THE EXECUTIVE REMUNERATION REPORTER

OUR APPROACH

Information current as at 03 March 2013

About The Executive Remuneration Reporter

My name is Dr Kym Sheehan.

I started The Executive Remuneration Reporter in October 2012, just before the peak AGM season here in Australia.

There are already a number of proxy advisors in the Australian market. However, I saw a need for a specialist advisory service in the area of executive remuneration and remuneration related resolutions. This need arises not only out of the requirements of the two-strikes rule (see opposite for an explanation of the rule). It also arises out of the need to take a fundamentally different approach to assessing company remuneration practices.

This fundamentally different approach moves away from a 'one size fits all' view of remuneration practices and instead seeks to understand how the company's practices are aligned with corporate strategy. This means that I do not advocate for particular types of performance measures, a particular mix of remuneration, or for particular vehicles for delivering long term incentives.

I hold the company to its own rhetoric. I also take a view on quantum.

To do this, I take a broader and longer term perspective on the company's remuneration practices than merely the one- year perspective in the remuneration report. I benchmark the company's remuneration quantum against other companies. I take my clues from the company's remuneration report as to what this market is.

Over the next few pages I set out the types of resolutions we analyse and advise on, so that you have a clear picture of what The Executive Remuneration Reporter can assist with.

I then walk you through our approach to analysing each of the resolutions, before outlining the form and content of a typical company report. Actual company reports are available for inspection on request.

Finally I set out our pricing structure and information about the delivery and timing of reports.

If you have any questions on reading this material, please contact me – kyms@theexecutiveremunerationreporter.com.au.

I look forward to working with you over 2013.

Kym Maree Sheehan

The two strikes rule

The two strikes rule seeks to hold directors more accountable for executive remuneration by extending the annual advisory vote on the remuneration report into a mechanism by which the board is potentially up for re-election at the spill meeting. The process is as follows:

- Every year the listed company must prepare a remuneration report as part of the directors' report
- Every year shareholders have an advisory vote to adopt that report
- If the resolution receives at least 25% of votes against the report (year 1), the company must explain in its next remuneration report (year 2) what it has done in response to that vote
- If the resolution receives at least 25% of votes against the report (year 2), a resolution is put to shareholders at the same AGM to call for a general meeting of the company to re-elect the directors (board spill resolution).
- The company must convene a meeting of members within 90 days and put resolutions to the meeting to elect directors (spill meeting).
- Any person who was a director at the time the board signed off on the financial reports for the year (year 2) and who is not re-elected by shareholders at this meeting ceases to hold office immediately before the end of the meeting.

The types of resolutions we analyse and advise on

During 2013, The Executive Remuneration Reporter will release individual company reports, AGM Spotlight reports and other research reports.

The individual company reports for the full report subscription options and the AGM Spotlight reports will make a recommendation on the resolutions at the AGM that relate to executive remuneration:

a) the advisory vote on the remuneration report;
b) any ASX Listing Rule 7 resolution that seeks shareholder approval for an employee share-based remuneration scheme,
c) any ASX Listing Rule 10.14 resolution that seeks shareholder approval for an issue of securities to a director;
d) any resolutions seeking shareholder approval to increase the amount of the directors' fee pool;
e) any resolution seeking shareholder approval under Chapter 2D.2 of the Corporations Act 2001 (Cth) in respect of a termination payment
f) any resolution seeking shareholder approval under Chapter 2E of the *Corporations Act 2001* (Cth) in respect of related party transactions that relate to remuneration
g) the board spill resolution
h) the spill meeting, should one occur.

Advisory vote on the remuneration report

The advisory vote on the remuneration report is a standing item at the AGM under s 250R(2) of the *Corporations Act 2001* (Cth). It is an ordinary resolution, so requires a simple majority of the votes cast at the meeting to support the adoption of the remuneration report.

ASX Listing Rule 7 Resolution seeking shareholder approval for a share scheme

An ASX Listing Rule 7 resolution will seek shareholder approval for issues of securities so as to avoid tripping the 15% rule in ASX LR 7.1.

