – What Compliance?* (June 2007) <http://www.guerdonassociates.com/News-Detail.asp?cid=69&navID=4&NewsID=179>.
[10]Productivity Commission, *Executive Remuneration in Australia, Final report No.49* (2009), p375.
[11] CSL Limited, *Annual Report 2009*, p43.
[12] Santos Limited, *Annual Report 2009*, p59.
[13] See, for example, RiskMetrics, Submission No 58 to Productivity Commission, *Executive Remuneration Inquiry*, 25 September 2009, 12.
[14]Ibid. See ASIC, *Information Release 05-42 Changes to ASIC class orders, practice notes and guidelines relating to new financial reporting requirements*, (27 July 2005) <http://www.asic.gov.au/asic/asic.nsf/byheadline/03-202+Valuing+options+for+directors+and+executives+?openDocument>

regard to continuous disclosure provisions has shown a link between ASIC enforcement activity and increased levels of compliance by listed companies[15].

ACSI notes that current reporting practices pose significant barriers to the introduction of the Government's 'clawback' proposal announced in response to the recommendations of the Productivity Commission. This proposal would introduce a clawback of executive bonuses where it is revealed that financial statements are materially misstated.[16] The clawback proposal is aimed at increasing the ability for shareholders to recover 'overpaid bonus amounts' from directors and executives based on the premise that they 'may have received larger bonuses as a result of the company's artificially high share price[17]'. ACSI notes that a significant majority of STI disclosures give no indication as to the proportion of an STI award which is attributable to specific performance conditions or outcomes. This means that it is virtually impossible to assess an 'overpaid bonus amount' as it cannot be determined what proportion of STI bonus outcomes were contingent on performance outcomes linked with misstated financial statements. The only option available would be to 'clawback' entire STI awards paid during periods where it is revealed that financial statements are materially misstated, even where bonuses may have been unrelated to the misstated financial results, such as outcomes linked to non-financial performance.

While noting that APRA's guidance and regulatory powers are separate from the remuneration reporting requirements of the Corporations Act, and are only applied to some listed financial institutions, ACSI notes that opaque disclosure of STI performance conditions amongst listed companies is inconsistent with the principles contained in APRA's Prudential Practice Guide on remuneration[18]. While there is extensive discussion of risk controls in the remuneration reports of many listed APRA regulated entities, there is a question of how these risk considerations translate into performance conditions. The disclosure of a detailed summary of STI performance conditions is therefore relevant to APRA's work in encouraging financial institutions to consider risk in executive remuneration structures[19].

Recommendation:
ACSI recommends that CAMAC review the operation of ss300A(1)(ba)(i-iii) in order to address the low level of compliance with these statutory reporting requirements, particularly where companies report short term incentives for senior executives. Such a review should reaffirm adherence to current legislative requirements, and encourage where possible the retrospective disclosure of STI performance conditions. ACSI notes that opaque disclosures give shareholders almost no indication of the performance conditions upon which short term incentive awards are based. ACSI believes that clarifying, enforcing and improving compliance with ss300A(1)(ba)(i-iii) would significantly improve remuneration disclosures and ensure remuneration reports continue to meet the needs of shareholders.

3. Remuneration tables and the disclosure of share-based payments

ACSI would like to comment on the current debate concerning the valuation and disclosure requirements relating to long term incentives, and specifically share-based payments. One argument put forward is that reporting should be confined to 'actual pay' as opposed to 'reporting theoretical accounting valuations of remuneration[20]'. We note that the current requirements for reporting long term incentives and share-based remuneration were well documented in the final report of the *Productivity Commission*.[21]

Observations on the disclosure of share-based payments

ACSI notes the problems with relying solely on the reported values of share based-payments granted to senior executives. Under the current regulatory framework, companies are required by accounting standard AASB 2 *Share-based Payment* to report on the estimated fair value of share-based incentives based on a range of accounting measures. These standards can give rise disclosures where there is a significant difference between reported and realised remuneration.

