MERCER

Mercer (Australia) Pty Ltd
ABN 32 005 315 917
33 Exhibition Street Melbourne Vic 3000
GPO Box 9946 Melbourne Vic 3001
Tel +61 3 9623 5555
Fax +61 3 8640 0800
www.mercer.com.au

20 January 2011

Mr G Miller
General Manager
Corporations & Financial Services Division
The Treasury
Langton Crescent
Parkes ACT 2600

Subject: Exposure Draft - Corporations Amendment (Improving Accountability on Director & Executive Remuneration) Bill 2011

Dear Mr Miller

This submission by Mercer is in response to the public invitation to comment on the Exposure Draft of the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011. Our objective in this submission is to comment only on those amendments outlined in the Explanatory Memorandum which link directly to the integrity of board processes involved in the determination of executive pay (Proposed Amendments). In this respect, we comment on:

- Strengthening the non-binding vote – the two strikes test (Chapter 1);
- Improving accountability on the use of remuneration consultants (Chapter 2);
- Prohibiting key management personnel (KMP) from voting on remuneration matters (Chapter 3);
- Prohibiting hedging of incentive remuneration (Chapter 4); and
- Persons required to be named in the remuneration report (Chapter 7).

Mercer is a leading global provider of consulting, outsourcing and investment services. Our services include consulting to corporations, boards of directors and board remuneration committees concerning the pay of directors and executives. In Australia, as with other jurisdictions in which Mercer operates, we have extensive experience in designing and implementing executive and board remuneration programmes. As a result, we understand how boards and remuneration committees function and we have assisted countless companies improve their executive remuneration disclosure and related governance processes under their respective reporting requirements, locally and around the globe.

Mercer (Australia) Pty Ltd is a wholly owned subsidiary of Marsh & McLennan Companies Incorporated. The views expressed in this submission are the views of Mercer (Australia) Pty Ltd and do not necessarily represent the views of Marsh & McLennan Companies, its affiliated companies or clients.

Our submission on the Exposure Draft follows previous submissions to the Productivity Commission's Executive Remuneration Inquiry in May 2010 and our subsequent November 2010 commentary on the Productivity Commission's draft report.

## Summary of Mercer's Comments on Exposure Draft – Corporations Amendment

The stated purpose of the Bill is to introduce a range of measures to strengthen Australia's remuneration framework and to implement recommendations made by the Productivity Commission in its final report to Government in December 2009. Furthermore, the Bill aims to empower shareholders to hold directors accountable for their decisions relating to executive remuneration and to eliminate conflicts of interest in the remuneration setting process and increase transparency and accountability in executive remuneration matters.

We preface our comments on the Proposed Amendments with reference to three issues arising from the Productivity Commission inquiry that demonstrate Australian companies have highly ranked corporate governance practices, executive remuneration levels that are low relative to the US and UK and shareholder support for the current regulatory structure.

First, the Productivity Commission's final report[1] notes the World Economic Forum has consistently ranked Australia in the top three countries for corporate governance since 2002-03. Similarly noted by the commission is Governance Metrics International 2008 ranking of governance in top Australian companies as fourth of 38 countries based on criteria including board accountability, internal controls, shareholder rights, executive remuneration and corporate behaviour (p. 126).

Second, the Productivity Commission's final report concluded "Australian executive remuneration levels generally remain below those in the United States and United Kingdom, being more in line with smaller European economies" (p. xix).

Third, submissions to the Productivity Commission inquiry by major Australian shareholder associations confirm general support for Australia's existing balance of legislation, listing rules and principles-based guidelines. The Australian Shareholders Association submission notes "extreme regulatory proposals being considered in other places are not necessarily relevant in this country" and "in so far as recommendations are for further regulation they call for minimal government intervention" (p.2). Similarly, the Australian Council of Superannuation Investors (ACSI) argues "the 'if not, why not' regime arising out of the ASX Corporate Governance Council Principles and Recommendations already provides a workable code of practice that has been widely accepted by both *[sic]* companies, shareholders and other stakeholders in Australia" (p. 10). ACSI concludes its submission by declaring "that we have much to be proud of in the Australian remuneration regulatory regime" and states that aside from some reforms it "does not believe there is a cause for wholesale change to this regime" (p. 16).

---

[1] Unless otherwise stated, all references to the Productivity Commission's report are to the final report as released on January 4, 2010.

