

Proposed Regulations Relating to Remuneration of Key Management Personnel

Remuneration Review No 26

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INTRODUCTION

This article presents and comments on proposed legislative changes relating to:

- restrictions relating to remuneration consultants,
- two strikes test,
- addressing comments on the Remuneration Report,
- key management personnel (KMP) remuneration voting prohibition, and
- KMP remuneration hedging prohibition.

RESTRICTIONS RELATING TO REMUNERAION CONSULTANTS

Appointment

In the draft Bill released at Christmas it was proposed that from 1 July 2011 contracts between a disclosing company and a remuneration consultant relating to the provision of advice on the nature and amount or value of remuneration for KMP must be made by a non-executive director on behalf of the company.

An article that appeared in the Australian Financial Review on 23 February 2011 indicated that the Government will water this down so that the appointment of a remuneration consultant will simply have to be approved by the board or remuneration committee.

The article also indicated that a new requirement would be introduced so that both the board and the remuneration consultant will need to make a declaration in the Remuneration Report confirming that the advice was provided independent of undue influence from company executives.

Although unclear the article seemed to indicate that lawyers and accountants may not be treated as remuneration consultants.

Advice From Remuneration Consultants

Proposed legislation will from 1 July 2011 require remuneration consultants to provide advice on remuneration (nature and amount or value) of KMP of disclosing companies solely to:

- directors of the company, or
- the remuneration committee.

However, such advice may not be provided to an executive director unless all the directors of the company are executive directors.

The advice may not be given to any person who is neither a director of the company nor a member of the remuneration committee.

Disclosures

Proposed legislation will mean that from 1 July 2011 if a remuneration consultant provided advice on the remuneration of KMP for the company for the financial year then the Remuneration Report needs to include the following information:

- i. the name of the consultant,
- ii. the name of each director who executed the contract under which the consultant was engaged, (likely to change given earlier comments on the appointment of remuneration consultants)
- 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 the above subparagraph.

Guidelines

The foregoing disclosures will make it imperative for boards to develop guidelines for engaging and dealing with remuneration consultants. In this regard the following points may be useful when developing those guidelines:

- the consultant/consultancy should not have provided advice to management either personally or for the company on remuneration or other matters for at least one year (could be up to say 3 years),
- the consultant/consultancy should have a database from which to draw data on market practice in relation to remuneration of KMP in relevant comparator companies,
- the consultant/consultancy should have significant relevant experience in advising on KMP remuneration,
- the individual consultants who are advising the company should have significant relevant experience in advising on KMP remuneration,
- the consultant/consultancy should be engaged by and report directly to board or remuneration committee,
- any interaction between management and the consultant/consultancy should be authorised by the board or remuneration committee and should be limited to receiving input to allow the consultant to undertake the work commission by the board or remuneration committee, and
- If interviews or working sessions involve management then whenever possible a representative of the board or remuneration committee should be present.

TWO STRIKES TEST

The “two strikes test” relates to the non-binding shareholder vote at the annual general meeting (AGM) on the company’s Remuneration Report.

The government exposure draft in relation to the “two strikes test” contains the following main elements.

Proposal	Comments
<ul style="list-style-type: none">• The proposal only applies to listed companies.	Companies and other organisations that are not listed do not need to be concerned with the proposal.
<ul style="list-style-type: none">• Only Remuneration Report votes that take place on or after 1 July 2011 are taken into account.	The first time when boards may face a spill motion will be at their 2012 AGMs.