For example, the fair value of share options granted to a senior executive can be far below the 'actual' or realised value received by the executive when options are exercised. A recent example of 'undervaluation' were the 225,000 shares granted to BHP Billiton CEO Marius Kloppers on 3 December 2004, which vested in full in

---

[15] M Welsh, 'Continuous Disclosure: Testing the correspondence between state enforcement and compliance' (2009) 23 *Australian Journal of Corporate Law* 206.
[16] See Australian Government, *Response To the Productivity Commission's Inquiry on Executive Remuneration in Australia,* (April 2010), p17. <http://mfsscl.treasurer.gov.au/Ministers/ceba/Content/pressreleases/2010/attachments/033/033.pdf>.
[17] Ibid.
[18] Australian Prudential Regulatory Authority (APRA), *Prudential Practice Guide – PPG115 Remuneration*, 30 November 2009.
[19] Ibid.
[20] Australian Institute of Company Directors (AICD), *Position Paper No15: Remuneration Reports* (June 2010).
[21] See Productivity Commission, *Executive Remuneration in Australia*, *Final report No.49* (December 2009), pp259-261, 342-344, and Appendix E Valuing equity-based payments.

August 2009. The fair value given to the grant in 2005 was £2.63GBP per share[22] or a total of £591,750, the realised value at 12 August 2009 was £15.55[23] per share or a total of £3.499million – this is almost six times the fair value disclosed in 2005. We note that in this case BHP Billiton provided a comprehensive explanation of this difference to shareholders, reiterating the long-term performance conditions which were achieved allowing the grant to vest.

Another example of 'undervaluation' was at Suncorp-Metway Limited ('Suncorp') where the 247,920 shares granted to former CEO John Mulcahy in January 2003 vested on 5 January 2008. The fair value of the original grant was disclosed as $2.138 million 'assuming all performance criteria are met'.[24] The realised value of the 80% of shares which vested, as on the first trading day after 5 January 2008 was $4.029 million, almost twice the fair value disclosed in 2003[25].

Another example from Suncorp demonstrates the potential for fair value estimates to 'over report' share-based payments. When John Mulcahy departed Suncorp in 2009 he forfeited 227,261 zero exercise price options (ZEPO's) which had a previously disclosed fair value of $5.656 million.

The potential for the estimated fair value to either overstate or understate the realised value of incentives is something of which institutional investors are aware. As an organisation that provides corporate governance advice to its member superannuation funds, which includes making recommendations on the remuneration reports of S&P/ASX200 companies, ACSI has never made a recommendation based exclusively on a 'theoretical' or fair value estimation of share-based payments. We judge the remuneration reports prepared by listed companies based on the realised value of incentives paid to executives and the expected value of incentives which have been granted. Our main focus is on the appropriateness of performance conditions attached to share-based payments.

ACSI is unaware of any institutional investors, or proxy advisors, who would judge a company based on the fair value of long term incentives where options are clearly underwater and performance conditions have not been (or are unlikely to be) met. It appears that this concern has arisen in the current climate where, in some cases, fair value estimates 'over report' actual remuneration. ACSI is mindful that this concern has not been expressed during periods of growth where equity based remuneration were often under reported. The media misreporting fair value estimates as 'take home pay' is another justification provided for removing requirements to value equity-based remuneration[26]. The accuracy of media articles should not drive reform in remuneration reporting, as institutional investors do not judge remuneration reports based on media articles. It is not clear that adjusting current reporting requirements will deal with isolated cases of misreporting. For example, reporting of aggregated amounts of 'realisable remuneration' may be equally likely to lead to misreporting[27].

In ACSI's view, suggested amendments to current reporting requirements that limit disclosure of share-based payments to the 'actual value' when an employees remuneration crystallises, would reduce transparency[28]. This type of reporting could make remuneration reports extremely retrospective – with the value of long term incentives only being disclosed 3, 4 or 5 years *after* a grant date, if at all. It is ACSI's strong opinion that such proposals would create remuneration reports which would not meet the needs of shareholders who wish to vote and engage with companies on an informed basis.