Within this context from the Productivity Commission inquiry, and as described in detail below, Mercer opposes the following Proposed Amendments:

- Introduction of a ‘spill’ motion requiring elected directors to stand for re-election if two successive votes on the remuneration report receive a ‘no’ vote;
- Prescriptive conditions relating to the engagement of remuneration consultants to provide advice on Chief Executive Officer (CEO) and KMP remuneration;
- The application of strict liability with regard to conditions of engagement and provision of advice on CEO and KMP pay by remuneration consultants; and
- Specified aspects of the remuneration consultant disclosure requirements.

Consistent with our submissions to the Productivity Council, Mercer supports the following Proposed Amendments:

- Prohibiting KMP and closely related parties from voting on their own remuneration;
- Prohibiting hedging of incentive remuneration; and
- Limiting disclosure in the remuneration report to KMP.

## Chapter 1 - Two Strikes and Board Spill

Proposed Amendments aimed at strengthening the non-binding vote on the remuneration report provide for a ‘spill’ motion, requiring all elected directors to stand for re-election if two successive votes on the remuneration report receive a ‘no’ vote. The spill motion requires a shareholder meeting to be held within 90 days of the second vote and the motion will be passed with 50% or more of the votes cast in favour.

These amendments address Recommendation 15 from the Productivity Commission:

*The Corporations Act 2001 should be amended to require that where a company’s remuneration report receives a ‘no’ vote of 25 per cent or higher, the board be required to report to shareholders in the subsequent remuneration report explaining how shareholder concerns were addressed and, if they have not been addressed, the reasons why.*

*If the company’s subsequent remuneration report receives a ‘no’ vote above a prescribed threshold, all elected board members be required to submit for re-election (a ‘two strikes’ test) at either:*

- *an extraordinary general meeting or*
- *the next annual general meeting.*

We oppose the introduction of a spill motion requiring elected directors to stand for re-election for the following reasons:

- There is a gross inconsistency in the logic introducing this amendment as given on page 5 of the Explanatory Memorandum which states: “Currently, if shareholders are dissatisfied, they have the power to vote to remove a director, although this is a somewhat extreme response, particularly if the director is having a positive impact on the value of the company.” Given the unquestioned significant role of the board in directing the affairs of a corporation on behalf of its shareholders, Mercer views the consequence of a board spill resulting from a minority vote against the remuneration report as excessive. The election will cause considerable disruption to the company and is disproportionate to the message a no-vote intends, particularly where shareholders are otherwise satisfied with the company's direction and performance.

- The 25 percent threshold is so low that it will almost inevitably allow a situation where a minority view is favoured over a significant majority, thus impinging on the principle of shareholder democracy. A negative vote in year 1 provides an opportunity for a major shareholder or group of shareholders to have undue influence over the board or other shareholders during the second year.

- The voting process leads to an 'all or nothing' outcome. For example, it is entirely feasible that one element of an otherwise acceptable remuneration proposal may be considered controversial, not only causing the report to be voted down, but also the ensuing disruption of a board election.

- Given the initial low threshold, we believe that this amendment will be instrumental in promoting a homogenised approach to the structure of executive remuneration. Such an institutionalised outcome may persuade directors to focus remuneration strategies on what is perceived to gain easy passage of the remuneration report rather than what is in the best interests of the company's long term value.

Mercer Recommendation
Given Australia's consistently strong comparative ranking in corporate governance on executive remuneration issues, Mercer believes this amendment is unnecessary and we argue that the existing 'comply or explain' approach is sufficient, particularly as no other jurisdiction has seen the need to force a full board to stand for re-election on such issues.

## Chapter 2 - Accountability on Use of Remuneration Consultants

Proposed Amendments in this chapter address concerns regarding the engagement of remuneration consultants to advise on executive and board remuneration. The first concern raised in the Explanatory Memorandum is the potential for conflicts of interest if the consultant provides advice to officers who might retain the consultant's services for remuneration or other consulting services. A second concern is that "remuneration consultants can 'ratchet up' remuneration levels". Further, in its response to the Productivity Commission inquiry (Australian Government Response to the Productivity Commission's Inquiry on Executive Remuneration in Australia April 2010), the Federal Government also raised the objective of "ensuring transparency and accountability to remuneration consultants" (p. 14).