This resolution is important because it ensures that shareholders' holdings are not diluted without their consent. Of course, 15% in twelve months still has a dilutive effect as the above example illustrates. This is why shareholders must stay aware of the company's capital raisings…particularly when offers of new shares are made selectively via an institutional book build rather than being open to all. Pro-rata issues of securities are excluded from the requirement to obtain approval under Listing Rule 7.2.

The shareholder consent issue is further complicated by the fact that many companies will seek shareholder approval after an issue of

Two strikes rule and accountability

Accountable boards take the first strike seriously and respond to shareholder concerns in three ways

1. Spending the time to learn about shareholders specific concerns
2. Re-examining the company's remuneration practices in light of these concerns
3. Telling shareholders about the outcome of this process in the next remuneration report.

Companies that do not respond adequately to shareholder concerns risk a second strike and the prospect of the board spill resolution.

securities (relying on Listing Rule 7.4) so as to effectively remove the number of securities issued from the rolling 15%-in-12-months total. When this occurs it portends further capital raisings by way of issues of new securities…because the board is seeking to keep its capital raising options open by ensuring it has the maximum 15% limit available to it.

Companies will seek shareholder approval of an employee share plan so as to exclude the options issued during the year under that plan from the 15% rule by relying on the exception in ASX Listing Rule 7.4. ASX Listing Rule 7.4 states the company may seek subsequent shareholder approval for an issue of securities which were not in breach of Listing Rule 7.1 at the time they were made.

ASX Listing Rule 10.14 Resolution seeking shareholder approval for an issue of securities to a director

Shareholders will frequently encounter these resolutions and so it is important to have a clear approach to analysing the resolution and how to cast your vote. The advantage of these resolutions from a shareholders' perspective is that they represent one key mechanism to control the size of executive remuneration. As a binding resolution based as an ordinary resolution, the decision of shareholders at the meeting is the decision of the company. If a company sees that it will not obtain sufficient votes for the resolution to pass at the meeting, it will drop the resolution from the agenda rather than risk defeat.

Resolution to increase the size of the directors' fee pool under ASX Listing Rule 10.17 and the company's constitution

This resolution is required under ASX Listing Rule 10.17 and also under the company's constitution.

ASX Listing Rule 10.17 states "An entity must not increase the total amount of directors' fees payable by it or any of its child entities without the approval of holders of its ordinary securities."

A company's constitution will typically restate that rule but supplement it. The following rule is taken from the constitution of Gryphon Minerals Ltd, clause 11.15

> The Directors shall be paid out of the funds of the Company, by way of remuneration for their services as Directors, a sum not exceeding such fixed sum per annum as may be determined by the Directors prior to the first annual general meeting of the Company, to be divided amongst themselves and in default of agreement then in equal shares. The remuneration of the Directors shall not be increased except pursuant to a resolution passed at a General Meeting of the Company where notice of the suggested increase shall be given to the Members in the notice convening the meeting…

Voting exclusions

An important feature of the regulatory design for voting on the remuneration report and the board spill resolution is the voting exclusion requirements which prevent directors and key management personnel and their associates voting on these resolutions. This is intended to provide a 'pure' signal of non-affiliated shareholder sentiment on the remuneration arrangements.

Voting exclusions also apply to the related party transactions under the Act, the termination payment provisions under the Act; and ASX Listing Rule 7 and Rule 10 resolutions.

Voting exclusions DO NOT APPLY to the spill meeting director elections.

While shareholders have the right to determine the overall size of the directors' fee pool, they do not have the right to determine the amount paid to any one individual non-executive director (or executive director, for that matter).

This is an important shareholder voting right.

Termination payments

It is important to remember that the legislation permits payments made in connection with loss or resignation from office up to a threshold determined by the period in office and the average annual base pay. Any payment beyond the threshold will require shareholder approval.

The provisions are complex and highly technical. 'Base pay' is not what you or I might understand by 'base pay' but what we might identify as 'fixed remuneration'. This arises through the definition of 'base pay' found in the *Corporations Regulations 2001* (Cth).

