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General Manager
Corporations and Financial Services Division
The Treasury
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Sent via email: executiveremuneration@treasury.gov.au

Government executive remuneration exposure draft: Ernst & Young submission

Dear Sirs,

The Government released the exposure draft of the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* on 20 December 2010. The Bill formalises the Government's response to the Productivity Commission's ("PC") final report on director and executive remuneration that was released in December 2009. Ernst & Young is pleased to provide this submission which we trust will assist the Government to refine and finalise the legislation.

Our experience

In the past two years, Ernst & Young's Australian Performance and Reward practice has worked with two-thirds of Australia's largest listed companies, as well as smaller listed companies, companies seeking an ASX listing, private companies and the Australian subsidiaries of multi-nationals. Our comments are based on our experience of working with Boards and management within these companies.

The aims of the draft legislation and our summary view

The stated aims of the proposed changes are to:

- Empower shareholders to hold directors accountable for their decisions relating to executive remuneration;
- Eliminate conflicts of interest in the remuneration setting process; and
- Increase transparency and accountability in remuneration matters.

Whilst we generally support the intent of the Government's proposed changes, we have serious concerns regarding the engagement of remuneration consultants and disclosure of fees and other services. In relation to these two aspects, the draft legislation imposes requirements that are more stringent than requirements:

- Recommended by the PC;
- Implemented by the Australia Prudential Regulatory Authority ("APRA"); and
- In place in other key overseas jurisdictions including the United Kingdom and the United States.

We also continue to have reservations regarding the detail of the "two strikes and re-election" proposal.

We strongly encourage the Government to revisit these aspects of the draft legislation as the consequences of the current drafting are significant.

Specific areas of concern that require further consideration

We are concerned that the legislation as currently drafted will:

a. Restrict management's ability to successfully implement the company's business strategy: One of the primary roles of management is to develop the business strategy for approval by the Board. The remuneration strategy and frameworks are a key management tool used to support the business strategy's implementation. Prohibiting management from accessing remuneration advice in relation to Key Management Personnel ("KMP") remuneration restricts management's ability to successfully implement the business strategy.

b. Extend the role of the Board into a quasi-management role: Given that the non-executive directors will be the only individuals able to access executive remuneration advice, the role of the Board is extended beyond its traditional supervisory and approval role. This extended role will be challenging to effectively fulfil due to their part-time status (i.e., only preparing for and attending monthly/quarterly meetings) and their relative lack of practical specialist remuneration knowledge, which is generally held by Human Resources Directors and Remuneration Managers.

c. Encourage the use of boutique remuneration consultancies, which may impact the quality of advice that companies receive: If companies are required to disclose all other services provided to the company and the associated fees in order to ensure that there is no perceived conflict of interest, Boards may become more likely to engage consultancies that undertake no other work for the company. Further, multi-service providers may choose to discontinue providing KMP remuneration advice to avoid the requirement to disclose commercially sensitive information regarding clients, projects and fees.

   This change will lead to Boards having to engage multiple firms in order to obtain the breadth of remuneration, governance, tax and accounting advice they require on KMP remuneration. This will increase both the financial cost, as economies of scale between providers is not achieved, and time investment, as increased co-ordination between consultants is required. Overall, the quality of advice will likely diminish particularly where multi-jurisdictional advice is required.

   Further, this new proposed disclosure requirement presupposes that multi-service firms have a conflict of interest, when a strong argument can be made that single service providers are more economically dependent as their firm likely receives a greater percentage of their total fees from one client.

d. Give undue power to minority shareholders through the 'Two strikes and re-election' proposal: We have concerns that the 25% threshold applied to the 'two strikes and re-election' proposal is too low, and may result in changes being made to the remuneration approach after a minority "no" vote, going against the view of the majority of shareholders.

