GRG Remuneration Review

Government Attack on Executive Remuneration

Remuneration Review No. 16

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INTRODUCTION

Two substantial amendments affecting executive remuneration have been announced by the Federal Government and they are:

- Reducing the amount of termination benefits that may be paid to top executives, and
- Removing tax deferral in relation to shares, rights and options.

Both aspects are discussed in this GRG Remuneration Review.

EMPLOYEE SHARE SCHEME TAXING CHANGES

In the 2009 Federal Budget, the Government made two announcements concerning employee share schemes that apply to shares acquisitions after 7.30 p.m. on 12 May 2009. The two announcements were to:

a) remove the tax deferral concession, and

b) limit the up to $1,000 per annum tax exemption to employees with taxable incomes of less than $60,000 after adjustment for fringe benefits, salary sacrifice and negative gearing losses.

It should be noted that lobbying has since occurred in relation to the proposed changes and as a result the Government announced on Sunday the 24th of May 2009 that it will receive submissions in relation to the proposed changes and reconsider the proposed amendments.

Nevertheless, immediate action that should be taken in response to the announcement includes:

- suspension of all general employee tax exempt share plans,
- suspension of all general employee tax deferred share plans,
- suspension of all salary sacrifice employee share acquisition plans,
- suspension of all non-executive director fee sacrifice share acquisition plans,
- suspension of all STI deferrals into company shares, and
- suspension of all equity based long term incentive (LTI) plans.

References to equity and shares include: rights, options, partly paid shares and stapled securities.

GRG through its work with clients and has developed several effective replacement LTI plans. Although alternatives need to be considered immediately, their implementation may be delayed until after the amending legislation has been passed.

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TERMINATION PAYMENTS

On the 5th of May 2009 the Federal Government released an exposure draft of amendments to the Corporation Act significantly limiting the termination benefits that may be paid to a broadened range of senior executives without shareholder approval. (Submissions in relation to the proposed amendments will be received by Treasury until 2 June 2009). Further the approval needs to be undertaken at a general meeting, not called for the purpose of approving the termination payment, held after the person's employment with the company has ceased.

Key Aspects of the Amendment

"The new arrangements will not apply retrospectively to existing contracts which have already been settled." (Explanatory Memorandum, Chapter 2, paragraph 2.6). Thus they will apply to new contracts.

The limit on termination payments without shareholder approval is one year's "base salary". "Base salary" is defined as having "the meaning generally accepted within the accounting profession". Such a definition provides little clarity, particularly in relation to whether salary sacrifice amounts including superannuation contributions, are included.

It applies to persons in managerial or executive offices as defined. The definition includes:

- If the company is a disclosing company:
    - for a company to which s300A of the Corporations Act applies for the previous financial year, if the person's details were included in the directors' report for that previous financial year,
    - the person is deemed to hold the managerial or executive office for the current year unless and until the person retires before the end of the current financial year,
- Otherwise, a managerial or executive office is:
    - an office of director of the company, or
    - any other office in connection with the management of the company's affairs that is held by a person who is also a director of the company or a related company.

The limit applies to a person who was a managerial or executive officer:

- at the time of the termination, or
- at any time within the three (3) years prior to the termination.

Payment in excess of the limit are prohibited and if paid carry severe penalties for both the payer and the recipient.

Shareholder approval needs to:

- be obtained at a general meeting,
- the general meeting cannot have been called for the sole or dominant purpose of passing the resolution,
- the retiree must have ceased employment with the company before the resolution is put to shareholders, and
- details of the retirement benefit must be set out in or accompany the resolution.

The low limit combined with the uncertainty that post-termination delayed approval entails means that companies will need to urgently consider future employment contract terms and current superannuation, short term incentive plans and long term incentive plan grants that vest on termination of employment.

Remuneration Components and Termination Benefits

The following table seeks to identify various categories of benefits and payments and then indicate their status in relation to the new termination benefit provisions.

Benefit or Payment	Status
Salary and benefits due for work performed up to the date of termination including during the notice period.	Not a retirement benefit
Short Term Incentive (STI) earned but not paid before the date of termination.	Not a retirement benefit
Superannuation benefits from contributions made by other employers and the employee prior to commencing the employment that has terminated.	Not a retirement benefit
Superannuation benefits from employee after tax contributions while in the employment that has terminated.	Not a retirement benefit
Superannuation benefits from employee salary sacrifice contributions while in the employment that has terminated.	Assumed not to be a retirement benefit but needs clarification.
Superannuation benefits from employer contributions consistent with superannuation guarantee provisions while in the employment that has terminated.	Not a retirement benefit
Superannuation benefits from employer contributions above the superannuation guarantee minimum level while in the employment that has terminated.	Intention seems to be to treat as a retirement benefit but the draft amendment is not clear as it refers to amount in excess of “the maximum amount required or permitted by a law of the Commonwealth, a State or a Territory”.
Superannuation benefit from defined benefit superannuation plan that was in existence when the relevant regulation commenced.	Not a retirement benefit
Pension of any kind (presumably paid by employer and not a superannuation fund).	Retirement benefit
Payment of **STI** award for year during which the termination occurred when the STI award has been brought forward due to the termination.	Assumed to be a retirement benefit to be consistent with treatment of LTI option vesting.
Payment of **STI** award for year during which the termination occurred but when the STI award is calculated and paid at the end of the year consistent with the treatment of other participants in the STI plan.	Assumed not to be a retirement benefit but needs clarification.
Long term incentive (LTI) vesting of options is automatic or accelerated due to the termination.	Retirement benefit

