

Improving KMP Remuneration Disclosures

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Introduction

Section 300A of the Corporations Act specifies the minimum disclosure requirements for Remuneration Reports of ASX listed companies in relation to key management personnel (KMP). For reference they are outlined in Attachment A. However, these are seen as not sufficient by many and some companies have gone further, pre-empting proposed Corporations Act amendments.

Proposed Amendments

Clearer Categorisation of Pay & More Transparent Disclosure of Termination Payments

While draft legislation has not yet been released it is understood that the Government intends to amend the Corporations Act to include in the Remuneration Report section of Annual Reports:

- a general description of the company's remuneration governance framework, if not covered in another section of the Annual Report,
- remuneration by categories such as:
 - crystallised past pay,
 - present pay, and
 - future pay,
- all payments for KMP upon their retirement from the company, and
- any options that have lapsed in the current financial year and indicating the year in which such options were granted.

Commentary

While many have been critical of the information disclosed in Remuneration Reports very few companies have taken the initiative and sought to address the deficiencies in s300A. Those that have made an attempt to address them have not gone nearly far enough as they have not achieved comprehensive and informative disclosures particularly in relation to the LTI component of KMP remuneration. It is GRG's view that companies should be better communicating KMP remuneration than currently required under s300A so as to provide shareholders with a clearer understanding of what KMP's have earned during the current year and what is available to be earned in future years from current arrangements. As a minimum it would seem relevant to disclose in relation to each KMP:

- fixed cash and benefits received during the year in respect of that year,
- STI received in the current year while making it clear:
 - if it related to the prior year, and
 - the award opportunity for the current year being reported upon,
- LTI grants is the area where there is considerable room for improvement. Attachment B provides an illustration of an approach that could be used as it covers the current disclosure requirements of s300A, significantly improves transparency and is consistent with the announced broad approach to be covered in new legislation (not yet released).

The approach reflected in Attachment B contains the following features:

- All prior year grants are covered when some or all of the grants in the relevant year have not vested or lapsed at the beginning of the current financial year,
- Each type and tranche of equity unit is reported in terms of numbers and grant values,
- Lapsing and vesting between the grant and the start of the current financial year are reported as to numbers, grant values, benefit values and variance between grant and vesting values (generally the grant value equals the target LTI value, therefore the variance between the grant value and the benefit value indicates the extent to which the KMP has earned more or less than the target value – such variance should be consistent with company performance over the vesting period),
- Current financial year lapsing, vesting and exercise of options are reported as to numbers, grant values, benefit values, variance between the grant and benefit values and exercise of options, and
- Future opportunities being the number and grant value of unvested equity units held at the end of the financial year.

When combined with explanatory comments on the company remuneration strategy and the specific LTI grants and perhaps some graphical representations, the table shown in Attachment B should significantly improve communication of KMP remuneration.

Company Performance and Vesting

S300A(1AA) provides that the discussion of company performance must cover the company's earnings and the consequences of the company's performance on shareholder wealth in the current financial year and the four prior financial years.

Compliance with the legislative requirement will not alone result in communications with shareholders that will allow them to properly consider whether the company's KMP remuneration policies and practices are reasonable and appropriate. Therefore, significantly better explanation of the performance-reward linkage is required to complement the improved LTI remuneration disclosure table discussed earlier in this GRG Remuneration Review. In this regard the following diagram seeks to highlight that:

1. Where company performance is relevant to the STI it will usually only be of one year and it will be the year prior to the current year as STI payments received in the current year usually relate to prior year performance,
2. Only part of STI payments will relate to overall company performance and therefore it will be important to make clear to shareholders what the performance linkages were, why they were appropriate and that the payments were appropriate given performance,
3. In relation to the LTI the current year's performance will usually not be relevant to vesting which occurred in the current year. Such vesting typically relates to performance of the company in prior years.
4. In relation to vesting of LTI grants it will be important to make clear to shareholders the linkages between company performance and vesting and why they were appropriate.

Performance Related Remuneration		Periods of Company Performance			Link to Company Performance	Comments
Plan	Performance Element	Years Preceding Prior Year	Prior Year	Current Year		
STI	Individual	Not relevant	This performance is relevant to current year STI payment but has limited connection to company performance	Not relevant	Weak 	Will not have a direct link to company performance
	Business Unit	Not relevant		Not relevant		Has a link to company performance but only one element of the company performance metric
	Company	Not relevant	This performance is relevant to the current year STI payment.	Not relevant		Should use internal financial measures that should increase the intrinsic value of the company which in turn should translate into improved returns for shareholders
LTI	Company	Company performance over several years is relevant to vesting of LTI grants in current year		Not relevant except to the extent to which current year grants may vest in future based on current and future years' company performance	Strong	Should use TSR when measured relative to market movements and company specific risk

Related Matters

Clawback of KMP Bonuses

The Government has also announced that it will amend the Corporations Act to require listed companies to disclose in their Remuneration Reports either:

- the steps they have taken to enable clawback of bonuses and other remuneration where a material misstatement has occurred in the company's financial statements, or
- if no such steps have been taken, a detailed explanation of why not.

It is understood that draft legislation for public comment will not be released until the second half of 2012.

Voting of Proxies

Despite the Government having announced that it would act quickly to change the Corporations Act to enable Board Chairs to vote proxies in favour of Remuneration Reports the amending legislation has not as yet been introduced into Parliament. As the time for drafting notices of meeting for AGMs to be held in the second half of 2012 is fast approaching there is an increasing risk that the legislation may not be passed in time for the next major AGM season.