Suggested approach to addressing areas of concern

We recommend the draft legislation is revised as follows:

- Align the engagement of remuneration consultants with PC Recommendation 11: The PC underwent a very detailed review and consultation process and did not recommended prohibiting management from accessing remuneration advice. Such prohibition has significant consequences as noted above.

- Amend the draft remuneration consultant disclosure requirement: Implement a requirement to disclose the Board remuneration consultant, a summary of the nature of the work provided and how any actual or potential conflicts of interest are managed. These disclosures will allow shareholders to assess the Boards policy for managing conflicts of interest directly rather than using proxies (such as fees spent, type of work undertaken) to draw their conclusions. This will empower shareholders by providing relevant information, and will hold Boards accountable for appropriately managing conflict of interest. We do not think the requirement to disclose the fees and other services provided by the firm is necessary, and we believe the disclosure may have unintended consequences as discussed above.

  If the Government believes some form of fee disclosure is required, our view is that any requirement should be based on "economic dependence" (i.e., what portion of the firm's total revenue is provided by that one client). If a specified revenue threshold is exceeded, additional disclosure requirements could be triggered.

- Amend the voting threshold in the 'Two strikes and re-election' proposal: The threshold should be 50% on each resolution to prevent actions being taken based on the views of a minority of shareholders.

The draft legislation has significant impacts on companies' Boards and Human Resource departments. When proposing such important legislation, it is essential that all relevant parties have sufficient time to share their expert and informed views with the Government, to ensure the final legislation is appropriate and in the best interests of all stakeholders. As such, we suggest the Government allows longer consultation periods in future.

We trust the information and views provided in this submission are useful. We would appreciate the opportunity to discuss our submission with you at your convenience.

Kind regards,



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Enc. Ernst & Young detailed comments regarding proposed legislative change.

Attachment – Ernst & Young detailed comments regarding proposed legislative change.

1. Introduction

1.1 About Ernst & Young's performance and reward team

In the past two years, Ernst & Young's Australian Performance and Reward practice has worked with two-thirds of Australia's largest listed companies, as well as smaller listed companies, companies seeking an ASX listing, private companies and the Australian subsidiaries of multi-nationals. We offer a fully integrated remuneration, tax, accounting and corporate governance service and a global network of resources.

Over recent years, we believe one of the keys to our success has been our ability to provide this fully integrated remuneration offering. The remuneration environment has evolved to include complex corporate governance, accounting, personal tax, corporate tax and legal issues, often across several jurisdictions. Clients who engage us typically expect us to bring insights across the breadth of these complex and inter-related issues. We believe multi-service providers, such as ourselves, are best placed to meet such expectations.

1.2 Our involvement in the review of executive remuneration

We have provided input at all stages of the PC's inquiry, providing a detailed submission on the PC's Issues Paper "Regulation of Director and Executive Remuneration in Australia", released in April 2009, and another submission in response to the PC's draft recommendations, released in September 2009.

We have also been actively involved in the Corporations and Markets Advisory Committee ("CAMAC") review. The Government, in response to the PC's final report released in December 2009, asked CAMAC to undertake further research into remuneration reporting and remuneration setting frameworks. CAMAC was asked to make recommendations on how the remuneration report disclosures and executive incentive arrangements may be simplified. Ernst & Young provided a detailed submission to CAMAC in response to the Information Paper released on 13 July 2010, and have had further detailed discussions in relation to improving remuneration disclosures.

In sum, we (as have a significant number of other parties) have invested a considerable amount of time and resources into the review of executive remuneration, recognising this is an important topic that impacts many stakeholders, who have varied, and at times conflicting, views and expectations of what executive remuneration should look like.

1.3 The content of this document

Given the significant comment we have already contributed to this debate (as noted above), we have focused this submission on the areas we are concerned will have negative unintended consequences; namely, the engagement and disclosure of remuneration consultants (refer Section 2). However, we also note concern with the drafting of the 'Two strikes and re-election' proposal (refer Section 3) and we close our submission with some observations on the other aspects of the draft legislation (refer Section 4).

