



OWNERSHIP MATTERS

Suite 4, Level 5, 167 Queen St, Melbourne VIC 3000 T +61 3 9602 4548 www.ownershipmatters.com.au

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General Manager
Corporations & Capital Markets Division
The Treasury

Email: corporations.amendments@treasury.gov.au

RE: Submission on 'Corporations Amendments – Improving disclosure requirements'

Dear Treasury,

Thank you for the opportunity to comment on the draft legislation to amend the Corporations Act to improve executive pay disclosure requirements. Ownership Matters (OM), formed in 2011, is an Australian owned governance advisory firm serving institutional investors. The opinions contained in this submission are those of OM and not those of its clients. This submission will respond only to those proposed amendments where OM considers its views are relevant, specifically those relating to proposed changes to remuneration reports and disclosure of executive remuneration information.

OM supports the intention of the amendments which is to improve disclosure of remuneration outcomes to shareholders and commends the Government for attempting to improve pay disclosure for shareholders. OM notes this latest initiative follows a series of changes designed to improve shareholder scrutiny of senior executive pay at listed companies including the 2009 termination payments legislation.

In this case, OM considers that the proposed changes introducing disclosure of 'actual' or 'realised' pay – through disclosure of past, present and future remuneration in addition to existing disclosure requirements – can be achieved by building on the existing disclosure framework without imposing new layers of disclosure in addition to the current reporting regime.

In this regard OM considers that adopting the remuneration reporting framework proposed by the UK's Financial Reporting Lab as a model for reporting 'actual' executive pay has considerable merit and could be adopted with minimal change to existing requirements and some amendments to suit local practice.¹ More information on the Financial Reporting

¹ The Financial Reporting Lab proposal bases its single figure for remuneration on the value of equity 'that vests in relation to the performance year' based on the share price at year end, reflecting the widespread practice of UK company long term incentive arrangements where performance periods mirror company financial years. In Australia it is relatively common for a performance period for a long term incentive to end during a financial year making it harder to adopt the UK practice. Any amendment in the Australian context could leave the decision of which equity value to report to the company, with the decision explained in a footnote to the table (much as companies disclose whether the annual bonus is reported on a cash or accruals basis). A company such as BHP would be able to choose between reporting in its 2012 remuneration report the value of the incentives vesting in August 2012 based on performance to 30 June 2012 or the value of the equity that vested in August 2011 based on performance to 30 June 2011.

Lab's proposal is available at <https://frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/A-single-figure-for-remuneration.aspx>.

A disclosure regime building on the Lab's proposal would minimise confusion by retaining much of the existing framework other than removing the requirement for the remuneration report to disclose the value of share based payments in accordance with AASB 2. This requirement is, from OM's experience, the source of almost all the confusion over executive remuneration disclosure arising from the statutory reporting regime. Its replacement with a value reflecting the value of equity incentives at vesting or exercise would capture the perceived need for 'actual' pay disclosure reflected in the proposed legislation while future pay would be captured by the existing requirement under the Act to report equity incentives granted during a financial year but instead valued using the face value of shares at grant date.² The scope of the legislative changes required would be minimal and would largely relate to defining the value of equity at vesting and grant and removing the requirement in the Corporations Act and the Regulations to value equity incentives in accordance with accounting standards in the remuneration report.

In relation to the specifics of the proposed legislation:

- **Remuneration governance framework:** The proposed s.300A(1)(aa) requiring disclosure of a company's framework for setting executive pay would provide minimal additional information to shareholders. This is because many companies already provide this information voluntarily and those companies who do not provide this information are unlikely to disclose meaningful information in response to the legislative change and will instead simply rely on boilerplate disclosure often produced by professional advisors.
- **Options:** OM supports this change. The removal of the requirements to report the value of options that lapsed during a financial year and the proportion of remuneration consisting of options will reduce meaningless disclosure. The new proposed requirement to specify the year of grant for the options that lapsed during a financial year will also aid shareholders in determining the actual remuneration received and forfeited by executives.
- **Benefits on termination:** OM supports this change. The proposed section 300A(1)(ea) will improve the information provided to shareholders on the total potential entitlements an individual executive may receive, and should reduce the number of payments made to executives on termination that appear to have been made under previously undisclosed contractual entitlements. OM would support an additional requirement, similar to that required for US companies, where companies would be required to disclose the dollar amount an executive would receive on retirement, a change of control or for termination without cause – either at the individual or the company's initiative - as at the company's financial year end for all executive KMP in office as at year end. This would allow shareholders to assess the potential liabilities a company may incur on a change of management or in the event of a change of control.
- **Remuneration outcomes:** OM does not consider that the proposed new section 300A(1)(ca) as presently drafted would increase shareholder understanding of the