The Proposed Amendments in this Chapter cover the engagement of consultants and disclosure of the details relating to the use of consultants.

Mercer firmly supports the need to avoid conflicts of interest with regard to executives influencing their own pay outcomes and the requirement to disclose the use of remuneration consultants. This is demonstrated in our submissions to the Productivity Commission inquiry and in our support for Proposed Amendments outlined in chapters 3 and 4 of the Explanatory Memorandum. However, we are opposed to the Proposed Amendments in their current form and to them being legislated and forming part of the Corporations Act. We contend that the amendments do not effectively address the objectives as outlined in the Explanatory Memorandum.

The following sections present our reasons for opposing the Proposed Amendments and outline alternative approaches to achieving the stated objectives without the negative consequences we believe the Proposed Amendments will create.

## *1. Engagement of remuneration consultants*

Proposed Amendments provide that a contract for advice relating to the nature, amount and value of the remuneration of one or more members of KMP can be executed only by a non-executive director of the company (except where all directors are executive directors). A breach of this section is an offence of strict liability as defined under the criminal code. Further, the consultant can also provide the advice only to a non-executive director. Providing the advice to executive directors or employees of the company is also an offence of strict liability.

These amendments were drafted to implement Recommendation 11 from the Productivity Commission:

*The ASX listing rules should require that, where an ASX300 company's remuneration committee (or board) makes use of expert advisers on matters pertaining to the remuneration of directors and key management personnel, those advisers 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.*

We support the objective of this recommendation which is to avoid conflicts of interest by minimising the scope for executives to influence the design of their own remuneration (p.xxix).

Clearly, the intent of the Productivity Commission was to manage this potential conflict through the ASX Corporate Governance Guidelines (comply or explain). However, the Proposed Amendments go well beyond what the Productivity Commission deemed an appropriate basis to manage such conflicts by incorporating a detailed prescriptive process into the legislation and specifying breaches of the legislation as an offence of strict liability. All of this to regulate the execution of a consulting contract for the provision of advice on executive pay which, in dollar terms, is far less significant than contracts for advice on capital expenditure, mergers and acquisitions, investment banking and the like which materially affect the performance and financial success of the company and do not require execution by a non-executive director. Similarly these consulting contracts pose less potential for conflicts of interest than related party transactions or audit assignments.

Proposed Amendments also go beyond the Productivity Commission's original recommendations by prohibiting management from engaging a remuneration consultant. The commission specified the requirement for the consultant to be engaged by the board or remuneration committee should apply if the committee or board makes use of consultants to advise on the remuneration of directors and KMP. The Productivity Commission was explicit in not prohibiting management access to information, commenting in its final report that the intention was to "require consultants to report directly to the board or remuneration committee (without constraining scope for them to consult with management)" (p. xxix).

We also contend there can be no conflict of interest, actual or potential, where management is the client. In these cases, the board is aware that materials presented by management - or by management's consultants - reflect management's recommendations. It is up to the committee to exercise judgment, being aware of the obvious potential for bias, in evaluating the quality and objectivity of such recommendations.

Our opposition to the Proposed Amendments regarding the engagement of remuneration consultants is not just that they go significantly beyond the Productivity Commission's recommendations, but that there is a strong likelihood of other unintended consequences:

- The Proposed Amendments may deter boards from seeking external advice and rely instead on internal recommendations put forward by management: in effect, an outcome counter to the stated objective of limiting the executives' ability to influence their own pay. Further, in seeking to block management's access to remuneration information, the amendments overlook the fact that disclosure requirements mean that comparative pay information on other CEOs and KMPs is in the public arena and enables CEOs and KMPs to compare and assess the competitiveness of their respective packages.

- The requirement that advice on the nature, amount and value of remuneration paid to one or more members of KMP must go to a non-executive director will limit management's ability to review and amend broad-based employee remuneration policies (e.g. benefits, group insurance, employment policies, employment contracts, incentive arrangements, including performance metrics, and superannuation plans) where these plans apply to all employees. In this respect, the amendments will expand the non-executive director's role to cover areas of management responsibility.

- The Proposed Amendment overlooks the reality of corporate life where the development of remuneration plans and policies requires a considerable exchange of information with a range of internal stakeholders to ensure legislative compliance of programs, accuracy of provisions, likely tax implications for participants and the like. It is unrealistic to assume a non-executive director will act as an intermediary between remuneration consultants and other executives and senior managers engaged in this work.