2. Engagement and disclosure of remuneration consultants

In our view, the primary issue with the draft legislation is the proposed rules regarding how remuneration consultants are engaged and disclosed. In order to assist the Government with understanding this complex issue and preparing appropriate legislation, this section:

- Outlines current state in terms of:
  - How companies develop remuneration strategies and frameworks; and
  - How consultants are currently used.
- Summarises the PC's recommendations on this matter and how the draft legislation differs from the PC's detailed and considered recommendations.
- Summarises the negative consequences associated with the draft legislation.
- Suggests an approach to avoid these negative consequences, whilst still achieving the Government's objectives.

2.1 Current state

2.1.1 Process for developing the remuneration strategy and frameworks

In order to understand the implications of the draft legislation, it is important to understand in detail the role played by different individuals in the decision-making process.

Management and the Board have distinct roles within a company. Typically, the Chief Executive Officer ("CEO"), with management's input, will propose the business strategy to the Board. The Board then reviews, debates and approves the strategy, which is then implemented by management.

There is an increasing trend towards greater interaction between Board and management, with both parties recognising the valuable input the other can have in formulating, implementing and reviewing the strategy.

This decision making process is also applied to the development of the remuneration strategy and frameworks. The remuneration strategy typically cascades from the business strategy and is a key business strategy implementation tool. The remuneration strategy is a considered approach to the integration of all remuneration elements. It determines what type of remuneration is provided to which executives and employees under various circumstances. It ensures the remuneration spend is affordable and that an appropriate governance framework supports remuneration decision making.

The Remuneration Committee has overall sign-off on KMP remuneration matters. *The ASX Corporate Governance Council's Corporate Governance Principles and Recommendations – Second Edition August 2007* outlines the duties of a Remuneration Committee:

> *The responsibilities of the Remuneration Committee should include a review of and recommendation to the Board on:*

- *The company's remuneration, recruitment, retention and termination policies and procedures for senior executives;*
- *Senior executives' remuneration and incentives;*
- *Superannuation arrangements; and*
- *The remuneration framework for directors.*

The Remuneration Committee may seek input from individuals on remuneration policies, but no individual should be directly involved in deciding their own remuneration.

In practice, management has significant input into the development of the remuneration approach. Typically, Human Resources steers the development of the remuneration approach, with input from the CEO. Other members of management are often requested to give input in identifying the key drivers of business performance and the behaviours which support achievement of the business strategy. These are then embedded within the proposals.

The Board/Remuneration Committee then review, debate and approve the remuneration approach (separately considering CEO remuneration), which is typically defined at a KMP level and cascaded throughout the organisation. Human Resources is then typically responsible for implementation throughout the organisation with involvement from other members of management as necessary.

The following table summarises the typical roles and accountabilities:

Role	Accountability (as relates to KMP remuneration only)
Board/Remuneration Committee	► Review and approve KMP (excluding the CEO) remuneration strategy, quantum and structures ► Develop and propose CEO remuneration strategy, quantum and structures (Remuneration Committee only) ► Review and approve CEO remuneration strategy, quantum and structures (Board) ► Review and approve the design and total quantum for any company equity plans (may be broader than just KMP)
CEO	► Develop and propose KMP (excluding the CEO) remuneration strategy, quantum and structures to the Remuneration Committee ► Develop and propose the design for any company equity plans (may be broader than KMP) ► Oversee the implementation of the approved remuneration arrangements
Human Resource Director, the Remuneration Manager, and often the Company Secretary	► Provide support to the CEO / Remuneration Committee regarding KMP remuneration ► Implementing the approved remuneration arrangements ► May be involved in Board matters and liaises with external consultants on behalf of the Board on confidential matters (e.g., CEO remuneration)

2.1.2 *How remuneration consultants are currently used*

Types of work and engagement approaches

The table below outlines some of the common types of work where remuneration consultants may be used, noting activities which may be conducted for the Board vs. management, or both. The last column on the right looks at who the remuneration consultant is typically engaged by, whether management is consulted and who is the direct recipient of the advice.