Proposal	Comments
<ul style="list-style-type: none"> If a negative vote of 25% or more applies to a Remuneration Report at an AGM then the next AGM notice of meeting must include a resolution to spill the board except when the prior notice of AGM included a spill resolution. 	<p>Spill resolutions cannot be put to shareholders in two consecutive years.</p>
<ul style="list-style-type: none"> If the notice of meeting for an AGM includes a spill resolution and a negative vote of 25% or more is received in relation to the Remuneration Report resolution, the spill resolution will need to be voted upon. If less than 25% of the votes on the Remuneration Report are negative then the spill resolution will not be put to shareholders for a vote. 	<p>The spill resolution has the effect of requiring all non-executive directors to stand for re-election and a spill meeting of shareholders.</p>
<ul style="list-style-type: none"> For the spill resolution to be carried requires at least 50% of votes in favour. 	<p>The requirement for at least 50% of votes to pass the spill resolution means that while an individual or group of shareholders with a combined shareholding of 25% of issued shares may trigger a spill resolution they will need to attract the support of a significant number of other shareholders to get the majority they need to bring about a change in the individuals who compose the board. This will reduce the possibility of the Remuneration Report voting process being used as a means of changing the composition of a board when the reasons for the change are not related to the Remuneration Report.</p>
<ul style="list-style-type: none"> If the spill resolution is passed then another general meeting of shareholders needs to be held within 90 days of the spill resolution being passed. Failure to hold the meeting means that each person who holds the office of director at the end of the 90 days period (other than those appointed towards the end of the 90 days within the notice period for a general meeting) commits an offence. 	<p>Much of the 90 days may be needed to arrange a venue for the meeting, draft the notice of meeting and to give shareholders sufficient notice of the meeting.</p> <p>During the period between the AGM and the spill meeting the directors will continue to hold office but may feel that they need to operate in a caretaker mode pending the outcome of the spill meeting.</p>
<ul style="list-style-type: none"> All non-executive directors will stand for re-election at the spill meeting and at least three directors, including executive directors, must be continuously appointed. Re-election means that service is deemed to be continuous. Thus, if insufficient are re-elected then those (up to the minimum number of directors requirement) who receive the highest number of votes in favour of their appointment will be deemed to be re-elected. If two or more directors receive the same number of votes in favour of their appointment then the remaining directors can choose which individual is appointed as a director. 	<p>If as a result of the vote on the spill resolution only two non-executive directors and the Managing Director compose the board then the board may feel that it needs to appoint more non-executive directors to achieve a well-balanced board. The proposed new laws seem to be silent as to whether the directors who were not re-elected may be reappointed. However, it would seem to be inadvisable to reappoint those individuals who were not re-elected particularly as they will need to stand for election at the next general meeting.</p>

Proposal	Comments
<ul style="list-style-type: none">• The company will not need to hold the spill meeting if by the end of the 90 day period:<ul style="list-style-type: none">▪ none of the non-executive directors remain as directors, and▪ all of them have been replaced as directors.	Of course, the newly appointed non-executive directors will need to stand for election at the next general meeting.

ADDRESSING COMMENTS ON THE REMUNERATION REPORT

If at an AGM 25% or more of the votes on the Remuneration Report are negative and comments are made at the AGM on the Remuneration Report then the next Remuneration Report must:

- explain whether those comments have been taken into account, and
- either how they have been taken into account or why they have not been taken into account.

The starting point is for the company to record any comments made on the Remuneration Report during the AGM and for the Chairman to seek clarification of any aspects that are vaguely or imprecisely expressed.

The board or remuneration committee would need to subsequently consider those comments and decide if any action is required. If action is required then it would normally be delegated to the remuneration committee which may seek the assistance of the company's remuneration consultant.

KMP REMUNERATION VOTING PROHIBITION

Proposed legislation will mean that from 1 July 2011 KMP (and their closely related parties) will be prohibited from voting on:

- on their own remuneration arrangements, as part of the non-binding vote on the Remuneration Report, and
- undirected proxies on all remuneration related resolutions.

KMP REMUNERATION HEDGING PROHIBITION

Proposed legislation will mean that KMP (and their closely related parties) will be prohibited from hedging remuneration that depends upon satisfaction of performance conditions. Most companies already have policies prohibiting hedging, therefore this legislative change will have little, if any, impact on executives.

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Market Benchmarking of Executive & Director Remuneration

GRG databases for top executive and non-executive director remuneration have been updated to include all annual report remuneration data for years ended up to 30 September 2010. Accordingly, now is an ideal time to have your top executive and non-executive director remuneration benchmarked against market practice.

The increased focus being placed on executive and director remuneration makes it more important than ever for Boards to be satisfied that they are adopting practices that are consistent with market practice and appropriate to their companies' circumstances.

If you would like an independent review of the market competitiveness of your company's remuneration practices for top executives and/or non-executive directors then GRG will be pleased to assist.

Please call Denis Godfrey on 02 8923 5701 (direct line) or Mike Carroll on 0416 226 131.