Remuneration Tables

ACSI notes that several groups have proposed modifications to statutory remuneration tables. Whilst commendable in intent, we remain concerned that proposed changes could potentially make remuneration reports longer and more complex, without the provision of adequate detail for institutional shareholders. ACSI is concerned that proposed changes to introduce reporting of the 'actual value' of remuneration may serve to create more complexity and confusion for shareholders[29].

Ernst & Young have provided a suggested 'ideal' remuneration report[30]. This suggested framework would have companies report 'Equity incentive opportunities (expressed as a dollar value or a percentage of fixed remuneration with an explanation regarding how this is converted into a number of shares/rights/options)' in a section detailing a summary of each executive's remuneration opportunity for the year. In a separate section of the remuneration report, companies would report 'actual remuneration' including 'share-based payments that

---

[22] BHP Billiton Limited, *2005 Financial Report,* (August 2005), p70.
[23] Based on the BHP Billiton PLC share price on 12 August 2009. This does not include additional dividend accrual value.
[24] Suncorp-Metway Limited, *Annual Report 2006,* p45 noted in ACSI, *CEO Pay in the Top 100 Companies: 2009, (*Research report prepared by ISS Governance Services, July 2010).
[25] Suncorp-Metway Limited, *Annual Report 2007/08,* p17. The closing share price on 7 January 2008 was $16.25.
[26] See, for example, Ernst & Young, *Submission No 2 to the CAMAC Review on Executive Remuneration*, 13 August 2010, p3.
[27] Guerdon Associates, *Submission No to the CAMAC Review on Executive Remuneration*, 13 August 2010, p16.
[28] See, for example, Australian Institute of Company Directors (AICD), *Position Paper No15: Remuneration Reports* (June 2010).
[29] This point was noted by KPMG. KPMG, *Submission No 15 to the CAMAC Review on Executive Remuneration*, 23 August 2010, p9.
[30] Ernst & Young, *Submission No 2 to the CAMAC Review on Executive Remuneration*, 13 August 2010, p5.

vested during the year (i.e., where there is no longer a "real risk of forfeiture", although disposal restrictions may still apply)'. Depending on the detail of equity incentive opportunities, this framework for disclosure would still rely on fair value estimates of share-based remuneration but appears to limit disclosures to the share-based remuneration granted in the reporting year. It is unclear how this would improve current reporting requirements. ACSI notes that companies are already able to provide information on the 'realised' or 'actual' value of share-based payments received under the current legislative framework. Under the current framework, companies are also able to comment on the likelihood that the performance conditions attached to share-based remuneration will be met.

As noted in *Ernst & Young's* submission, the disclosure of the 'actual value' of share-based payments can create an appearance of a disconnect between performance and payment[31]. This is due to the fact that the 'actual value' of share-based payments that vest in a given year may reflect performance over a number of years. ACSI notes that this proposal could serve to increase the possibility of misinterpretation by shareholders and that reporting fair value and 'actual values' of share-based remuneration in separate sections of a remuneration report could also add to the complexity of remuneration reports, and may not provide greater clarity for shareholders. ACSI recognises that a number of companies already disclose the actual value of vested share-based remuneration received by executives under the current legislative reporting framework.[32]

Guerdon Associates have prepared a proposed amendment to the Corporations Regulations which includes the reporting of realisable remuneration and grants received[33]. These proposed amendments would mandate the reporting of two remuneration tables. The first table would record the 'realisable remuneration' received by senior executives during the reporting year. This approach appears to require reporting an aggregate amount of remuneration received including share-based payments realisable during the relevant year, fixed pay, short term incentives, and any termination benefit received during the year. The proposed amendment also requires the disclosure of a table of 'grants received' which appears to be very similar to current legislative reporting requirements – although the disclosure of long term incentives appears to be limited to fair value estimates for grants made during the relevant reporting period only.