- Similarly, it is acknowledged in practice and theory that it is a function of the board to determine the remuneration of the CEO and to review the CEO's recommendations for direct reports. By limiting access of the CEO to external remuneration and expert advice, these provisions will erode the role of the CEO and expand that of the board to areas that more properly belong with the CEO.

- Remuneration consultants typically consult with management in preparing advice for the board to ensure their advice is informed and relevant to the company business strategy and operating context. The capacity to consult management on such issues, while simultaneously reporting to the board, is essential to provide robust advice aligned with business objectives and based on appropriate performance criteria. The prohibition on providing advice to anyone but a non-executive director will prevent this consultative approach to formulating recommendations to the committee or board.

- The fact that a breach of the amendments would be an offence of strict liability will further limit the number of providers of remuneration advice in the industry as many multi-services firms are already discouraged from providing executive remuneration services due to additional disclosure requirements. This outcome is contrary to the interests of companies and their shareholders who benefit from the breadth and depth of resources that large, global multiservice firms such as Mercer bring to the issues of executive and director remuneration.

Finally, we note that most Anglo-American jurisdictions advocate that the board or remuneration committee retains its own expert advisors on remuneration matters. No other governance code or regulatory regime limits management's freedom to retain advisors; nor does any other governance framework provide for a strict liability offence as a context surrounding the engagement of remuneration consultants (or any other type of consultant).

More specifically, and although the rules are not yet in effect, under the Dodd-Frank Act in the US, compensation committees must have the authority to retain advisers: "*The compensation committee… may, in its sole discretion, retain or obtain the advice of a compensation consultant… [and] shall be directly responsible for the appointment, compensation and oversight of the work of a compensation consultant…. This paragraph may not be construed –(i) to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant; or (ii) to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfilment of the duties of the compensation committee."*

The Act does not prohibit management from hiring it own consultant. These requirements will be implemented by US Securities Exchange Commission (SEC) rules and, the penalty for noncompliance will be stock exchange delisting.

<u>Mercer Recommendation</u>
The approach used in the Dodd-Frank Act presents a viable alternative to the proposed amendment in that it allows management to engage consultants and the penalty of delisting for noncompliance is midway between the intent of the Productivity Commission for "comply or explain" guidelines and the proposed penalty of strict liability.

## *2. Disclosure of remuneration consultants*

Proposed Amendments in chapter 2 introduce additional disclosure requirements relating to the use of remuneration consultants. Specifically, if a remuneration consultant provides advice on the remuneration of KMP of a company, the following details are required to be disclosed in the annual report:

i. The name of the consultant;
ii. The name of each director who executed the contract under which the consultant was engaged;
iii. The name of each person to whom the consultant directly gave the advice;
iv. A summary of the nature of the advice and the principles on which it was prepared;
v. The amount and nature of consideration provided under the contract for the advice;
vi. The nature of any other work the consultant did during the financial year for the company; and
vii. The amount and nature of consideration for any work described in point vi above.

The Proposed Amendments address Recommendation 10 from the Productivity Commission:
*The ASX Corporate Governance Council should make a recommendation that companies disclose the expert advisers they have used in relation to the remuneration of directors and key management personnel, who appointed them, who they reported to and the nature of other work undertaken for the company by those advisers.*

We argue against the Proposed Amendments on disclosure for three reasons: they go beyond what the Productivity Commission deemed an appropriate basis to manage disclosure; they go beyond requirements of other key jurisdictions; and they do not achieve the stated objective for the disclosure requirement.

First, we contend that by incorporating the requirements into the Corporations Act, rather than including them in the ASX Corporate Governance Council's Guideline, the proposed legislation goes beyond what the Productivity Commission deemed was an appropriate basis to manage disclosure.

Second, we argue that it does not "bring Australia into line with other key jurisdictions requiring the disclosure of the use of remuneration consultants" as stated in the Explanatory Memorandum (see p. 9;2.5), but in fact exceeds the disclosure requirements of major jurisdictions such as Canada, the UK and the US on this particular aspect of disclosure. For example, in the US, the jurisdiction with the most demanding consultant disclosure requirements, there is no obligation to disclose the specific individuals that executed the contract or received the advice, nor is there a requirement to disclose the nature of any additional services performed.