Because the size of the threshold varies with the years of service in a board or managerial position (with the maximum payment being 12 months' average annual base pay over the previous three years), newly appointed executives are at risk of tripping the threshold if their employment is terminated within the first twelve months. This arises because most companies promise a payment of 12 months' fixed remuneration if the company terminates 'without cause', or 'at its convenience'.

Related party transactions

There are two different requirements for shareholder approval of related party transactions involving the company's directors:

- For remuneration: under s 208(1) of the *Corporations Act 2001* (Cth) (or 'chapter 2E')
- For other director related transactions: under ASX Listing Rule 10.14 (directors) and also under chapter 2E of the Act.

Chapter 2E exempts reasonable remuneration from the requirement for shareholder approval. It also exempts arm's-length transactions involving related parties from shareholder approval.

Board spill resolution (two strikes rule)

A board spill resolution will appear on the AGM notice of meeting for a company that incurred a strike against its remuneration report at the previous AGM (and a board spill resolution wasn't conducted at that AGM). See the side bar for a further explanation.

Spill meeting director elections

In terms of regulatory design, we are never supposed to get to this point. If the issue is purely about the remuneration and if boards have responded to those concerns, then the regulatory design (with

Board spill resolution

The peak 2012 AGM season was the first time that companies faced the potential of a board spill resolution. Because the need to vote on the spill resolution turns on the outcome of the remuneration report vote at the same AGM (at least 25% of the votes cast being against the resolution to adopt the remuneration report), the spill resolution is shown as 'conditional' within the notice of meeting.

The board spill resolution essentially

- calls for a general meeting of shareholders to occur within 90 days of the AGM
- states that all the directors (other than the managing director) who were directors of the company at the time when the board approved a resolution to sign the directors' report for the year are removed from office immediately before the end of that general meeting, and
- states that resolutions to elect persons to the office that will be vacated immediately before the end of meeting are held. This gives shareholders the right to elect directors...who may be the current non-executive directors seeking re-election or any new nominees.

If the resolution is passed at the meeting (it is an ordinary resolution requiring a simple majority of the votes cast at the meeting to be in favour of the resolution), the spill meeting must be called within 90 days. The legislation also recognises that a spill meeting will not be necessary if none of the directors who were 'spilled' are seeking re-election.

With the prospects of a board spill resolution, the remuneration report vote at the same AGM becomes important...but that shouldn't alter your approach to that resolution. After all, it is possible to vote against the remuneration report and against the board spill resolution.

shareholders voting as anticipated) would deliver that result: no second strike.

In some companies the patterns of shareholdings means the regulatory design works differently. Where the directors are the majority shareholders but cannot vote their shareholdings to support the remuneration report or oppose the board spill resolution there is an opportunity for other shareholders to force the board spill. A minority shareholder can take advantage of the low levels of shareholder voting to force the two strikes at successive AGMs and then the board spill resolution. This could be motivated by dissatisfaction with the remuneration arrangements. It could be motivated by other reasons.

It is important to acknowledge at this point that in widely held companies where the directors are not majority shareholders, the two-strikes regime can operate as intended. That shareholder voting at some companies is low – a point mentioned in some 2012 remuneration reports by way of dismissing the idea that the first strike represented 'true' shareholder sentiment – is in my view an opportunity to work to educate shareholders on the importance of voting at AGMs and general meetings.

The director elections at a spill meeting proceed as do director elections at AGMs **with one key difference**. Section 250X(3) of the *Corporations Act 2001* (Cth) provides that the candidates receiving the highest numbers of vote are elected to the board to fill the gaps.

Our approach to analysis

In approaching the remuneration related resolutions on the agenda at the AGM, we adopt an open-minded approach to the company's remuneration practices. We do not seek to impose any one particular system of remuneration practices on the company by making recommendations to vote against the resolution where the practices revealed do not fit within the 'template' adopted by others in the market place.

We aim to hold the company to its own rhetoric by examining the policy and then the practices that result from that policy.

Remuneration report resolution (advisory vote on the remuneration report)

Our individual company reports always analyse this resolution first before considering any specific remuneration resolutions on the AGM agenda.