Note, the Board or management may engage external consultants in conjunction. For example, management may appoint one consultant to provide advice regarding the design of an incentive plan, while the Board may engage a second provider (or enforce "Chinese walls" with the same provider to support independence) to review management's proposal.

Type of work	Activities for Board only	Activities for management only	Activities for Board or management	Engagement approach
Remuneration strategy	► Independent review of current remuneration strategy	► Advice regarding implementation of remuneration strategy	► Review and assistance in development of remuneration strategy	► Engaged by Board or management ► Consult with management ► Advice provided to Board or management
Remuneration benchmarking	► Provision of market remuneration information relating to CEO remuneration	► Consult regarding implementation of executive benchmarking strategy (e.g., definition of peer group, positioning policy)	► Assistance to develop executive benchmarking strategy (e.g., definition of peer group, positioning policy) ► Provide market remuneration data to help inform non-executive director and executive remuneration decisions	► Engaged by Board or management (depending on subject of benchmarking) ► May consult with management when directed ► Advice provided to individual who engaged the consultant but not to the individual who is the subject of the advice.
Incentive plan design	► Independent review of management proposals	► Provision of market practice ► Implementation implications (e.g., incentive funding/cost modelling)	► Development of guiding design principles ► Review of alignment of plan to strategy and market practice	► Engaged by Board or management ► Consult with management ► Advice provided to Board or management
Taxation and accounting	n/a	► Advice regarding tax and accounting implications of remuneration arrangements (e.g., equity plans)	n/a	► Engaged by management ► Consult with management ► Advice provided to management
Legal	► Review and advice regarding CEO contracts	► High-level legal advice on employment contracts and remuneration arrangements (e.g., equity plans)	► Ongoing advice including: legislative updates, regulations updates, review of contracts	► Summary implications often provided to the Board

Nature of advice

Consultants can provide a variety of information to Boards and management, ranging from market practice information through to formal recommendations. The information can be used to provide context only, with no recommendations. The majority of remuneration consulting would not result in a recommendation being presented to the Remuneration Committee directly from the consultant. Rather, the consultant would present potential alternatives for the Board's consideration. Often, the arrangements are not implemented exactly as suggested by the remuneration consultant.

2.2 The Productivity Commission review

The PC noted that avoiding conflicts of interest was a key principle underpinning the executive remuneration reforms. Following its detailed review, which lasted approximately nine months and involved consultation from various parties, the PC made two recommendations which aimed to support minimisation of conflict of interests:

- The ASX Corporate Governance Council should recommend that companies disclose the expert consultants they have used in relation to the remuneration of directors and KMP, who appointed them, who they reported to and the nature of other work undertaken for the company by those consultants.

- The ASX listing rules should require that, where an ASX 300 company's Remuneration Committee (or Board) makes use of expert consultants on matters pertaining to the remuneration of directors and KMP, those consultants be commissioned by, and their advice provided directly to, the Remuneration Committee or Board, independent of management. Confirmation of this arrangement should be disclosed in the company's remuneration report.

2.3 Comparison of draft legislation and Productivity Commission recommendations

The draft legislation in relation to remuneration advice is more stringent then the views expressed by the PC. The following table summarises the key differences.

	Current rules	PC's proposal	Government's draft legislation
Engagement and provision of advice			
Board can engage consultants on KMP remuneration to give advice to Board	P	P	P
Board can engage consultants on KMP remuneration to provide advice to management[1]	P	P	O
Management can engage consultants on KMP remuneration to provide advice to the Board	P	P	O
Management can engage consultants on KMP remuneration to provide advice to management	P	P	O
Management can obtain advice on KMP remuneration	P	P	O
Disclosure of consultants			
Disclosure of consultant name	O	P*	P^
Disclosure of fees paid to consultant	O	O	P
Disclosure of other work performed by consultant	O	P*	P^
Disclosure of other fees for other work performed by consultant	O	O	P

*if not, why not ^mandatory

No explanation has been provided by the Government for why the draft legislation is more stringent than the PC's recommendations.