Third, we do not oppose disclosure of the name of the consultant; however, we believe it is important to clarify the purpose of the disclosure to determine the extent of disclosure required. We believe the proposed amendments do not contribute to the stated objective "to avoid conflicts of interests and to minimise the scope for executives to influence the design of their own remuneration" (p.xxix). Instead they undermine the ability of the company and its board to make informed and objective decisions regarding remuneration matters within an environment that would allow necessary collaboration on how best to link remuneration to corporate strategy without disclosing commercially sensitive information. They also question the business contribution and integrity of firms and their employees who have established a legitimate reputation for their expertise in dealing with the complex issues surrounding the determination of executive pay.

In this respect, the amendments are based on four misconceptions regarding the way in which companies engage with their remuneration consultants.

1. ***Remuneration consultants dictate pay outcomes.*** The role of remuneration consultants is generally not well understood by shareholders. Contrary to views often presented in the general press, consultants do not tell remuneration committees or management what to do, nor do we negotiate employment or pay arrangements, set remuneration philosophies, or determine pay levels, equity awards or incentive plan payouts. We do provide objective information, insights and advice to clients (boards, remuneration committees and management) to help them make informed decisions on executive pay. While advice from consultants may be influential, clients do not always follow that advice and may use a range of advisers to inform their decisions. As acknowledged in the Explanatory Memorandum (p. 9;2.3), boards have the primary responsibility for determining executive remuneration.

2. ***The use of consultants "can 'ratchet up' remuneration levels".*** (See Explanatory Memorandum p.9; 2.2) We believe the increase in executive pay, particularly over the past decade, is largely the result of an information efficient executive pay market resulting from increasing remuneration disclosure requirements. By way of example, academic research indicates three effects resulting from executive pay disclosure: first, it forces lower paying firms to better align with market averages to meet the 'going rate' expectations of candidate or incumbent executives; second, it prompts some firms to move to an identified position of market leadership; and third, there is a consistent tendency noted for companies to increase the weighting on performance-based pay.[2] The first two of these effects, moving to the market average and taking a position of leadership, inevitably increase the fixed component of pay while the third contributes to a lift in total remuneration. It is noteworthy that the introduction of disclosure, originally intended to increase the transparency of pay outcomes for shareholders, has had the unintended consequence of increasing pay.

---

[2] See for example, P. Gélinas and M. Magnan 2004, 'Increased compensation costs: An externality of mandatory executive compensation disclosure', paper presented to Administrative Sciences Association of Canada, Quebec, June 5-8; K. Lo 2003 'Economic consequences of regulated changes in disclosure: the case of executive compensation', Journal of Accounting and Economics, vol 35, no. 3, pp. 285-314; Y. Park *et al* 2001 'Executive pay and the disclosure environment: Canadian evidence', *The Journal of Financial Research*, vol. 24, no. 3, pp. 257-65.

3. ***A conflict of interest exists when multiservice firms are used to provide remuneration advice to corporations.*** The assumed conflict of interest is that consultants employed by multiservice firms fail to provide objective advice to their remuneration committee clients and instead enhance management's remuneration levels in an effort to establish, preserve or enhance consulting fees from other engagements with management. Not only is this a flawed assumption, but so too is the corollary premise that single service firms recommend lower pay for management and therefore the use of such firms does not require shareholder or regulatory scrutiny. There is no evidence that companies that use multiservice firms that perform other services for the company have higher CEO pay or that those that use single service have lower pay. Available academic research shows no consistent evidence of a statistical relationship between a consulting firm's business model and CEO pay levels.[3]

4. ***Shareholders are in a position to determine whether conflicts of interest exist or are being addressed when a board uses remuneration consultants.*** We believe that remuneration committees, rather than shareholders, are better positioned to determine whether they are making appropriately considered decisions that are not influenced by potential conflicts of interest.

   Mercer Recommendation
   Remuneration committees should be able to rely on protocols adopted by multiservice consulting firms to mitigate any potential conflicts. For example, Mercer's formal letters of engagement with clients disclose the nature of any other, non-executive remuneration services, provided to the respective client. See Appendix A for further detail on Mercer's protocols.

   Again, we feel a viable solution would be to refer to the Dodd-Frank Act in the US which requires that companies must consider factors affecting compensation consultant's independence and disclose whether the compensation committee retained a consultant and, if so, whether the work raised any conflicts of interest, including the nature of any conflict that did arise and how it was handled. See Appendix B for more detail on these provisions.