Benefit or Payment	Status
LTI vesting of rights and shares is automatic or accelerated due to the termination.	Assumed to be a retirement benefit but needs clarification.
LTI vesting of entitlement to a cash LTI payout is automatic or accelerated due to the termination.	Assumed to be a retirement benefit but needs clarification.
LTI shares, rights, options and cash payouts which run their course and vesting is not triggered by the termination.	Assumed not to be a retirement benefit but needs clarification.
Accrued untaken leave payout	Retirement benefit
Pay in lieu of notice	Retirement benefit
Severance payment	Retirement benefit
Retention payment that vests or has its vesting accelerated by the termination of employment.	Assumed to be a retirement benefit but needs clarification.
Retention payment that is made at the end of the retention period along with other retention payments because termination was outside employee's control such as death, disablement and company initiated termination for other than cause.	Assumed not to be a retirement benefit but needs clarification.
Sign-on awards (deferred cash or shares, rights or options) to compensate for benefits foregone at previous employer that were to vest at the end of a period but vesting is accelerate due to the termination.	Assumed to be a retirement benefit but needs clarification.
Sign-on awards (deferred cash or shares, rights or options) to compensate for benefits foregone at previous employer that vest at the end of a period irrespective of whether or not employment terminates.	Assumed not to be a retirement benefit but needs clarification.

Action Needed

Current Plans

Subject to clarification of the scope of the proposed amendments and to possible adjustments to the amendments before the legislation is introduced to Parliament, companies need to review those aspect of the following to the extent to which they may be considered to be retirement benefits. The following table is provided as a guide only, because specific responses need to be determined having regard to the specific circumstance faced by companies and their executives.

Aspect	Changes to be considered
Superannuation Contributions	▪ For defined benefit plans the company contributions should be included as part of the Base Package with flexibility to reduce superannuation contributions to the SGC minimum. ▪ In relation to salary sacrifice contributions, consider the extent, if any, to which there is scope for such contributions within the one year's base salary limit.
STI Plans	▪ Review the provisions dealing with terminations of employment and consider: o Identifying situations when nil STI awards will apply, (these are the only ones where STI participation would cease in the event of termination of employment), o Include terminated employees as participants when year end STI awards are calculated and paid but reduce award opportunities to reflect the portion of the year worked.
LTI Plans	▪ Review the provisions of the plan that deal with terminations of employment and consider: o Lapsing grants for the portion of the year not worked, o Allowing employees the choice of relinquishing LTI grants on termination or selling them back to the company for a price determined by the company, if they wish to avoid a taxation liability in respect of their then value. o Determining the extent of vesting at the end of the measurement period along with other participants.
Retention Plans	▪ Review the provisions of the plan that deal with terminations of employment and consider: o Deleting termination of employment as a point in time where vesting is determined but retaining it for lapsing purposes i.e. on termination lapsing will apply otherwise the retention plan continues. o Determine at the end of the retention period the extent to which retention benefits are to be paid.
Sign-on Awards	▪ Consider changing from vesting after a period of service to payment after a period of service irrespective of when termination of employment occurs.

New Contracts

In relation to new contracts, there are several aspects that may need to be addressed differently to that which has applied in the past. Given that statutory entitlements and superannuation in excess of the statutory minimum will be treated as part of retirement benefits it follows that any additional benefits will be likely to, in many cases, exceed the one year's salary limit that may be paid without shareholder approval. At the time when executives are entering into service agreements they will be looking for certainty as to their entitlement in certain circumstances. Thus, the following aspects may need to be addressed differently to the way they have been dealt with in the past.

Aspect	Changes to be considered
Pay in Lieu of Notice	▪ Notice has been useful to the employer in terms of being able to: o retain the services of the executive until a replacement may be found, and o ensuring that the executive is sidelined from competing for a period following the termination. If these purposes remain relevant to a company then it may prefer to continue to include notice periods in employment contracts and either have the executive work the notice period or accept that payment will be subject to shareholder approval. ▪ Notice as a form of severance payment has been common practice and will be less acceptable going forward given the need for shareholder approval. ▪ Compensation in the form of additional salary or another form of benefit may need to be considered instead of pay in lieu of notice as a severance payment.
Severance Payments	▪ Compensation in in the form of additional salary or another form of benefit may need to be considered instead of severance payments.
Retention Payments	▪ The design of retention plans needs to be considered so that benefits are not triggered by a termination of employment.
Sign-on Awards	▪ The design of sign-on awards needs to be considered so that benefits are not triggered by a termination of employment.

GRG Contacts

GRG is well positioned to assist boards in reviewing their company's remuneration strategies, incentive plans and employment contract terms. Many of the top Australian listed companies are among our substantial client base.

GRG maintains databases on director and executive remuneration. We capture all the aspects required to be covered in Remuneration Reports and therefore provide an authoritative source of advice in relation to market practices and emerging trends.

Please feel free to call any of the following consultants on **02 8923 5700**

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For more information on GRG and copies of GRG publications please access our website:

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