

15 March 2013

General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: corporations.amendments@treasury.gov.au

Dear Sir / Madam

Exposure Draft to Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012 – A Comment

Egan Associates is pleased to respond to Treasury's discussion paper on the above proposed amendments to the Corporations Act. Egan Associates is an established consultancy advising the leading companies and public organisations of Australia and New Zealand on executive and board remuneration and governance matters.

We are broadly supportive of the proposed amendments being made to the Corporations Act 2001 but would like to make the following general and technical comments to assist the proposed legislation better achieve its stated aims.

General Comments

The material referred to below has of necessity a technical overlay responding to the proposed legislation. In essence it is our view that a well crafted Remuneration Report which incorporates financial data and an explanation of the company's remuneration policy and structure meets all the requirements foreshadowed in the proposed legislation.

While our organisation is keen to see clarity optimised, we are not convinced that the proposed legislation achieves that outcome, but rather extends the burden on companies to meet a compliance requirement which will not prove helpful to the retail investor. It would be our assessment that companies of scale are progressively adapting their communication to meet shareholder requirements and to demonstrate alignment between the company's performance and key management personnel (KMP) reward outcomes.

The existing standards require the integration of financial reports, including statutory information, with a descriptive Remuneration Report. For reasons of clarity, where the latter is required to be published in the financial accounts a more appropriate Remuneration Report may be one which has a simpler form, with the financial accounts incorporating statutory information requirements.

Our experience is that for more than 90% of Australia's leading companies Boards are addressing their accountabilities responsibly and are endeavouring to address the challenges of attracting and retaining appropriate talent in accordance with corporate performance and each entity's capacity to pay. In this context it is our assessment over several decades of practice that the Board's primary task remains that

of exercising independent judgement, informing themselves on market practice and managing the risks associated with their reward strategy and its integrity.

Technical Comments

As you would be aware, the relevant proposals contained in the exposure draft legislation and accompanying explanatory memorandum (EM) to the introduction of the Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012 suggest requiring listed disclosing companies to disclose the following amounts of remuneration paid to KMP:

1. Remuneration granted before the current financial year and paid during the current year;
2. Remuneration granted and paid during the current year; and
3. Remuneration granted but not yet paid in the current year (regardless of whether or not any such payment is ultimately dependent on satisfaction of a performance condition).

The EM states that “presenting information in this way will assist shareholders to distinguish between present pay, future pay, and pay that has been received due to past pay being crystallised” (at paragraph 2.31). Further, “this will mean disclosing companies will now report what is realised pay for KMP” (at paragraph 2.32).

We do not disagree with the stated intent of the proposed legislative amendments. If introduced in their present form, the new provisions will clearly specify the actual remuneration outcomes paid and payable to KMP. The proposed amendments will, however, *not* necessarily improve comprehension of KMP remuneration. Currently required disclosures already facilitate the identification of amounts proposed to be separately disclosed in the remuneration report under the draft legislation.

Most critically, providing the proposed additional summary disclosure in respect of KMP remuneration will *not* either by itself or in concert with the current required disclosures reinforce the pay for performance alignment desired by shareholders. Detailing actual KMP remuneration received (something which can already be ascertained under the current required disclosures) provides an indication of performance outcomes but does *not* sufficiently link the remuneration actually paid with those performance outcomes.

Whilst identifying realised KMP remuneration is important, in our opinion this information would be most relevant to shareholders if provided in the context of reward for relevant performance over a designated performance period. Specifically, actual remuneration outcomes should be explicitly linked to either a 12 month performance period (including not just fixed annual remuneration but also deferred components of short term incentives referable to the same period) or a designated performance period of more than 12 months (aligning, for example, with the performance period under the company’s long term incentive plan).

In this way, actual remuneration outcomes referable to each designated period would allow for an assessment of the appropriateness of the remuneration in the context of the performance achieved over the relevant period. Adopting this approach would mean *not* including prior year *short term* incentive grants in current year realised remuneration (as proposed under the draft legislation) as this would ‘contaminate’ the latter with prior year performance. It would also mean current year *long term* incentive grants would be assessed from the perspective of actual performance outcomes achieved over the relevant performance period (and *not* actual award received in a particular future year referable to an extended prior performance period).

Unless applied retrospectively, our proposal above would require an initial passage of time for the clearest pay-for-performance picture to emerge. Specifically, depending on whether *short term* incentives incorporate a deferral component and/or are subject to clawback arrangements, it may initially be up to an additional year before realised remuneration for a particular 12 month period can be finalised. In respect of *long term* incentive outcomes, this initial period may be up to the duration of the relevant performance period (although the Board would have an indication prior to this time of the appropriateness of likely remuneration for performance to date).

An overseas perspective

To provide an overseas context to our comments above, we note the recent introduction in the United Kingdom of the second version of the Draft Statutory Instrument on Directors' Remuneration: the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (Draft Regulations). The Draft Regulations (proposed to come into force on 1 October 2013) represent a raft of revised remuneration reporting regulations aimed at increasing transparency on directors' pay.

Specifically, and relevantly for present purposes, improving transparency will allow for better assessment of pay for performance alignment. The additional information required to be disclosed by the proposed Draft Regulations should be information to help investors assess the relationship between executive remuneration and company performance.

In respect of long term incentive awards (in particular, awards made in respect of performance over 'multiple reporting periods'), the Draft Regulations propose to improve transparency by requiring additional disclosure in relation to the dates of the relevant initial grants, the periods adopted to assess performance and the year the award is ultimately included in the company's financial statements.

Under proposed Section 7-(1)(e) of Part 3 to the Schedule, a Single Total Figure should be disclosed in the company's remuneration report for amounts "received or receivable for multiple reporting periods where –

- (a) final vesting is determined as a result of the achievement of performance conditions that end in the year being reported on or shortly after the end of that period; and
- (b) the final value is not dependent on the achievement of further performance conditions".

Accordingly, the Draft Regulations propose to allow for better assessment of pay for performance alignment by requiring additional disclosure relating to the initial grant, the relevant performance period and the ultimate award year (*non-financial disclosure*) and supplementing this with disclosure of the Single Total Figure (*financial disclosure*).

The proposed additional disclosure under the Draft Regulations incorporates a very similar perspective to our proposed disclosure of executive long term incentive outcomes above.

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Should you require further information on our comments above, please contact either myself or Daniel Yin on (02) 9225 3225.

Yours sincerely



John V Egan