---

[3] See for example, C. Armstrong *et al* 2008 'Economic characteristics, corporate governance, and the influence of compensation consultants on executive pay levels', Social Science Research Network, Available at *http://ssrn.comabstract=1145548*; B. Cadman et al 2009 'The incentives of compensation consultants and CEO pay', Social Science Research Network, available at *http://ssrn.com/abstract=1103682*; M. Conyon *et al* '2009 Compensation consultants and executive pay: evidence from the United States and United Kingdom', Academy of Management Perspectives, vol. 23, no. 1, pp. 43-55

Outlined below are the specific reasons why we oppose key elements of the proposed disclosure amendments:

- ***Disclosure should only apply to advisers to the remuneration committee***
  The amendments require disclosure for any advice on the remuneration of the KMP irrespective if advice was obtained by the board or management. The objective of avoiding conflict does not support extending the disclosure requirement to services provided solely for management. We note the same argument as in our opposition to the prohibition of management engaging consultants on page 6.

- ***Names of individual directors executing a contract should not be disclosed***
  As mentioned earlier, it is generally acknowledged in practice and theory that it is an accountability of the board to determine the remuneration of the CEO and to review the CEO's recommendations for direct reports. The additional disclosure may give the impression of limiting accountability to the specific director who executed the contract or received the advice, rather than maintain the collective board accountability.

- ***Names of persons to whom the consultant gave advice should not be disclosed***
  The requirement to disclose the names of each person to whom the consultant gave advice aims to limit the provision of advice to non-executive directors only. As previously described, under existing remuneration disclosure requirements comparative pay information on other CEOs and KMPs is already in the public arena and enables executives to compare and assess the competitiveness of their respective packages.

- ***Summary of the nature of advice, the principles involved and amount of consideration provided***
  The description of this amendment is vague and we contend is unlikely to lend itself to a clearly defined requirement. In its current form, it is likely to leave companies exposed as they would need to anticipate what level of information would reasonably be required. We also note that providing a summary of the advice and principles on which it was prepared may create competitive harm as it would divulge information on business strategy.

  <u>Mercer Recommendation</u>
  We believe disclosure of the consulting firm's name is sufficient information for shareholders to form an assessment of the advisor. If further disclosure is required then it should be limited to the specific aspects of remuneration (e.g. fixed pay, short- and long-term incentive design) on which the remuneration committee received advice and be disclosed only if the board acted on the information.

- ***Disclosure of nature of and fees received for other work is a poor proxy for conflicts of interest***
  We oppose this Proposed Amendment for several reasons as it creates the false presumption that if other services are provided there is a conflict of interest, it may result in competitive or proprietary information being disclosed and it will reduce competition and choice.

a. The Proposed Amendment will require the provision of potentially misleading information that will not enable shareholders to assess potential conflicts of interest but instead will create the false presumption that if other work is performed there is automatically a conflict of interest.

   The implication of the Proposed Amendment is that the mere fact of other services being performed indicates that the consulting advice lacked objectivity. However, it does not highlight the potential conflict if a single service firm receives a significant portion of its revenue from one client. The firm's financial stability may be threatened if it provides advice that a client does not want to hear; however, as there are no other services to be disclosed, it is assumed there is no potential for a conflict of interest.

b. The Proposed Amendment will result in competitive information being disclosed as the nature of other services will require companies to reveal services involved with potential mergers and acquisitions or changing a subsidiary or a division's business strategy. Even in the US, which requires extensive disclosure of the use of remuneration consultants, there is no requirement to disclose the nature of the additional services. The rules require disclosure of fees paid to board executive compensation consultants only if the aggregate fees for additional services exceed US$120,000.

c. Disclosing the 'nature of other services' will reduce competition and choice as companies are reluctant to disclose confidential services and may decide to use only consulting firms. Or it may discourage companies from using multiservice firms in more than one capacity and therefore diminish the consulting resources available in the market. In turn, this will discourage multiservice firms from providing executive remuneration services. This outcome is contrary to the interests of shareholders who benefit from the breadth and depth of resources that large, global multiservice firms bring to the issues of executive and director remuneration. Further, as previously stated, companies would likely turn to single service consulting firms yet these firms may be influenced by the high percentage of revenues that a single client may represent.