Reporting 'realisable remuneration' or 'actual values' may be helpful for retail investors and other stakeholders, who may not understand the difference between fair value estimates of share-based payments and the actual value of share-based payments on vesting. As noted above, such disclosure is consistent with the current legislative reporting requirements. ACSI is concerned that adding to current disclosure requirements may create further complexity in reporting share-based remuneration. The preparation of two separate remuneration tables has the potential to create more confusion amongst investors, particularly where an aggregate amount of 'realisable remuneration' is reported in addition to a summary of grants received. In ACSI's opinion, it may be more difficult for retail investors to reconcile two separate tables of 'realisable remuneration' and 'grants received', than for investors to interpret current remuneration reporting tables.

ACSI asserts that there are no barriers in the current legislative framework for companies to report on 'actual remuneration' received during a reporting period and comment on the expected value of long term incentives including share-based payments. In ACSI's opinion, the valuation issues noted above do not warrant modifying current reporting requirements as institutional investors are able to make informed decisions based on the information which is currently included in remuneration reports taking into account fair value estimates, and the actual or realised value of share-based remuneration.

Recommendation:
Reporting the actual value of share-based payments received by company executives or total realisable remuneration is consistent with current legislative reporting requirements. We recognise that including aggregate 'realisable remuneration' or 'actual values' of share-based payments received in remuneration reports may be useful when reporting summary remuneration outcomes, this may be particularly useful for retail investors. In ACSI's opinion, such disclosures are unnecessary for institutional investors who are able to make informed judgments on share-based payments based on what is currently disclosed. ACSI recommends that no change be made to current reporting requirements relating to the disclosure of share-based payments to company executives.

4. Disclosure of termination arrangements

ACSI also notes several issues relating to the reporting of contractual termination entitlements for key management personnel required under s300A(1)(e)(vii) of the Corporations Act. In recent years we have noted

[31] Ernst & Young, *Submission No 2 to the CAMAC Review on Executive Remuneration*, 13 August 2010, p6.
[32] See, for example, Transfield Services Limited, *2009 Annual Report* (October 2009), pp50-60.
[33] Guerdon Associates, *Submission No to the CAMAC Review on Executive Remuneration*, 13 August 2010, p16.

that the payments received by executives on termination often do not reflect the previously disclosed termination payments provided for under the relevant executive's contract. Two recent examples are:

- **Downer EDI Ltd:** the disclosure of the termination payment received by outgoing CEO Geoffrey Knox, who resigned on 30 July 2010, noted that Knox was eligible to receive 243,103 shares on termination which were granted under the company's 2008 long term incentive scheme[35]. These long term incentives were never subject to shareholder approval and despite the requirements of s300A(1)(e)(vii), the treatment of these incentives was never disclosed by the company; and

- **Aristocrat Leisure Ltd:** where the former CFO, and executive director, Simon Kelly left the company on 31 July 2009. On termination Kelly received:
    - A bonus payment of $400,000 under a 'deed of release' in recognition of a 'prior contractual obligation' and 'retention arrangements'[36].
    - A further bonus of $120,723 for the part of the 2009 financial year served reflecting the "bonus he would have been entitled to in 2009 if his employment had continued for the full year" reduced to reflect the portion of the year served[37].
    - Termination payments of $1.13 million[38].

  Kelly's total termination payments were therefore $1.65 million (more than 1 percent of Aristocrat's 2009 operating cash flow) and more than twice Kelly's reported remuneration for the 2008 year. This payment appeared to be in excess of contractual termination entitlements disclosed in the 2008 remuneration report which allowed for a notice period of three months, or payment in lieu, and a termination payment equivalent to nine months' remuneration[39]. The report did not disclose any entitlement to retention payments or a bonus on termination.