We firstly examine the company's policy with respect to each of the following elements

Non-executive director remuneration: size of overall pool, approach to setting fees and breakdown into base fee and committee fees, superannuation payments, shareholding policy, any legacy retirement benefit schemes

Executive remuneration

Fixed and variable remuneration

- Fixed remuneration: policy on setting and reviewing, including use of peer groups
- Short-term incentives: policy on size of payments (target and maximum potential), vehicle/s (cash, equity and deferred cash/equity), performance criteria and relationships between the performance criteria and company strategy; policy on exercising discretion including clawback provisions and malus adjustments
- Long-term incentives: policy on size of grants, frequency of grants, vehicles used (such as options, performance rights), performance criteria, performance period, the scope to retest performance, and shareholding policy

Key contractual provisions: policy on contractual terms including fixed term/ongoing contracts, notice periods (company and executive), termination payments under various termination scenarios (resignation, termination with cause, termination without cause, change of control, retirement, permanent incapacity/death), terms relating to STI and LTI payments under various termination scenarios

We then test how this policy has been put into practice for the year of the report. To do this, we typically take the CEO and a selection of the executive management team and, based on a number of years of data (typically determined by the tenure of the CEO, although in 2012 we looked at 5 years and up to 8 years of data), examine

Non-executive director remuneration: changes over the time period and size of legacy retirement benefit scheme accruals, the total expenditure per year and the amount of 'headroom' within the directors' fee cap.

Executive director remuneration

- Fixed remuneration: annual increases to fixed remuneration
- Short term incentives: actual payments versus target STI and maximum potential STI, any exercises of discretion and how the STI payments compared with performance for the year
- Long term incentives: awards made during the year, awards vesting and lapsing; accumulated unvested awards; shareholdings
- Key contractual terms: any changes to policy

We finally consider any changes to remuneration policy flagged for the financial year ahead (eg in the 2013 annual reports we will look for disclosure of practices to apply for FY14) for each of the remuneration elements. In this way we separate out the practices that actually occurred from the promises of changes to be made. We believe this allows us to better balance out actual practice versus promised change in arriving at our final voting recommendation.

ASX Listing Rule 10.14 resolution (issue of securities to a director)

We approach this resolution in a slightly different way to the remuneration report resolution. We begin by considering the directors' current remuneration so that we can make an assessment of how this grant of securities will fit into the overall remuneration being awarded to the executive. To do this we consider the director's current holdings of unvested share-based payment (options, rights, deferred shares) and his or her current equity holdings.

We then consider the terms of the proposed grant. We consider the size of the grant in terms of the number of units of equity being granted, the vehicle being used (performance rights, options, deferred shares), the performance conditions attached to the grant (and how these compare with the company's current LTI practices), the termination provisions (and how these addresses different scenarios, including any scope for the board to exercise discretion).

In making our final voting recommendation it is the degree of fit with the company's overall remuneration strategy and operational strategy that is most compelling.

Approaching the remuneration report resolution when the potential exists for a second strike

We do not approach a potential second-strike on the remuneration report in a different manner but instead consider carefully the ramifications of the board spill resolution.

In other words, we distinguish between poor remuneration practices (through a recommendation to vote against the remuneration report) and the futility in some companies (typically those with a director majority shareholder) of bringing on a spill meeting (by recommending a vote against the spill resolution).

Board spill resolution

We carefully consider our recommendations on the board spill resolution. In doing so, we analyse whether the company's current shareholdings mean that any subsequent spill meeting would be pointless. We also consider the extent to which the board has taken steps to renew its membership in the last two years.

Increase in directors' fee pool

We carefully consider here the rationale for the increase to the directors' fee pool and the proposed new limit. We draw upon our earlier analysis of the non-executive director remuneration policy and practice undertaken to reach a recommendation on the remuneration report resolution.

ASX Listing Rule 7 resolution (eg to approve a share plan to avoid the 15% rule in Listing Rule 7.1)

The primary rationale for seeking shareholder approval is to allow the issue of securities made under an employee share plan to be excluded from the calculation of 15% of capital being issued in a rolling twelve month period (ASX Listing Rule 7.1 and the exception in Listing Rule 7.2).