   This diminished choice has adverse implications for executive remuneration program design. Only the large multiservice firms have global knowledge and presence, have the financial resources to invest in substantial databases and research, or the depth of talent to staff intensive projects such as a merger or acquisition. As companies are being asked to assess risk in their incentive plans, multiservice firms have the analytic tools and the business consulting expertise to assist them.

d. The Proposed Amendment does not specify whether disclosure should relate to the 'nature of and fees for other work' performed for the company by the specific adviser, the consulting firm or all affiliated entities of such firm. In the case of a consultant such as Mercer, which is ultimately owned by Marsh & McLennan Companies Incorporated, the consultant's affiliates may have broad global reach across diverse sectors and affiliated companies have separate management. Executive remuneration consultants at Mercer are unlikely to know the nature and scope of services provided by these affiliated companies for clients around the world.

## Chapter 3 - Prohibiting KMP voting on remuneration

The Proposed Amendment will prohibit KMP and closely related parties from voting their shares on their own remuneration arrangements and undirected proxies on all remuneration resolutions.

This amendment addresses Recommendations 4 and 6 from the Productivity Commission:

*The Corporation Act 2001 should specify that company executives identified as key management personnel and all directors (and their associates) be prohibited from voting their shares on remuneration reports and any other remuneration-related resolutions.*

*The Corporations Act 2001 and relevant ASX listing rules should be amended to prohibit company executives identified as key management personnel and all directors (and their associates) from voting undirected proxies on remuneration reports and any other remuneration-related resolutions.*

Mercer supports the prohibition on KMP and related parties voting their shares on their own remuneration arrangements because it addresses an issue that poses a clear conflict of interest for the parties concerned.

However, we oppose that part of the Proposed Amendment which prohibits KMP or closely related parties from voting undirected proxies on all remuneration related issues on the basis that an undirected proxy implies a shareholder's intention to vote in favour of a board proposal. To prevent a shareholder from exercising this intention takes away the right to have their vote counted. Given the potentially significant impact of a 25 percent 'no' vote as outlined in Chapter 1, Mercer believes this Proposed Amendment will add further to the likelihood of a minority 'no' vote having a disproportionate influence over a significant majority in favour of a remuneration proposal.

## Chapter 4 - Prohibition on hedging incentive remuneration

The Proposed Amendment will prohibit management personnel (and closely related parties) from hedging remuneration that depends on satisfaction of specified performance conditions.

This amendment addresses Recommendation 5 of the Productivity Commission:
*The Corporation Act 2001 should prohibit all company executives from hedging unvested equity remuneration and vested equity remuneration that is subject to holding locks.*

Mercer supports this amendment on the basis that hedging performance-based remuneration dilutes the intention of performance pay as a means of alignment with shareholder interests. We note the Bill provides examples of arrangements that will or will not be considered ‘hedging’.

## Chapter 7 - Persons named in remuneration report

The Proposed Amendment will limit remuneration disclosures to defined KMP of the consolidated entity.

This amendment addresses Recommendation 9 of the Productivity Commission:
*Section 300A of the Corporations Act 2001 should be amended to reflect that individual remuneration disclosures be confined to the key management personnel. The additional requirement for the disclosure of the top five executives should be removed.*

Mercer supports limiting individual remuneration disclosure to KMP on the basis that executives nominated as KMP are, by reason of their seniority and roles, participants in the overall planning of the corporation’s strategic objectives and operating priorities and thus exert significant influence on the performance of the company.

## Concluding Commentary

Mercer’s overall view is the Proposed Amendments provide an overly prescriptive and legalistic approach, with penalties out of line with the nature of the offences, and generally go beyond the recommendations articulated by the Productivity Commission. We believe the approach taken is unwarranted and inconsistent with the global reputation of Australia’s governance framework.

We do not believe the Proposed Amendments achieve the stated objective of the Bill to “eliminate conflicts of interest in the remuneration setting process and increase transparency and accountability in executive remuneration matters” but instead add a level of reporting complexity and create an impression the determination of executive remuneration is more important than other decisions of the board.