2.4 The implications of the proposed legislation

2.4.1 Engagement and provision of advice

Ernst & Young's concerns with the draft legislation:

- Restricts management's ability to successfully implement the company's business strategy: One of the primary roles of management is to develop the business strategy for approval by the Board. The remuneration strategy and frameworks are a key management tool used to support the business strategy's implementation. Prohibiting management from accessing remuneration advice in relation to KMP remuneration restricts management's ability to successfully implement the business strategy.

- Extends the role of the Board into a quasi-management role: Given that the non-executive directors will be the only individuals able to access executive remuneration advice, the role of the Board is extended beyond its traditional supervisory and approval role. This extended role will be challenging to effectively fulfil due to their part-time status (i.e., only preparing for and attending monthly/quarterly meetings) and their relative lack of practical specialist remuneration knowledge, which is generally held by Human Resources Directors and Remuneration Managers,

  Management and the Board often engage remuneration consultants to assist in the development and validation of remuneration structures and quantum. Prohibiting management from engaging external consultants shifts responsibility

[1] In cases where the Board is not relying on an independent view

previously sitting with management to the Board. The shifting of responsibility will require Boards to take on the role of management, undermining the principle that Board and management duties should be separate.

Advice obtained by management often relates to administrative and implementation issues. Under the proposed changes, the Board will be required to obtain this advice. We believe this is beyond the role of the Board, which is to oversee management's execution of business strategy, not become involved in remuneration implementation issues.

The types of advice which can currently be provided to management include remuneration benchmarking information for the executive team (to enable the CEO to make recommendations to the Board), market practice regarding remuneration strategy and plan design, incentive plan accounting and taxation advice, equity plan valuations and performance calculations (e.g., Total Shareholder Return performance).

- Increased Board time commitment: The Board will need to be more involved in liaising with remuneration consultants, the design of KMP reward strategy and frameworks and implementation tasks. This increased involvement and responsibility will require an increase in time commitment. The increased time commitment results in:
  - A potential reduction in the number of Non Executive Directors willing (and with the necessary competencies) to become Remuneration Committee members.
  - A reduced number of Boards being served by Non Executive Directors who are members of Remuneration Committees or an increase in the number of Non Executive Directors serving on the Remuneration Committee to absorb the additional work.
- Inhibiting the CEO in making remuneration recommendations for their executive team: As discussed, the CEO is responsible for making recommendations regarding KMP remuneration to the Remuneration Committee. Typically, the CEO will work with Human Resources to obtain market information relating to the remuneration quantum and mix for similar roles in the market to inform the recommendation to the Remuneration Committee. Under the proposed legislation, the CEO will no longer be able to access external advice regarding the remuneration for direct reports who are defined as KMP.

  Although market data is only one input into remuneration quantum, the lack of market quantum information available to a CEO via limited access to external consultants may result in remuneration packages that are misaligned with the market being presented to the Remuneration Committee. Alternatively, the CEO would step back from the process and the Remuneration Committee would undertake the market review for the KMP, requiring them to develop a better understanding of each KMP's role, their importance to the organisation and performance for the year.
- Limited management input into consulting advice: Consultants will be wary to hold discussions with management throughout projects as advice may inadvertently be provided to management and the consultant will be charged with a criminal offence.

  Ernst & Young's suggested improvements to the draft legislation:
  - Given the consequences noted above, remuneration consultants should not be prohibited from providing advice to management.
  - To manage conflicts of interest, we suggest that where the Board/Remuneration Committee wishes to rely on external advice, the consultants be commissioned by, and their advice provided directly to, the Remuneration Committee or Board, independent of management (per the PC's recommendation).

