



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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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 met 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 Paper² 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

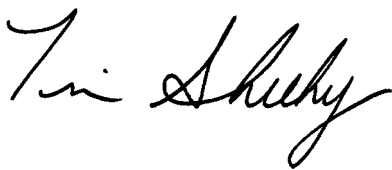
CSA reiterates that it is of the view that it is feasible to simplify reporting to shareholders on remuneration for the reasons detailed above.

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

A handwritten signature in black ink, appearing to read 'Tim Sheehy', written in a cursive style.

Tim Sheehy
CHIEF EXECUTIVE