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Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

The Australian Council of Super Investors (ACSI) is pleased to make the following submission to the Australian Government in response to the Exposure Draft of the *Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012* and its accompanying Explanatory Memorandum.

ACSI recognises that the current Bill is the latest in a number of positive reforms put forward by the Government which have improved accountability and transparency in executive remuneration practices. ACSI is among those investor groups who have welcomed reforms including the shareholder vote on termination pay, and the 'two strikes' test on remuneration which has significantly increased the level of engagement between company boards and investors on executive remuneration issues.

About ACSI

ACSI represents 39 profit-for-members superannuation funds who collectively manage over \$350 billion in investments on behalf of Australian superannuation fund members. As a representative of long-term investors, ACSI is focussed on promoting high standards of corporate governance in the Australian market.

Over the past 11 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, 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 submission on the Government's Exposure Draft.

Submission Outline:

In summary form, the key points of ACSI's submission are as follows:

- **Clawback of remuneration.** ACSI supports the proposed amendments to introduce reporting of clawback mechanisms. The proposed 'if not, why not' approach to the clawback of bonuses following a material misstatement of accounts is a non-prescriptive method to ensure that boards consider this contingency within executive bonus plans. The Government should consider engagement with the ASX Corporate Governance Council to assess whether the 'if not, why not' approach might be applied through its *Principles and Recommendations* rather than the *Corporations Act*.
- **Termination pay reporting.** ACSI welcomes the Government's proposal to enhance reporting of payments made on the termination and retirement of key management personnel.
- **Disclosure of past, present and future pay.** ACSI is supportive of efforts to streamline and standardise the reporting of executive pay. Disclosure of remuneration arrangements is an essential requirement for institutional shareholders to evaluate remuneration reports.

The introduction of 'past, present and future' disclosure requirements in addition to current reporting standards will however add to the complexity of reporting, and will not enhance shareholder understanding of executive pay plans. It is ACSI's strong view that the current framework can instead be adjusted to incorporate 'past, present and future' reporting in a way which would benefit shareholders and companies.

Each of these issues is elaborated on in detail below.

Clawback of Remuneration

ACSI supports the principle of clawback mechanisms within executive remuneration plans. This is particularly relevant where a material misstatement has occurred and substantial bonuses have been paid to key management personnel.

While these principles are important, we recognise that there are a significant number of practical issues involved with clawback arrangements. For example, prescriptive clawback arrangements run the risk of embroiling the company in legal battles with its executives over the terms of past bonuses. Issues of materiality and quantifying the exact proportion of a bonus paid on the basis of a misstated result are also highly complex.

The Government has successfully avoided these practical issues in the proposed amendments detailed in the *Exposure Draft*. The proposed 'if not, why not' approach to the clawback of bonuses following a material misstatement of accounts is a non-prescriptive method to ensure that boards consider this contingency within executive bonus plans.

Given that a material misstatement of financial accounts is a relatively rare event in S&P/ASX300 companies, ACSI hopes that the discussion around appropriate clawback arrangements will be applied to a broader set of circumstances. Using the example of arrangements currently in operation within the financial sector, we would support adoption of clawback arrangements that allow for the

reduction of deferred or long term bonuses in cases where there has been excessive risk taking or a significant deterioration of financial performance (aside from a material misstatement).

Recommendation:

ACSI supports the Government's Exposure Draft terms on clawback. The proposed 'if not, why not' approach to the clawback of bonuses following a material misstatement of accounts is a non-prescriptive method to ensure that boards consider this contingency within executive bonus plans.

As part of this process, the Government should consider engagement with the ASX Corporate Governance Council to assess whether the 'if not, why not' approach might be applied through its *Principles and Recommendations* rather than the *Corporations Act*.

Termination pay reporting

For many years ACSI has seen that there is often a discrepancy between contractual termination entitlements disclosed under s300A(1)(e)(vii) of the *Corporations Act* and the payments actually received by executives on their departure. Another related issue is that according to information disclosed to the ASX, very few senior executives are terminated. In many cases, the resignation¹ or mutually agreed termination² of executives also trigger termination entitlements which may have little connection with the contractual termination entitlements reported under s300A(1)(e)(vii).

It is for these reasons that ACSI strongly supports the exposure draft amendment to s300A(1)(e) as it enhances transparency of termination payments.