Throughout this submission we have detailed our objections to the specific aspects of the Proposed Amendments and expressed our opinion that existing guidelines and legislation in place in other jurisdictions are more effective and less obtrusive in giving effect to the objectives articulated by the Productivity Commission. The rules in other jurisdictions are primarily based on disclosure not the regulation of behaviour and do not seek to limit the ability of boards and management to collaborate on the issue of remuneration and business performance, and to seek advice from a range of sources. The typical enforcement mechanism is delisting, and not an offence of strict. Other provisions to consider to achieve the objective of avoiding conflicts of interest and to minimise the potential for executives to influence their own remuneration, include:

- Disclosure of protocols in place to avoid conflicts -- citing our global standards; and
- Disclosure of factors the remuneration committee considered in determining if the consultant was independent.

We appreciate the opportunity provided to present Mercer's views on the proposed amendments. Should you wish to discuss further any issues raised in our submission, please do not hesitate to contact us.

Yours sincerely,

**Christine Deveney**
**Principal**
Tel: 02 8864 6364
Email: christine.deveney@mercer.com

**Yolande Foord**
**Principal**
Tel: 03 9623 5692
Email: yolande.foord@mercer.com

## Appendix A

Mercer has adopted processes and procedures to minimise the potential for the firm's relationship with a client to exert inappropriate influence over executive remuneration advice.

- In addition to its overall Code of Conduct, Mercer has adopted **Global Business Standards** to manage any potential conflicts related to executive remuneration consulting. These are incorporated into our engagement letters, which are required for all client relationships.
- Specifically, we establish and document clear **reporting relationships** between the consultant and the committee, and rules regarding whether and how information and recommendations are shared with management team members.
- We **disclose** to our remuneration committee clients Mercer's relationship with the client organization, including fees and services.
- **Our incentive programs** for consultants also support objectivity. Consultants are not paid bonuses or commissions for sales of other services to clients. Consultants' remuneration does not depend on the programs they design.
- **Our reporting structure** also supports objectivity. Executive Remuneration Consultants do not report to client relationship managers or to consultants in other lines of business. They report through our human capital line of business, of which executive remuneration is one segment.
- Executive remuneration consultants are required to **report to our leadership** any effort on the part of management or another Mercer consultant to influence our executive remuneration advice.

We also work with our clients to establish any additional safeguards tailored to meet their specific needs or concerns. We believe that our Global Business Standards mitigate the potential for our remuneration committee consultants to be inappropriately influenced by management.

## Appendix B

### Compensation committee and adviser independence

Under the Dodd-Frank Act, compensation committees and their advisers must meet independence standards to help ensure that pay decisions reflect shareholders' interests. After developing independence standards, the SEC must direct securities exchanges not to list the securities of companies that fail to comply. Set forth below is a summary of the Dodd-Frank Act provisions on compensation committee and adviser independence.

- ***Compensation committee members***. All compensation committee members must be independent directors. In determining independence, SEC rules must instruct stock exchanges to consider the committee member's source of compensation – including consulting, advisory or other fees – and whether the member is an affiliate of the company.
- ***Compensation consultants, legal counsel and advisers.*** A compensation committee's ability to retain compensation consultants, legal counsel and other advisers is regulated as follows:
- ***Adviser independence.*** Though the act doesn't explicitly require independent advisers, compensation committees selecting consultants, legal counsel or other advisers must consider independence factors to be identified by the SEC. These independence standards must be "competitively neutral among categories of consultants, legal counsel, or other advisers and preserve the ability of compensation committees to retain the services of [firms] of any such category." In developing independence standards, the SEC must consider these factors:
  - Other services provided to the company by the adviser's employer
  - Fees paid by the company to the adviser's employer as a percentage of that employer's total revenues
  - Conflict-of-interest prevention policies and procedures of the adviser's employer
  - Any business or personal relationship between the adviser and a compensation committee member
  - Any company stock owned by the adviser
- ***Authority to retain advisers***. The compensation committee must have sole discretion and authority to retain and obtain advice from advisers and be directly responsible for their appointment, compensation and oversight. The committee does not have to implement or act consistently with any advice or recommendations, and appointing a service provider does not limit the committee's ability or obligation to exercise its own judgment in fulfilling its duties.
- ***Disclosure of consultants.*** Proxy statements must disclose whether the compensation committee retained a consultant and, if so, whether the work raised any conflicts of interest, including the nature of any conflict that did arise and how it was handled.
- ***Funding for advisers.*** A company must provide appropriate funding to pay advisers' fees, as determined by the compensation committee.
- ***Study and review.*** The SEC must review the use of compensation consultants meeting the independence standards and issue a report to Congress on their impact.