² The Government could consult over a simple mechanism for valuing exercise price options and similar instruments such as 'share acquisition rights' such as using a 'deemed' value similar to those used for income tax purposes.

actual and potential remuneration for senior executives and directors of listed Australian companies. This is because the requirements are in addition to the existing statutory pay disclosure requirements – which will increase the length and complexity of remuneration reports, contrary to the Government's intention – and because of the lack of guidance over what constitutes 'past', 'present' and 'future' remuneration.

- As an example of this confusion the present Act defines remuneration with reference to accounting standards. This potentially allows a company to report the value of past remuneration received on equity vesting using the grant date fair value calculated under AASB 2 and not the actual value of shares received as shown in this example: During the year the CEO of company X received 1 million shares on vesting which had a fair value at grant of \$1.23 and a value at vesting of \$6.50 (based on the closing share price at the vesting date). It would be arguably open to the company to disclose \$1.23 million in past remuneration as the value of remuneration received calculated in accordance with accounting standards and not the realised remuneration of \$6.5 million.
- The 'past', 'present' and 'future' pay model developed by CAMAC for most listed companies simply re-presents information already disclosed in the remuneration report.³ Past remuneration will include the cash bonus accrued for the prior year as well any retention or 'non-standard' cash payments from prior years that vested during the year. These payments are usually reported in the statutory pay table. Past pay will also include any equity granted in past years that vested during the year (presently reported under s. 300A(1)(e)(iii) and Regulation 2M.3.03(1)(15&16)) while present remuneration will include fixed pay. Future remuneration will consist of the cash bonus accrued for the current financial year to be paid following year end, usually reported in the current statutory pay table, any other payments vesting in the future and any equity granted during the year (reported already under Regulation 2M.3.03(1)(15)). The repackaging of these existing disclosures will simply lengthen the remuneration report and increase, not decrease, complexity.
- **Clawback:** OM supports this change. The proposed amendment will simply require a listed company to disclose whether it has clawed back past remuneration paid to KMP upon discovery of a material financial misstatement in any of the last three year financial years, and if no clawback has occurred, why not. OM notes there appears to be considerable confusion surrounding this proposed amendment which simply mandates an 'if not, why not' disclosure rather than a requirement for companies to actually develop clawback arrangements.
- The proposed reporting requirement contained in the amendment is however triggered only in a very narrow set of circumstances – a material restatement of past accounts, with materiality based on the accounting standard definition. OM notes this set of circumstances arises very seldom and is likely to be interpreted in such a narrow way that the section will seldom be triggered. As an example it is unlikely that a reduction in the carrying value of an asset acquired during the past three years would constitute a 'material misstatement or omission'.

³ The only companies where actual pay received cannot be determined through existing remuneration disclosures are those that operate deferred cash bonus plans vesting over multiple years where the amount of cash is indexed to a non-standard and non-visible rate, such as movements in a portfolio of listed or unlisted securities. Among large Australian listed companies only Macquarie falls into this category.

- In response OM would suggest the clawback amendment be redrafted so that a company would be required to disclose if it had clawed back any remuneration during the financial year based on the outcomes of decisions made in the prior three financial years or events that occurred during the financial year, and if not, why no such clawback had occurred. While the type of clawback applied should be disclosed – either cancellation of outstanding equity incentives, the cancellation or reduction of deferred cash incentives or reduction of current year incentives – disclosure of the identity of the individuals to whom the clawback is applied should not be required. This is because requiring companies to disclose the identity of these individuals is likely to reduce their willingness to apply clawback. From OM's discussions with listed companies it is aware of several that have clawed back amounts previously allocated due to deterioration of business performance rather than any restatement but have been reluctant to disclose the identity of the individuals involved.

We reiterate our support for the Government's efforts at improving the transparency of executive remuneration to shareholders. Please feel free to contact us concerning any aspect of our submission.

Yours sincerely,



Dean Paatsch & Martin Lawrence

Ownership Matters Pty Ltd