These examples highlight the gap between contractual entitlements disclosed under s300A(1)(e)(vii) and the actual termination payments received by departing executives. Another related issue is that according to information disclosed to the ASX, very few senior executives are terminated. In many cases, the resignation[40] or mutually agreed termination[41] of executives also trigger termination entitlements which may have little connection with the contractual termination entitlements reported under s300A(1)(e)(vii). The amendment of s200AA-J requiring shareholder approval for termination entitlements that exceed one year's base salary should serve to improve transparency in cases where termination entitlements are put to a shareholder vote. However, we note that this provision does not apply to pre-existing contracts and even where contracts are approved by shareholders there may still be discrepancies between disclosed remuneration entitlements and actual remuneration received by executives on termination.

The cases noted above show the potential for discrepancy between contractual termination entitlements disclosed under s300A(1)(e)(vii) and the payments actually received by executives. CAMAC may wish to consider the current operation of s300A(1)(e)(vii) as part of its review. ACSI is supportive of proposals to improve the transparency around termination entitlements. Requiring companies to disclose the contractual provisions that gave rise to the relevant termination or retirement payment, at the time the payment is made, is one way in which s300A could be amended to more effectively meet the needs of shareholders.

Another improvement to the reporting of termination payments under s300A(1)(e)(vii) would be a requirement for companies to disclose the estimated value of termination payments *ex ante.* This would require companies to disclose the estimated value of incentives (both cash and share-based) that the executive would have received on termination, retirement or resignation as at the reporting date. This would allow investors to compare the estimated value of termination and retirement benefits, as included in *ex ante* disclosure, with actual termination or retirement benefits received.

Recommendation:
ACSI notes that there is often a discrepancy between contractual termination entitlements disclosed under s300A(1)(e)(vii) and the payments actually received by executives. ACSI therefore supports the introduction of a requirement for companies to report the maximum value of termination pay on an *ex ante* basis which would allow investors to compare estimated termination benefits with actual termination benefits received. ACSI also recommends that companies be required to disclose the contractual provisions that gave rise to the relevant termination or retirement payment, at the time the payment is made, as another way in which s300A could be amended to more effectively meet the needs of shareholders.

[35] Downer EDI Limited, *GRANT FENN APPOINTED NEW MANAGING DIRECTOR AND CEO,* (ASX Release, 2 August 2010), p7.
[36] Aristocrat Leisure Limited, *2009 Annual Report* (25 March 2010), p37.
[37] Ibid.
[38] Ibid.
[39] Aristocrat Leisure Limited, *2009 Annual Report* (25 March 2010), p37.
[40] See, for example, Downer EDI Limited, *GRANT FENN APPOINTED NEW MANAGING DIRECTOR AND CEO,* (ASX Release, 2 August 2010), p1.
[41] See, for example, David Jones Limited, *Departure of CEO*, (ASX Release, 18 June 2010), p1.

5. Termination benefits

ACSI rejects submissions that seek to repeal recent amendments to the Corporations Act to increase the threshold requiring companies to seek approval for executive termination payments[42]. ACSI notes that the legislation was introduced as a consequence of the excessively high threshold of seven times remuneration that applied previously. The 12 month base pay threshold introduced by the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* (Cth) actually reflects the practices of the majority of ASX 200 companies.

ACSI notes that his threshold does not represent a 'cap' on termination benefits. The provision simply requires companies to convince their shareholders that payments over twelve month's base salary are appropriate. Accordingly, ACSI's member superannuation funds and other investors are able to would review these proposals on a case by case basis.

Current legislative requirements have been in place for barely twelve months, yet there have been claims made that these changes have led to an increase in fixed pay amongst executives despite that fact the absence of empirical evidence to support such a claim. Raising the threshold is inconsistent with the expectations of Australian institutional shareholders. Specifically, investors expect remuneration to be linked to long-term performance. Shareholders do not benefit from termination payments which provide reward for failure.

Recommendation:
ACSI recommends CAMAC reject submissions calling for an increase in the threshold requiring companies to seek shareholder approval for executive termination payments included in ss200AA-J of the Corporations Act.

