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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.

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[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

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[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.

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[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.

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[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