[redacted] these plans in the explanatory notes in a way that allows for further adjustment of performance terms. We look primarily at the performance period, the scope to retest performance, the terms dealing with different termination scenarios, deferral periods, and clawback. We also take a view on the number of share-based payments being granted in light of the executives' overall remuneration.

Remuneration-based related party transactions (chapter 2E of the *Corporations Act 2001* (Cth))

Companies may seek shareholder approval of a grant of securities to a director under s 208(1) of the *Corporations Act 2001* (Cth) as a related party transaction.

Companies need not seek shareholder approval if the transaction falls within the reasonable remuneration exception in section 211 of the Act.

The practice to date has been to roll-up approval for this purpose with approval under ASX Listing Rule 10.14, although each has separate requirements for disclosure in the explanatory notes that accompany the notice of meeting.

We consider the separate disclosure requirements for the related party component of the resolution in light of the fact that the 'reasonable remuneration' exception in s 211 is not being relied upon.

Termination payments (chapter 2D.2 of the *Corporations Act 2001* (Cth))

A company may seek shareholder approval to allow it to make a termination payment that falls outside the thresholds specified for termination payments in chapter 2D.2 of the Act (a maximum of 12 months' base salary, defined broadly in the associated regulations).

Typically such approval is sought in advance in respect of the share-based payments that might vest on termination.

As one of the voices speaking in favour of the 12 months' threshold at the time of the reforms, the position taken in our recommendations is consistent with that approach and forms the starting point for the analysis.

A termination payment resolution may sometimes be combined with shareholder approval of an issue of securities under ASX Listing Rule 10.14 and also potentially as a related party transaction under chapter 2E of the *Corporations Act 2001* (Cth). In such instances, the additional purposes for which approval is sought are factored into the voting recommendation.

Spill meeting director elections

New director appointments appearing on the notice of meeting for a spill meeting can either be board nominees or nominated by others.

The first step in the analysis for any new director nominees is to work out who nominated them. If the nomination or nominations are from one particular shareholder, we consider the shareholdings in the company. There is no magic number of board representatives attached to a particular size of minority shareholding and it is usually a matter of negotiation.

The second step in the analysis is to consider the qualifications and experience of the directors to be directors of the company.

There is no magic list of qualifications, experience or qualities a director must have to fulfil this role. It is also important to consider the qualifications and experience across the board as a whole. An important issue to consider is board harmony. While some 'grit in the wheels' can be useful on a board, it is important that the board is able to both work collegially, yet allow for robust discussion and debate.

What if no directors are elected as a result of the spill meeting?

A public company is required to have at least three directors. If the results of voting on these ordinary resolutions to re-appoint an existing director/appoint a new director would result in the board having fewer than 3 directors (recalling that any executive directors count as part of the three), s250X(3) of the *Corporations Act 2001* (Cth) provides that the candidates receiving the highest numbers of vote are elected to the board to fill the gaps.

To cater for this requirement, the best interests of shareholders are served if the voting at the spill meeting is conducted by way of a poll.

Shareholders should also consider the importance of expressing a clear voting intention in this instance! You can appoint a proxy to vote on your behalf but rather than leaving the matter at the proxy's discretion, I encourage you to express a clear intention by voting 'for' or 'against' each of the resolutions.

Outline of a typical AGM voting report

An AGM voting report has five key sections

(1) Preliminary matters
(2) Remuneration report resolution
(3) Any other remuneration-related resolutions
(4) Appendix One - market comparisons for benchmarking
(5) Appendix Two – a complete voting record on the remuneration-related resolutions since the introduction of the remuneration report vote in 2004.

Preliminary matters

This section of the report identifies the company, the meeting type, the meeting date and time, closing date for submission of proxy voting instructions.

It also identifies the resolutions to be analysed in the report, with The Executive Remuneration Reporter's recommendation and the Board's recommendation. Where the Board has not made a recommendation, this is also noted in this section.

Remuneration report resolution

This resolution is always analysed first in the report as the details in this analysis inform the positions taken on any other remuneration-related resolutions at the AGM. It works methodically through the remuneration practices of the company, separating out consideration of any forward looking disclosures of change to practice from the remuneration practices that applied in the year in question.