6. The case for simplifying incentive components of executive pay through the legislative architecture

Simplifying the incentive components of executive remuneration arrangements through the 'legislative architecture' is difficult without imposing prescriptive requirements. ACSI believes that company boards are best placed to create remuneration structures which may be simple or complex, depending on the objectives of the company.

ACSI does not believe that it should be the role of the Government or Government agencies to prescribe remuneration design requirements that could potentially impose arbitrary designs aimed at 'simplifying incentives' that are not suited to a company's objectives. We note that there are a range of possibilities and configurations that will determine the design and impact of short and long term incentives. The consideration of these issues requires remuneration committees, and boards, to be mindful of the needs of the company to attract and retain executives, and to reward executives for genuine outperformance.

Additionally, we believe that there is a responsibility on shareholders, in particularly institutional investors, to apply scrutiny to incentive plans. This is why effective disclosure is important, and why ACSI encourages companies to engage directly with institutional investors on remuneration issues. ACSI believes that it is company directors and in particular non-executive directors who are best positioned to make these determinations.

Recommendation:
Simplifying the incentive components of executive remuneration arrangements through the 'legislative architecture' is difficult without imposing prescriptive requirements. ACSI believes that company boards are best placed to create remuneration structures which may be simple or complex depending on the objectives of the company. ACSI is therefore opposed to the introduction of prescriptive legal or regulatory arrangements aimed at simplifying the components of executive remuneration.

7. The case for revising the existing 'remuneration setting framework' in order to simplify incentive components of executive remuneration arrangements

ACSI notes that separate from the Minister's request for CAMAC to make recommendations on how best to revise the legislative architecture, CAMAC has also been requested to examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying the incentive components of executive remuneration arrangements. We take this to mean an examination of remuneration setting mechanisms outside the legislative framework. While ACSI sees that there is no merit in imposing prescriptive

[42] See AICD, *Submission No 3 to the CAMAC Review on Executive Remuneration*, 13 August 2010, p5; and Origin Energy, *Submission No 17 to the CAMAC Review on Executive Remuneration*, 24 August 2010, p5.

legal requirements aimed at 'simplifying' the components of executive incentives, there may be scope for the preparation of guidance on accepted 'good practices' in remuneration.

We note that several groups publish guidance on executive remuneration practices and remuneration reporting. As included in CAMAC's information paper – ACSI, the ASA, IFSA and the AICD have all produced guidance on what is considered 'good practice' in executive remuneration by each group's respective constituents.

If it is thought that the 'remuneration setting framework' should provide more guidance on remuneration practices, outside prescriptive legal requirements, ACSI suggests that guidance could be produced to indicate what is considered 'good practice'. The best source for this guidance would be the ASX Corporate Governance Council *Principles and Recommendations* which operate under an 'if not, why not' reporting requirement and also provide general guiding principles which listed companies can refer to. At present, Principle 8 of the ASX Corporate Governance Council *Principles and Recommendations* provides some general guidance on remuneration issues and makes direct reference to the reporting requirements set out in s300A of the Corporations Act.

Recommendation:
If it is thought that the 'remuneration setting framework' should provide more guidance on remuneration practices, outside prescriptive legal requirements, ACSI suggests that could be produced to indicate what is considered 'good practice'. Such guidance could be provided by the ASX Corporate Governance Council *Principles and Recommendations* which operate under an 'if not, why not' reporting requirement and also provide general guiding principles which listed companies can refer to.

Conclusion

In summary, ACSI believes that, with the exception of short term incentive disclosures, Australia's current legislative framework for the disclosure of executive remuneration in listed companies generally operates in a way which meets the requirements of institutional shareholders. We strongly contend that any attempts to create simplified or summary disclosures should not replace the disclosure of detail for institutional investors. We reiterate that there is scope to alter the current legislative provisions to reduce complexity and ensure remuneration reports continue to meet the needs of shareholders.

Do not hesitate to contact us if you would like to discuss the contents of this submission or require further detail.

Yours Sincerely

Ann Byrne
Chief Executive Officer