Attachment A – Section 300A Overview

Section 300A of the Corporations Act specifies that certain aspects must be covered in Remuneration Reports being:

1. Discuss the board policy for determining KMP remuneration and the relationship between that policy and company performance.
2. Explanation of performance conditions used in relation to KMP remuneration including: what are they, why were they chosen, how is performance measured and whether the conditions have been satisfied. If the performance condition involves external benchmarking then a summary of the factors used to make the comparison and a list of the comparator companies or index.
3. Details of remuneration for the year for the KMP.
4. If a KMP's remuneration includes securities which are not dependent upon satisfaction of a performance condition then why was it not dependent upon a performance condition.
5. The relative proportions of each KMP's remuneration composed of fixed and variable (STI & LTI etc.) elements.
6. If options were part of a KMP's remuneration then:
 - a. Value at grant of options granted to the KMP during the year, and the percentage it represents of remuneration for the year,
 - b. Value at exercise of options that were exercised during the year,
 - c. Value at lapse (assuming that vesting conditions were satisfied) of options that lapsed during the year because a vesting condition was not satisfied,
7. For employment contracts with KMP:
 - a. The duration of the contract,
 - b. Notice periods, and
 - c. Termination payments.
8. An explanation of the board's proposed action or an explanation of why no action is proposed in respect of comments made when a "strike" (25% or more votes against the Remuneration Report) was received at the prior AGM,
9. Disclosures in relation to external remuneration consultants who provided remuneration recommendation in relation to KMP,
10. The material on company performance referred to in point 1 above needs to deal with, amongst other matters:
 - a. Company earnings, and
 - b. Consequences of the company performance on shareholder wealth in the current financial year – in essence the legislation requires consideration of total shareholder return (TSR) over the financial year.

As discussed in the following, improvements in disclosure will be required when proposed legislation is passed by Parliament and to enhance communication with shareholders so as to minimise the possibility of "strikes".

Attachment B – Example LTI Disclosure Table

KMP (Name & Role)		John Smith, General Manager											
Year of Grant		2009			2010		2011		2012			TOTALS	
Type of Equity Unit		Options T1 (1)	Options T2 (2)	Options T3 (3)	Performance Rights	Deferred Rights	Performance Rights	Deferred Rights	Performance Rights	Deferred Rights	Options (4)		
Grant	Number	300,000	300,000	300,000	50,000	25,000	70,000	20,000	100,000	20,000	200,000		
	Value	\$90,000	\$90,000	\$90,000	\$25,000	\$25,000	\$52,500	\$30,000	\$100,000	\$40,000	\$140,000	\$682,500	
	Annual Grant Values	\$270,000			\$50,000		\$82,500		\$280,000			\$682,500	
Prior Years	Year		2010	2011									
	Lapses & Forfeitures	Number	100,000	200,000									
		Grant Value Forfeited	\$30,000	\$60,000									\$90,000
		Benefit Value Forfeited	\$20,000	\$140,000									\$160,000
	Vested	Number	200,000	100,000									
		Grant Value	\$60,000	\$30,000									\$90,000
		Benefit Value	\$40,000	\$70,000									\$110,000
Variance Between Grant and Benefit Values		-\$20,000	\$40,000									\$20,000	
Current Year - 2012	Lapses & Forfeitures	Number			150,000	12,500							
		Grant Value Forfeited			\$45,000	\$6,250						\$51,250	
		Benefit Value Forfeited			\$180,000	\$15,625						\$195,625	
	Vested	Number			150,000	12,500	12,500					200,000	
		Grant Value			\$45,000	\$6,250	\$12,500					\$140,000	\$203,750
		Benefit Value			\$180,000	\$15,625	\$15,625					\$0	\$211,250
		Variance Between Grant and Benefit Values			\$135,000	\$9,375	\$3,125					-\$140,000	\$7,500
Options Exercised	Number	200,000	100,000	150,000									
	Value (includes benefit value on vesting)	\$240,000	\$120,000	\$180,000									
Future Opportunity	Number	0	0	0	25,000	12,500	70,000	20,000	100,000	20,000	200,000		
	Grant Value	\$0	\$0	\$0	\$12,500	\$12,500	\$52,500	\$30,000	\$100,000	\$40,000	\$140,000	\$280,000	
Note	<p>1 Options vest based on completion of one year of service.</p> <p>2 Options vest based on completion of two years of service.</p> <p>3 Options vest based on completion of three years of service.</p> <p>4 Options have a four year term, an exercise price of 150% of the share price at the date of grant and are full vested at grant.</p>												

Key Management Personnel Remuneration Advice

GRG is a specialist advisor on remuneration for key management personnel (KMP) i.e. non-executive directors, executive directors and other top executives. To facilitate its independent advisory function GRG maintains two remuneration databases with one concentrating on non-executive directors and the other on top executives. This data analysis allows GRG to remain up to date with current trends and developments and to be able to benchmark company practices against market practice. The increased focus being placed on KMP 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 company's circumstances.

If you would like an independent review of the market competitiveness of your company's remuneration practices for KMP then GRG will be pleased to assist. Please call Denis Godfrey or James Bouchier on (02) 8923 5700 or Mike Carroll on 0416 226 131.