    Ernst & Young currently operates under this structure for a number of large clients. The process of engagement is as follows:
    - Ernst & Young outlines the scope of services available to the Board and is engaged directly by the Board.
    - The scope of services letter typically outlines a list of specific services that can be provided to management on remuneration matters and this list of services is approved by the Board.

- When working on Board requested work, we seek input from management as, and when, requested by the Board. All advice requested by the Board is provided directly to the Board unless otherwise instructed.

- For all Board papers, Ernst & Young's internal procedures require two partners to sign-off on the advice. For Board papers containing a recommendation, Ernst & Young's internal procedures require a third, independent partner review of the advice.

- An alternative approach that Ernst & Young would support, is that contained within the APRA principles that apply to financial institutions. Ernst & Young would be supportive of a similar regulation to be extended across all industries. APRA's regulations (relating to use of external advice) are:

  - If a Board Remuneration Committee engages external consultants, the governance standards require that the consultants be commissioned in a manner that ensures that their engagement, including any advice received, is independent. The Board Remuneration Committee will need to exercise its own judgement and not rely solely on the judgement or opinions of others.

  - Where a Board Remuneration Committee chooses to seek advice from a third party, there is a potential for conflicts of interest to arise where the third party provides, or may seek to provide, other advice or services to the regulated institution or its executives. In engaging a consultant, APRA expects the Committee not to engage a consultant who is acting concurrently or has acted recently on behalf of management or of any executive of the regulated institution.

2.4.2 Disclosure of remuneration consultants

Ernst & Young's concerns with the draft legislation:

- Encourages the use of boutique remuneration consultancies, which may impact the quality of advice that companies receive: If companies are required to disclose all other services provided to the company and the associated fees in order to ensure there is no perceived conflict of interest, Boards may become more likely to engage consultancies undertaking no other work for the company. Further, multi-service providers may choose to discontinue providing KMP remuneration advice to avoid the requirement to disclose commercially sensitive information regarding clients, projects and fees.

  This change will lead to Boards having to engage multiple firms in order to obtain the breadth of remuneration, governance, tax and accounting advice they require on KMP remuneration. This will increase both the financial cost, as economies of scale between providers is not achieved, and time investment, as increased co-ordination between consultants is required. Overall, the quality of advice will likely diminish particularly where multi-jurisdictional advice is required.

- Proposed work and fee disclosure does not assist shareholders to assess conflicts of interest: The proposed work and fee disclosure may be misinterpreted, implying that (a) a remuneration consultant cannot be considered objective if the consultant's firm performs other work for the company, and (b) a remuneration consultant whose firm does no other work for the company is conflict-free. Ernst & Young believes the same conflict of interest risks occur when the remuneration consultant provides no other services for the company as the provider relies more heavily on the income stream from completing the work than a provider who operates in other areas of the business. Therefore, economic dependence from a whole of company perspective should be considered.

  The disclosure of the fees for remuneration consulting work may not be an indication of the volume of remuneration advice required by the company, but may instead reflect a strategic Human Resources function decision. For example, some clients will have small Human Resources teams and therefore look to external consultants to provide additional capacity during busy periods while other companies may have large Human Resources functions requiring limited consultant spend. Without knowing the strategic decision behind the use of remuneration consultants, it is difficult to assess the level of work conducted by consultants that is based on lack of resources.

Similarly, companies may require significant remuneration spend for ongoing administration and compliance of the remuneration function (e.g., remuneration report review, taxation advice, incentive valuations and contract advice). The level of spend by these companies on largely transactional work may be misinterpreted by shareholders.

- Requirements are more stringent than in other jurisdictions and for any other form of advisor: Disclosure of the detail proposed would mean the disclosures required of remuneration consultants are more stringent then a) any other country and b) any other company consultant, including auditors, legal consultants and bankers.

