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## **CORPORATIONS AMENDMENT (IMPROVING ACCOUNTABILITY ON DIRECTOR AND EXECUTIVE REMUNERATION) BILL 2011**

### **INTRODUCTION**

This submission focuses on the application of proposed changes relating to “**Improving Accountability On The Use Of Remuneration Consultants**”. My comments address a range of practical issues that companies may encounter if the legislation is introduced in its current form. I have had practical experience as a remuneration executive within a large organisation for 10 years, and now provide consulting services.

While there has been much debate over the needs to entrench the proposed amendments into legislation, the following contribution is offered on the basis that the Government has chosen this direction. The points that I will identify in this submission are issues that I believe are important for practical application of amendments to the legislation.

### **DEFINITION OF REMUNERATION CONSULTANT**

The exposure draft provides the following definition:

*remuneration consultant* means a person:

- (a) who, under a contract for services with a company, provides advice relating to the nature and amount or value of remuneration for one or more members of the key management personnel for the company; and
- (b) who is not an officer or employee of the company.

The proposed amendments will benefit from further clarification of the definition of who is a Remuneration Consultant. As it stands, the proposed definition may be interpreted as applying to all external people that provide input to remuneration consideration of the Remuneration Committee and the Board. This raises a number of practical issues for Boards and may significantly increase complexity and administrative workload for non executive directors (NED), especially the chair and members of the Remuneration Committee.

The advice and data provided by Remuneration Consultants is information to assist Boards in making decisions on executive remuneration. This includes what is happening in the market, and the quantum and structure of the remuneration arrangements. However, to enable the Board to finalise remuneration decisions,

the NEDs require contributions from other professionals. These may include, but are not limited to:

- Lawyers providing contract and compliance advice;
- Lawyers drafting documents relating to incentive plans;
- Advice on the valuation of equity instruments for long term incentive plans;
- Accountants who advise how the values of remuneration will be reflected in the accounts and the remuneration disclosure; and
- Potentially, this definition may also capture providers who advise on superannuation, taxation and other employment matters relating to KMP remuneration.

In practice, the above broader group of providers needs to work with other internal professionals, ie, input to the remuneration report, preparing company accounts and finalising legal documents. Their roles are typically not central to the decision taken by Boards in relation to remuneration structure, quantum and relativity to peer groups, however, they are essential inputs into the process of a Board. For example, an external legal advisor may be engaged to prepare the document containing the terms of a long term incentive plan, which must be approved by the Board. The task is to translate the plan design approved by the Board into the legal document to ensure that operation of the plan is consistent with the Board decision. Under the proposed definition the legal advisor could be deemed to be a remuneration consultant.

If these, and any other provider that provides any input into the remuneration processes for the CEO and other Key Management Personnel (KMP), fall within the definition of remuneration consultants it will raise significant practical issues for NEDs involved in the process. This may be in the form of a substantial increase in workload to manage these multiple relationships and the integration of various inputs, or alternatively, in increased costs due to the Board needing to engage an external provider to co-ordinate the activities of a number of providers.

#### **REMUNERATION CONSULTANTS TO BE ENGAGED BY A NED**

The proposal that a NED, typically the Chair of the Remuneration Committee, is responsible for engaging the Remuneration Consultant is in line with existing good practice. This is a sensible provision “conditional on” the clarification of the following two points:

- A Remuneration Consultant is defined as a consultant providing remuneration advice on market information, structure and quantum of remuneration and does not include other professionals that may provide some level of input, ie, legal, actuarial, accounting advice or other input that the Board or Committee seeks to assist in finalising the remuneration arrangements for the KMPs. This is due to the reasons outlined above; and

- The above requirement should not preclude the Board from being able to share relevant parts of the Remuneration Consultant's advice to the CEO, Human Resources Director and Head of Remuneration, as the Board determines appropriate. The reasons that support the sharing of this information are addressed later in this paper.

Mandating the direct engagement of the Remuneration Consultant without addressing these two points may result in difficulties in implementing the proposed amendments.

### **REMUNERATION CONSULTANT TO REPORT TO THE NED**

It is good practice that the Remuneration Consultant provides their advice direct to a NED, typically the Chair of the Remuneration Committee. However, the practical issue is how the necessary work is undertaken to:

- Translate the information provided by the Remuneration Consultant, and other advisors, into the remuneration arrangement for each KMP;
- Obtain input from the CEO on the remuneration recommendations for the other KMPs;
- Design remuneration structures aligned with the business strategy; and
- Develop the necessary legal and financial documentation, which the board requires to make a decision and implement the changes.

