

Are ASX Listed Companies Breaching the Law?

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INTRODUCTION

Having recently opened an office in Melbourne Godfrey Remuneration Group undertook detailed research into the key management personnel (KMP) remuneration practices of ASX listed companies with head offices in Victoria and having market capitalisations of more than \$500 million. As part of that research we observed that several companies may be breaching the ASX Listing Rules.

This caused us to reflect on the need for boards of ASX Listed companies to obtain advice on KMP remuneration. This GRG Remuneration Insight focuses on two ASX Listing Rules and the relevant related party provisions of the Corporations Act as compliance with these provisions often involves advice from independent external remuneration consultants.

ASX LISTING RULES

Revenue is Not a Suitable KPI for Incentive remuneration for Directors

Analysis of key performance indicators (KPIs) used in short term incentive (STI) plans indicated that revenue is being used as a KPI by many companies. It is also being used by one company as a vesting condition for securities granted under its long term incentive plan. ASX Listing Rule 10.17 clearly states that *“an executive director’s salary or director’s fees must not include a commission on, or percentage of, operating revenue”*. While the wording of this Rule could do with some improvement its intention seems to be clear. The intent appears to be to preclude the use of “revenue” as a KPI in any form of incentive remuneration for executive directors.

Unfortunately, Remuneration Report disclosures in relation to STI plans are generally broad in nature with the result that it is unclear as to whether the “revenue” KPI is being restricted to KMP who are not directors. However, given that the KPIs used for senior executives tend to have been cascaded down from those used for the Managing Director there is a strong possibility that those companies using “revenue” as a KPI may be doing so for executive directors. If this is the case then they are breaching the intent of ASX Listing Rule 10.17.

The reason for “revenue” to be excluded from use as a KPI for executive directors is clear. Its use could lead to the pursuit of revenue growth irrespective of its contribution to profitability and could lead to destruction of shareholder value.

Incentive Remuneration Must Not Be Paid To Non-Executive Directors

Analysis of disclosures in relation to non-executive director (NED) remuneration indicates that some appear to have been paid bonuses. Listing Rule 10.17.2 states: *“If a non-executive director is paid, he or she must be paid a fixed sum”*. Thus, the payment of bonuses to NEDs is clearly not permitted under the ASX Listing Rules.

A possible explanation may be that the directors who received the bonuses were, in fact, executive directors. At times the distinction between executive and non-executive director roles can become blurred. Generally, a NED is a director who does not form part of the executive management team. They are not employees of the company and are not required to attend the company's premises to perform their work except for attendance at board, committee and other meetings. Similarly, they are not required to devote specified periods of time to the fulfilment of their responsibilities.

Of course, if a director is an executive director then the fees they receive do not count toward the aggregate fees limit (fees cap) approved by shareholders for NEDs.

It should also be noted that, except for fee sacrifice arrangements, grants of securities (shares, right & options) to NEDs as part of their remuneration do not count as part of the aggregate fees limit. Of course, such grants need separate shareholder approval when new issues of shares may be involved. Also grants of securities are considered to be fixed sums.

CORPORATIONS ACT

Remuneration Must Be Reasonable or Approved By Shareholders

Section 208 of the Corporations Act requires shareholder approval of financial benefits provided to related parties unless one of several exemptions applies. A financial benefit includes remuneration and related parties include executive and non-executive directors.

Shareholder approval of an increase in the aggregate fees limit (ASX Listing Rule 10.17) does not authorise remuneration to be paid to NEDs under section 208 of the Corporations Act. Thus such payments need to fall under one of the exemptions unless specific shareholder approval is obtained. Such approval is rarely sought. The most relevant exemption is in section 211 which authorises remuneration that is reasonable in the circumstances of the company and the director.

For a board to be able to evidence that it has acted responsibly in forming the opinion that remuneration is reasonable it is advisable for it to have obtained professional advice from an independent expert in the field of director remuneration. Such an expert would need to have a comprehensive database of remuneration practice for comparable roles as reasonableness needs to be determined by reference to market practice for comparable roles. It is this need that has led to reliance on advice from external remuneration consultants such as Godfrey Remuneration Group.

Advice Must Be To Non-executive Directors From Approved Consultants

When obtaining the independent KMP remuneration advice it needs to be remembered that:

- a) The external remuneration consultant (ERC) must be approved by the board, and
- b) The ERC must provide the advice to non-executive directors.

These requirements are contained in section 300 of the Corporations Act.

Conclusion

The complexities involved with KMP remuneration make it increasingly more difficult for boards to satisfy the needs and preferences of all stakeholder groups. At times it may be necessary to adopt approaches that are not totally consistent with various guidelines but are nevertheless considered by the board to be the best approaches for the company. In such cases it will be critical to explain in detail the rationale for the approach adopted if proxy advisor support is to be obtained.

However, there remain certain aspect of the Corporation Act and the ASX Listing Rules that are not within the discretion of boards. These aspects need to be complied with even if the board is of the view that a different approach may be more relevant in the company's circumstances.