

Productivity Commission Recommendations

Remuneration Review No 22, March 2010

1. Introduction

Two important releases have recently been made in relation to corporate governance and executive remuneration in Australia. They are:

- Productivity Commission Inquiry Report No 49, Executive Remuneration in Australia, dated 19 December 2009, and
- Australian Prudential Regulation Authority (APRA), Prudential Practice Guide PPD 511 – Remuneration, dated 30 November 2009.

These releases are the subjects of two GRG Remuneration Reviews. This GRG Remuneration Review focuses on the Productivity Commissions recommendations whereas another Review, which may be accessed via our website, focuses on the APRA guidelines.

2. Productivity Commission Inquiry Report

Following is a table presenting the main recommendations of the Productivity Commission and GRG's comments on them.

Recommendations	Targeted Benefits	Comments
Board Capacities		
1) Any declaration of 'no vacancy' at an AGM to be agreed to by shareholders.	<ul style="list-style-type: none"> • Increases shareholders' input on board size and composition and addresses perceptions of a 'directors' club'. 	The ability of a company to fill a vacancy with a non-executive director will be influenced by the extent, if any, to which there is headroom within the currently approved aggregate fees limit (AFL) and/or the preparedness of shareholders to approve an increase in the AFL.
Conflicts of Interest		
2) On an 'if not why not' basis: <ul style="list-style-type: none"> a) remuneration committees to comprise at least three members, all non-executive directors, with a majority and the chair independent, b) companies to have a charter setting out procedures for non-committee members attending meetings. 	<ul style="list-style-type: none"> • Constrains executive influence on pay. • Promotes best practice for all listed companies. 	These arrangements are now in place at most listed companies but there may still be some tussles over the way in which executive directors (typically the CEO) and /or HR executives attend the meetings and participate in discussions and decisions on pay. Most boards find it very valuable to have CEO input on the performance of his/her direct reports, but there are many ways in which this can be achieved and Chairmen may increasingly need to explain and resolve these processes.

GRG Remuneration Reviews are articles to assist directors and senior executives who have responsibilities in relation to Board and senior executive remuneration and other human resources issues. Their role varies between articles with some aimed at stimulating critical thinking, others updating information and others simply acting as a reminder of principles and approaches where awareness may need to be heightened.

Recommendations	Targeted Benefits	Comments
3) For ASX300 companies, executives to be prohibited from sitting on remuneration committees.	<ul style="list-style-type: none"> Constrains executive influence on pay. Aligns with APRA initiative for finance sector and targets companies able to meet compliance cost. 	This is an extension of point number 2.
4) Prohibit executives and directors voting their own shares on remuneration reports.	<ul style="list-style-type: none"> Increases shareholder signal on non-binding vote. 	<p>This is unlikely to have a material impact on most large ASX listed companies as the shareholdings of executives and directors tend to be a small percentage of issued shares.</p> <p>It may address a potential conflict of interests of a major shareholder who is also holds an executive role such as Managing Director.</p>
5) Prohibit executives hedging unvested equity remuneration or vested equity subject to holding locks.	<ul style="list-style-type: none"> Improves alignment between executives and shareholders. Engenders confidence in pay practices. 	If a company has equity-based components of remuneration it will need to have a written Remuneration Policy which explains the objectives and the structure of the remuneration arrangements and ensures that executive directors are not placed in a position of actual or perceived conflict.
6) Prohibit executives and directors voting undirected proxies on remuneration reports.	<ul style="list-style-type: none"> Increases shareholder signal on nonbinding vote. 	This is an extension of point number 4.
7) Require proxy holders to cast all their directed proxies on remuneration reports.	<ul style="list-style-type: none"> Increases shareholder signal on non-binding vote. 	This point number 7 and point number 12 are closely aligned and will involve institutional investors in either undertaking extensive reviews of Remuneration Reports and/or relying upon the advice of proxy advisors. If the latter becomes prevalent then they will have been delivered enormous power with little accountability.
Disclosure		
<p>8) Improve information content and accessibility of remuneration reports through:</p> <ol style="list-style-type: none"> a plain English summary of remuneration policies, reporting actual remuneration received, and total company shareholdings of individuals in the report. 	<ul style="list-style-type: none"> Better informed shareholders. Reduced confusion (and misreporting) about pay structures. Enhanced engagement between boards and shareholders. 	<p>Whilst simplification is a fine aim there are forces already acting (such as deferral of bonus into stock) which are serving to complicate remuneration even further.</p> <p>The disclosure of actual levels of remuneration will also have potential consequences that are perhaps not yet fully understood. One of these is the disruption to databases that draw on disclosed data. Whilst imperfect there have been a few years of settling of the approach. Any new approach will have both transitional issues and may potentially produce some large headline figures for 'actual' pay as older plans vest.</p> <p>Remuneration Committee members will have to explain these figures in some cases, whilst others will have to deal with surveys showing revised benchmarks at a time of uncertainty in regard to resurgent remuneration increases.</p>