Further, assessment of performance, including achievement of KPIs, performance against financial and operational targets and performance against long term incentive plan hurdles, requires co-ordination across both internal and external resources, such as, internal audit, external audit, human resources, finance, and legal advisors.

While the Board has overall accountability for the remuneration decisions, their role is not to manage all the administrative aspects of remuneration arrangements for the KMPs. If this is the outcome of the proposed amendments to the legislation, it will result in either NEDs needing to devote significant time to these activities, or, more likely, the Board engaging external providers to assist them in administering these arrangements. A sensible approach is for the Board to continue to have access to management resources, ie, the Human Resources Director and/or the Head of Remuneration, to assist them in facilitating the activities. This by no means diminishes the direct accountability of the NEDs for the ownership of the relationship and the communication with the Remuneration Consultant. A precedence of this already exists in how the Head of Internal Audit engages with the Chair of the Audit Committee. Clearly, the Audit Committee engages and manages the relationship with the External Auditors, with the Internal Auditors also having a direct relationship with the Audit Committee assisting the Committee to perform its responsibilities.

## **USE OF REMUNERATION CONSULTANT ADVICE**

The proposed amendments to the legislation increases the separation of activities:

- With the Board having responsibility to undertake, or engage external providers to undertake, all activities associated with KMP remuneration; and
- The CEO having the responsibility for the remuneration of other executives and employees of the Company.

In practice this is not such a clear delineation and may cause conflicting behaviour within organisations. The proposed amendments to the legislation does not appear to specifically prohibit the Board from deciding to share information that it receives from the Remuneration Consultant with the CEO, the Human Resources Director and Head of Remuneration. However, it would be unfortunate if the proposed amendments were interpreted as limiting the Board's ability to share this information and utilise management resources. If this was to occur it may result in a number of unintended outcomes. For example:

- Not all direct reports to the CEO may be KMPs. Where this arises, the Board will be setting remuneration arrangements, including incentive targets for the CEO and other KMPs, with the CEO potentially making decisions for other seniors managers independent of the considerations of the Board. This may cause confused behaviour due to conflicting priorities;
- Similarly, if the CEO does not have access to information considered by the Board, there may be disconnects been the target setting for the KMPs reporting to the CEO and other levels of the organisations.
- The CEO has a responsibility to review and recommend to the Board the remuneration of Direct Reports. If the Board cannot share the information with the CEO related to the other KMPs, the CEO may be significantly inhibited in making these recommendations, or may need to source separate information at an additional cost to the Company. Of course, any information provided to the CEO would need to exclude information provided by the Remuneration Consultant relating to the CEO's own remuneration.

While I support the premise that the Remuneration Consultant reports directly to the Board, and is independent of management, to overcome these practical management issues it is important that the proposed amendments do not inhibit alignment and the sensible flow of information to enable decisions to be made at multiple levels of the organisation. The integrity of the system will be maintained by the Board owning the relationship with the Remuneration Consultant, receiving all information directly from the Remuneration Consultant, and then deciding how and what parts of the information may be used within the organisation, including what information is shared with specific senior managers to achieve alignment down through organisations.

## **SUMMARY OF SUGGESTIONS TO IMPROVE THE PROPOSED AMENDMENTS**

The following suggestions are focused on improving the proposed amendments to achieve clarity of accountability in the management of executive remuneration, and in particular, to assist in its the practical application. The proposed amendments would benefit from:

1. Providing a narrower definition of who constitutes a Remuneration Consultant. Limiting it to those who are providing information and advice on market data, and remuneration structure and quantum, will avoid unintended complexity and/or increased costs burdens on companies;
2. Conditional on a narrower definition of a Remuneration Consultant addressed in Point 1, a Non Executive Director, ie, the Chair of the Remuneration Committee, be responsible for engaging a Remuneration Consultant where required;
3. Conditional on a narrower definition of a Remuneration Consultant addressed in Point 1, the Remuneration Consultant will provide their advice direct to the Board, or a representative of the Board, ie, the Chair of the Remuneration Committee;
4. That these amendments should not be interpreted as precluding the Board from being able share elements of the advice with CEO, Human Resources Director and the Head of Remuneration, to enable the CEO to make recommendations on the remuneration of the other KMPs; and
5. The these amendments should not be interpreted as precluding the Board, or the Remuneration Committee, from engaging directly with the Human Resources Director and/or the Head of Remuneration for assistance in the facilitation of processes.

The above suggestions would assist in achieving the intention of the proposed legislative amendments with the Board having clear accountabilities for executive remuneration, whilst in practice not significantly increasing the complexity of the role of Non Executive Director and/or compliance costs to companies.

Laurie Wood  
January 2011