- Commercial sensitivity of disclosures: The disclosure of work, fees and the principles upon which the advice was prepared may reveal proprietary information from both the client and the consultant's perspective (e.g., how a consultancy prices its services, the consultant's methodologies, or insights into commercially sensitive strategic reviews the client is undertaking).

- External remuneration advice is only one input to the Board's decision making: Inferred in the draft legislation is that all remuneration consultant advice is adopted by Boards. This is often not the case, particularly in relation to remuneration quantum, where individual negotiations can lead to final remuneration packages which are significantly different from initial remuneration consultant advice. The disclosure of the consultant and the related fees would encourage shareholders to draw the conclusion that all elements of the company's remuneration structures are based on advice from the external consultant, which may not be the case.

Ernst & Young's suggested improvements to the draft legislation:

- Ernst & Young supports the enhanced disclosure of remuneration advice. However, this should be limited to disclosing who advised the company, a brief summary of what topics they advised on, and how the Board manages any potential conflicts of interest.

  These disclosures will allow shareholders to assess the Board's policy for managing conflicts of interest directly rather than using proxies (such as fees spent, type of work undertaken) to draw their conclusions. This will empower shareholders by providing relevant information, and will hold Boards accountable for appropriately managing conflict of interest. We do not think the requirement to disclose the fees and other services provided by the firm is necessary, and we believe is has unintended consequences as discussed above.

- If the Government believes some form of fee disclosure is required, our view is that any requirement should be based on "economic dependence" (i.e., what portion of the firm's total revenue is provided by that one client). If a specified proportion of revenue threshold is exceeded, additional disclosure requirements could be triggered.

2.5 Aspects that require clarification

We note the following items are currently unclear in the current draft of the legislation:

Aspect	*Ernst & Young comments*
Can the remuneration consultant discuss/gather input from management? The draft legislation does not specify if the consultant can seek input from management when providing remuneration advice to the Board.	Management provide important context, understanding of the business need/issues in assessing and developing remuneration approaches, potentially limiting the cost duplication of obtaining advice. Additionally, given the many other time pressures faced by the individual Board directors, it is appropriate to consult with management to obtain information.
Can management access the advice provided? The current proposed approach does not specify if advice can be provided to management after it is provided to the Board.	In order to successfully implement remuneration decisions, management will require access to external advice. If the Board must engage all advice, management will still need some mechanism whereby they can access advice.

How are KMP defined? The legislation specifically applies to KMP remuneration advice – KMP is an accounting term.	KMP are agreed with the company's auditor around the time of year-end for development of the annual report. Given the definition is defined retrospectively the same definition may not apply for the forthcoming year (particularly in the case of restructures and new hires where KMP status is not yet defined). It is not clear how KMP are to be defined in the draft legislation.
What type of 'advice' is covered? The legislation specifies advice relating to the nature, quantum or value of KMP remuneration however does not specify further what is meant by advice.	It is important for the Government to a definition of advice (i.e., advice regarding remuneration quantum or ongoing advice regarding overall strategy and structure). It is currently not clear what would be included in a definition of 'advice'.

3. "Two strikes and re-election" proposal

3.1 The proposed approach

The exposure draft contains legislation to implement the "two strikes and re-election" proposal. The Government's proposal is a modified version of the PC recommendation and attempts to address concerns that the two strikes rule would lead to Board instability, including a mechanism to ensure a minimum of three directors are retained. In addition to the Managing Director (who is not required to stand for re-election), the two other positions will be filled by those directors with the highest number of votes cast in their favour at the "spill meeting".

3.2 Ernst & Young's view

In our view, the current advisory vote does not require strengthening since, as mentioned in our submission to the PC, most companies already take action to understand and address high "no" votes.

However, if the Government is intent on strengthening the advisory vote, we are concerned that the proposal does not address the point raised by several parties, including Ernst & Young, that the "strike" threshold should be set at 50% in line with other resolutions.