Recommendations	Targeted Benefits	Comments
9) Remuneration disclosures to be confined to key management personnel.	<ul style="list-style-type: none"> • Aligns Act with accounting standards. • Reduces compliance costs. • Improves readability. 	
10) Companies to disclose executive remuneration advisers, who appointed them, who they reported to and the nature of any other work undertaken for the company. ('If not, why not')	<ul style="list-style-type: none"> • Constrains executive influence on pay through transparency. • Promotes best practice for all listed companies. 	<p>These are areas that Boards and Remuneration Committees have commonly adopted in advance of regulatory requirements.</p> <p>Broadly, Remuneration Committees should not engage advisors who are acting concurrently or have acted recently on behalf of management or of any executive. We believe it is important for the Remuneration Committee to be seen to be acting appropriately as well as to be acting appropriately. Thus, prudent Remuneration Committees should seek advice from professional remuneration advisory firms that clearly have no conflict of interest i.e. should not be or have recently been involved in providing advice to management of the company either personally or for the company. Such precluded advice should not be limited to remuneration advice but should include any form of professional advice.</p>
11) For ASX300 companies, advisers on executive pay to be commissioned by, and their advice provided directly to, the board, independent of management.	<ul style="list-style-type: none"> • Constrains executive influence on pay. • Aligns with APRA initiative for finance sector. • Targets companies able to meet compliance costs. 	<p>This may require an adjustment to past practices and may involve some or all of the following:</p> <ul style="list-style-type: none"> • Remuneration Committees only receiving advice from firms that do not provide any other form of advice to management of the company, • Agreement with the advisor whereby the advisor undertakes not to engage in discussion with management about other possible work while the advisor is appointed by the Remuneration Committee, • Formal appointment of Remuneration Committee advisors for specific periods, or • Appoint of an individual to the Remuneration Committee as the independent expert under a condition that the person not be permitted to provide advice to management during the period of appointment.
12) Institutional investors to voluntarily disclose how they have voted on remuneration reports (and other remuneration-related issues).	<ul style="list-style-type: none"> • Better informed (potential) investors. • Targets agency issues, particularly for compulsory superannuation contributors. 	See also number 7.

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Remuneration Principles		
13) Remove cessation of employment as the taxation point for deferred equity subject to risk of forfeiture.	<ul style="list-style-type: none"> Removes barrier to deferred remuneration. Consistent with longer term alignment. Removes need for special tax rulings. 	While this is logical and would lead to better plan design, it is unlikely to be adopted by the Government as it will delay tax collection.
Shareholder Engagement		
14) Confirm allowance of electronic voting without amendment of company constitutions.	<ul style="list-style-type: none"> Improves efficiency and integrity of shareholder voting. Potential for cost savings. 	
15) 'Two strikes and re-election resolution': a) 25 per cent 'no' vote on remuneration report triggers reporting obligation on how concerns addressed, b) subsequent 'no' vote of 25 per cent activates a resolution for elected directors to submit for re-election within 90 days.	<ul style="list-style-type: none"> Increases shareholder signalling and power. Increases pressure on companies to respond to shareholder concerns. Targets unresponsive boards. 	<p>This is possibly the most contentious aspect of the Commission's recommendations.</p> <p>Most observers believe this is unlikely to be adopted 'as-is' by government since there has been a strong backlash from directors and feedback that it may actually discourage some shareholders from voting 'no' since they would not wish to destabilise the whole board. More likely is that the spill will apply to the Remuneration Committee Chair and potentially members.</p> <p>This recommendation could be open to abuse by minority shareholders who are seeking to change the structure of a Board even though they may not have an issue with the remuneration practices.</p>

GRG Contacts

GRG is well positioned to assist Boards and Remuneration Committees 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.

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

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