Other remuneration-related resolutions

Any other remuneration-related resolutions proceed in the sequence they appear in the notice of meeting.

Appendix One: Market comparisons for benchmarking

In this part of the report, the methodology used to devise a sample for benchmarking is explained, with summary statistics and the data for the sample provided by way of tables.

Appendix Two: Complete voting record on remuneration-related resolutions

The voting results for all remuneration-related resolutions since the first AGM featuring the remuneration report vote are summarised.

Data sources

We reference our data sources so that you always are able to verify the data on which our analysis and recommendations are based.

Outline of a typical GM voting report

The following is a typical outline of the report:

(1) Preliminary matters – the same as those outlined for the AGM voting report
(2) The remuneration related resolutions on the meeting agenda
(3) Appendix One – market comparisons for benchmarking
(4) Appendix Two – complete voting record.

Data sources are also included within the GM voting report.

Pricing structure

Our pricing structure for the full report subscriptions is simple: we charge **$110 (including GST) per company per calendar year** (1 January to 31 December). This fee is for one user (because we make the reports available to you via our website). **We charge an additional fee of $110 (including GST) to add another user to your account.**

If you take out one of the set subscriptions (All the Majors – ASX 50; ASX 200 Select Energy and Resources; ASX 200 Select Financial Services; or ASX 100 Select Consumer), the prices are set and the only additional fee you will incur is to add another user to your account ($110 including GST per user).

If you take out **a bespoke subscription** (you choose the companies you want to have coverage for), in addition to the fee charged per company per year ($110 including GST x the number of companies in your subscription), there is **a one-off fee of $220 (including GST) to set up and maintain your own subscription 'home page' on our website.** We do not charge any additional fees to add additional users to your account.

All fees are payable in advance.

Pricing structure for the AGM/GM Spotlight Subscription

The AGM/GM Spotlight Subscription is a weekly report (during peak AGM season – otherwise fortnightly or monthly) that summarises the recommendations on remuneration-related resolutions at AGMs and GMs for companies covered by The Executive Remuneration Reporter.

This subscription has a set fee of $330 (including GST) for the calendar year 1 January to 31 December 2013. Due to the nature of this subscription, it is not possible to have two users on the same subscription. A discount is available for a second and subsequent subscription.

Delivery and timing

All reports are delivered via the website. Full reports are made available by not later than 2 weeks before the scheduled date of the AGM/ GM. You will receive an email to advise that a report is available for download.

The AGM/GM Spotlight Reports occur on a regular basis – a notice appears on the company website to advise when a new report is available.

Set subscriptions

For 2013, there are four set full report subscriptions available:

All the Majors – ASX 50 ($5,500 including GST)

ASX 200 Select Energy and Resources (36 companies from the S&P/ASX 200 index) ($3,960 including GST)

ASX 200 Select Financials (16 financial services companies from the S&P/ASX 200 index) ($1,760 including GST)

ASX 100 Select Consumer (16 Consumer staples and consumer discretionary companies from the S&P/ASX 100 index) ($1,760 including GST)

All of the above subscriptions rely on the index series maintained by Standard and Poors. Changes to the index will be reflected in the subscription offerings.

The current companies list is always available on the website.

FURTHER INFORMATION

For further information on subscription options for 2013 contact

Dr Kym Sheehan

THE EXECUTIVE REMUNERATION REPORTER

ABN 48 950 182 685

PO Box 746, South Yarra, Victoria, 3141

Mobile: +61 (0)414 062 788

Email: kyms@theexecutiveremunerationreporter.com.au

Website: https://subscriber.theexecutiveremunerationreporter.com.au

---

The proxy voting guidance and advice issued by The Executive Remuneration Reporter is pursuant to regulation 7.1.30 of the *Corporations Regulations 2001* (Cth) in that it is advice on the manner in which voting rights attached to securities or voting rights attached to interests in managed investment schemes may or should be exercised. As such it does not constitute financial advice and should not be construed as such.

OUR APPROACH V5 13MARCH 2013