Shareholders may vote against a remuneration report for a variety of (potentially inconsistent) reasons. As outlined in our prior submissions, Ernst & Young does not believe a threshold below 50% in either the first or second year is appropriate for the following reasons:

- Making changes to the remuneration approach after a minority "no" vote arguably goes against the view of the majority of shareholders.
- Companies impacted will likely incur reputational damage, which would be to the detriment of the majority of shareholders supporting the remuneration approach.
- Boards wishing to avoid reputational damage may take a "safe" approach to remuneration and/or invest greater time in remuneration at the expense of other issues, which may not be consistent with the strategic aims of the company.

Consequently, if the government proceeds with the proposed legislation, we suggest that the majority of shareholders be required to vote against the remuneration report to trigger the "spill resolution" (i.e., greater than 50% in the first and second year).

In addition, we suggest the removal of the requirement for companies to provide an explanation of whether comments on the remuneration report made at the company's most recent AGM were taken into account. We believe that the requirement for companies to justify what they have done in response to the "no" vote is sufficient to achieve the aims of the legislation.

Additionally, the government may wish to clarify if the legislation applies to all disclosing entities or to listed companies only.

4. Other proposed changes

We broadly agree with the remainder of the Government's proposals.

4.1 Removal of the requirement to disclose remuneration for the five highest paid

Ernst & Young view: Support

This change is a simplification which we support. The impact of this change is to limit disclosure to KMP only. We believe this is appropriate, since the Remuneration Report is intended to focus on the executive team (who are typically all included under the definition of KMP). These are the individuals who have the ability to make decisions on behalf of the company and its shareholders, and it is for these individuals that shareholders require information to assess the extent to which remuneration is aligned with their interests.

4.2 Prohibiting hedging of incentive remuneration

Ernst & Young view: Support but with a suggested clarification/amendment

Under the proposed new law, a KMP or closely related party will be restricted from entering into any arrangement that limits the executive's exposure to risk relating to an element of their remuneration that depends on the satisfaction of a performance condition.

We support the principle of the requirement. However, the suggested wording in the legislation does not provide clarity around what the prohibition relates to. If we assume the prohibition relates to hedging of unvested awards, we agree, since hedging over unvested awards removes or reduces the alignment of rewards with performance and should not be permitted.

However, the explanatory memorandum references both "unvested equity remuneration" and "vested equity subject to holding locks". We do not agree with prohibiting hedging of vested equity (regardless of holding locks), as this is remuneration that has been earned by the individual. In addition, it goes beyond the current requirements in the ASX's Corporate Governance Principles.

4.3 A requirement for shareholder approval for the Board to declare "no vacancy"

Ernst & Young view: Broadly support

The requirement for companies to seek shareholder approval for a declaration of "no vacancy" is intended to allow shareholders greater oversight of company Boards and increased influence over Board composition. We support this change as it may increase opportunities for Board renewal and may enhance Board diversity.

However, the ability to attract a valuable and highly suitable director who might become available between AGMs will be unnecessarily restricted. Also, as noted by the PC, in order to achieve the best operational outcomes for the company, it is important that existing Board members support the election of new directors.

4.4 Prohibiting KMP from voting on remuneration matters

Ernst & Young view: Support with modification

We agree KMP should be prohibited from voting on remuneration resolutions relating directly to their own arrangements or those of their peers. However, we believe KMP should be allowed to vote on the Remuneration Report as a whole as the Remuneration Report is a retrospective document detailing the financial year's remuneration arrangements and is not a prospective determination of remuneration. Additionally, the KMP are entitled to exercise their voting rights as an ordinary shareholder. We believe the right of a shareholder is to vote on the Remuneration Report and therefore KMP should not be excluded.

4.5 A requirement that all directed proxies are voted

Ernst & Young view: Support

This change is intended to prevent non-Chair proxy holders from "cherry picking" which proxies to vote. We agree with this change, and believe it is important for the views of shareholders to be accurately reflected in the voting outcomes.