A further improvement ACSI has previously suggested to CAMAC on 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 welcomes the Government's proposal to enhance reporting of payments made on the termination and retirement of key management personnel. This disclosure could be further enhanced by the addition of an *ex ante* disclosure requirement as discussed above.

Improving disclosure requirements in the remuneration report

Reducing the complexity of remuneration reports was a topic discussed at length during the CAMAC consultation of remuneration reporting which led to the Committee's final recommendation on 'past, present and future' reporting.

¹ See, for example, Downer EDI Limited, *GRANT FENN APPOINTED NEW MANAGING DIRECTOR AND CEO*, (ASX Release, 2 August 2010), p1.

² See, for example, David Jones Limited, *Departure of CEO*, (ASX Release, 18 June 2010), p1.

The difficulty raised by ACSI and others during CAMAC's consultation was that the introduction of 'past, present and future' remuneration disclosures has the potential to add complexity to reporting, without conveying any greater insight to investors. (This observation applies to both retail and institutional investors). It is ACSI's strong view that 'past, present and future' should not be mandated *in addition* to current reporting requirements.

We would make the observation that all of the elements of 'past, present and future' remuneration are already included in remuneration reports. Investors are able to assess the various elements of remuneration via the statutory pay table and the additional disclosures (such as the value of options exercised during the reporting period).

Amending s300A to better reflect 'past, present and future' Pay

The Government's aim of improving remuneration disclosure with a clear demarcation between 'past, present and future' payments can be achieved through amendments to s300A. These amendments would be generally welcomed by investors, and companies who are often concerned with misunderstanding of share based payments (and particularly fair value estimates of share based payments).

It should be noted that concern over the reporting of share based payments is not consistent. In ACSI's experience, companies are only concerned in cases where fair value estimates over-value executive pay. There is little or no concern expressed when fair value estimates undervalue executive pay.

In order to address confusion around share based payments, s300A and the relevant sections of the *Corporations Regulations* could be amended to remove current requirements to report share based payments within the statutory remuneration table. These figures could be replaced with the value of share based payments that vested during the relevant reporting year. In practice, this would reflect the value of the share based short term incentives and long term incentives.

A working model for this type of reporting has been developed in the UK by the Financial Reporting Council's [Financial Reporting Lab Report](#). Introducing this change would create a statutory remuneration table that effectively reported 'past and present' pay. This form of reporting would answer the often asked question – 'how much remuneration did the relevant executive *actually* receive during the year?'

This leaves the issue of future pay unresolved. Australian companies are already required to disclose the details of equity incentives and other long term payments allocated during the year that vest in future years. It may aid investor understanding of remuneration report disclosures if the requirement to report the 'fair value' of equity incentives under AASB2 was removed. The *UK Financial Reporting Lab* framework provides a workable alternative whereby share based incentives are detailed but their value is 'face value' of shares at the date of allocation. This type of reporting would give an insight into 'future' pay.

One benefit of the UK framework is that it allows for the reporting of the face value of equity incentives granted, rather than potentially misleading fair value disclosures. Implementation of these changes will however require careful consideration, as we cannot simply replicate UK market initiatives without acknowledging the differences in jurisdiction. For instance, in Australia many companies do not assess long term incentive payments award bonuses at financial year end which

could impact the reporting of equity incentive outcomes. Developing a consistent approach to reporting the value of options with an exercise price is another issue that would require discussion with companies and investors.

We understand that BHP Billiton have put forward a working model for this and ACSI believes that this could form a useful precedent for enhanced reporting that meets the underlying intention of the Government's proposals.

Recommendation:

Reporting of 'past, present and future' in the manner proposed in the draft bill and explanatory memorandum should not be added to current disclosure requirements.

Options are available to amend current reporting requirements and reduce confusion regarding fair value estimates of share based payments and better represent the remuneration received by key management personnel. These amendments would require a standardised approach and the *UK Financial Reporting Lab* provides a practical template which can be adapted for the Australian market.

Conclusion

ACSI supports the substance of the Exposure Draft prepared by the Federal Government. Please do not hesitate to contact me or Ed John, Executive Manager – Governance and Engagement if you would like to discuss our submission in more detail.

Yours sincerely,



Ann Byrne
Chief Executive Officer

Cc: The Hon Bernie Ripoll MP