

Submission

Exposure Draft: Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012

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Purpose of Submission

To comment on the proposed amendments to the Corporations Act relating to remuneration disclosures contained in the Exposure Draft: Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012 and to make recommendations on amendment of some aspects of the proposed legislation and the broader purpose and context of disclosures on remuneration. The submission addresses:

- The purpose of remuneration disclosures
- Consideration of the broader context of remuneration disclosures
- Areas of the proposed legislation requiring further consideration.

Purpose of Remuneration Disclosures

The purpose of remuneration disclosures should be to provide a simple and clear explanation of remuneration policies and practices for directors and top management for shareholders. The focus should be on guidelines rather than prescription allowing each company to be able to tell its story in its own context. The current provisions, with detailed prescription of the information required and usage of accounting terminology, work against this objective. There are, on a rough count, currently 118 items of information required to be disclosed in the remuneration report with the current proposals adding 10 and taking away 1. Selective adoption of the Corporations and Markets Advisory Committee (CAMAC) recommendations on remuneration disclosures which were put forward as a comprehensive package to simplify and clarify remuneration disclosures is likely to result, overall, in a more complex rather than a simpler disclosure regime for the governance of remuneration.

Recommendation 1: *The focus of the current amendments and future legislation on remuneration disclosures should be focused on guidance rather than prescription.*

Consideration of the Broader Context of Remuneration Disclosures

The remuneration disclosures form one part of the broader annual reporting requirements of companies which are determined not only by the Corporations Act but by the listing rules, the ASX Good Governance Recommendations and Principles, the accounting standards and for financial institutions, the prudential standards. Calls have been, made as part of the CAMAC review of annual reporting, to have a coordinated review of all these requirements to reduce overlap, confusion and complexity of reporting. This is particularly the case for

smaller companies who face a disproportionate burden for their size and resources in terms of the disclosures required.

Recommendation 2: *Remuneration disclosures to be considered in any broader consideration of legal and other requirements for annual reporting by companies.*

The impact of the two strikes rule on the non-binding vote on remuneration reports also needs to be taken into account in any consideration of remuneration disclosures due to the significant consequences involved. The first two years' experience has identified significant concerns with the inappropriate use of the provision on non-remuneration issues and the disproportionate impact on small companies. In the 2012 season, over 78% of companies with a first strike were below the ASX 300 index. In reviewing a representative sample of these reports it is very difficult to find the alleged remuneration issue on which the "no vote" is based. Also, based on the Productivity Commission research in 2010 this was not the group considered to have any significant remuneration issues and it is unfair and inappropriate that they should be bearing the burden of legislation primarily designed to address significant outliers and perceived corporate governance failures from the past in some large companies. It would therefore be appropriate for there to be a review by the appropriate authority such as the Australian Securities and Investment Commission (ASIC) to consider the impact on smaller companies of the two strikes rule. There is however a need to take further action to mitigate the adverse consequences by removing or modifying the current 2 strikes provision.

Recommendation 3: *That the impact of the two strikes rule on smaller companies be reviewed by an appropriate authority (e.g. ASIC).*

Recommendation 4: *Consideration should be given in this review to removing the 2 strikes rule or at least making it applicable to only ASX 100 listed companies. Other measures which could be considered are to make the voting threshold 75% of issued shares or have a simple majority threshold of votes cast in line with general voting practice.*

Areas of the Proposed Legislation Requiring Further Consideration

1. The introduction of past, present and future pay categories.

This is the main area which requires substantial further consideration. The interaction of the new categories and the existing statutory disclosures based on the accounting standards will be difficult to manage. It is likely to lead to more complex reports with multiple tables and the need for further explanation to reconcile differences and overlaps between them.

A number of terms/concepts need to be clarified to ensure a consistent approach is taken. These include the meaning of the terms: "total amount"; "granted"; and "paid". The categorisation of short term incentives earned in the previous year and paid in the subsequent year also needs to be considered if alignment of pay and performance is not to be disconnected. The potential for double counting between the categories also needs further consideration.

Ideally, as originally proposed by CAMAC, the new categories should replace the accounting disclosures for the purpose of providing a clear and simple explanation of realised remuneration (past and present pay) and deferred remuneration (future pay). There will, however, still be a need to clarify and provide guidance on the approach to be taken along the lines of the work done in the UK by the Financial Reporting Lab for the Department of Business Innovation and Skills (BIS) which engaged a number of report preparers and readers to ensure a consistent approach.

The accounting definitions of pay can, and should, be used in the financial reports allowing the remuneration report to operate, as originally intended, as an explanation of remuneration policy and practice and its alignment with organisation performance. If the accounting disclosures are to be maintained in the remuneration report then the new categories should be advisory and not mandatory. This is in line with the practice already implemented by a number of companies to provide a summary of actual, realised or realisable pay to assist shareholders in understanding their pay policy and practice. Guidance on terms would still be helpful in these circumstances to promote a more consistent and comparable approach to pay summaries.

The development of this guidance and clarification of the definitions to be used in adopting these pay categories should be undertaken by a working group sponsored by an appropriate authority. The working group should consist of leading experts on corporate governance and remuneration policy and practice rather than be a representative group. Input should be sought from report readers through appropriate governance bodies/forums.

Recommendation 5: *That either the new categories be developed to replace the current accounting standard based disclosures or the new categories be advisory only rather than mandatory.*

Recommendation 6: *That a working group be established under an appropriate sponsoring authority to clarify terms and definitions and provide guidance on the application of the new categories whether mandatory or advisory.*

2. *Disclosure of the remuneration governance framework.*

Many companies already disclose the remuneration governance framework as part of the description of the remuneration policy. While in itself this proposal is positive, the explanatory memorandum makes a number of suggestions on items to be included which are at best tangential in relation to a company's decision making processes on remuneration or are at a level of detail which is likely to confuse rather than enlighten. This is another area where guidance on the appropriate structuring of the remuneration report to outline remuneration governance processes would be a more effective approach than setting a prescription. As an alternative to legislation on this issue, ASIC could provide guidance on matters which should be outlined in the report as part of their periodic review of compliance and practice in relation to the Corporations Act remuneration disclosure requirements.

Recommendation 7: *That guidance be provided on remuneration governance processes rather than set a prescription.*

3. *Benefits on termination*

Further clarification is required on how this provision is intended to operate. The working group proposed above for pay categories could also consider this issue.

Recommendation 8: *The proposed working group, sponsored by an appropriate authority, to further consider guidance on the operation of this provision.*

4. *Clawback*

Given the principles based approach taken to this provision it is likely that expectations will develop over time on how this provision should be applied. It would be advisable, therefore, to review the application of this provision in three years' time to see how it is being applied and whether expectations about reporting under the provision by shareholders are reasonable and meet the intent of the provision. Particular consideration should be given to mid and small cap companies. This is an area which might form part of the ASIC periodic review of the application of the remuneration disclosure provisions.

Recommendation 9: *That an appropriate authority consider the operation of the clawback provision in the periodic review of the Corporations Act remuneration disclosure provisions.*

Summary of recommendations

Recommendation 1: *The focus of the current amendments and future legislation on remuneration disclosures should be focused on guidance rather than prescription.*

Recommendation 2: *Remuneration disclosures to be considered in any broader consideration of legal and other requirements for annual reporting by companies.*

Recommendation 3: *That the impact of the two strikes rule on smaller companies be reviewed by an appropriate authority (e.g. ASIC).*

Recommendation 4: *Consideration should be given in this review to removing the rule or at least making it applicable to only ASX 100 listed companies. Other measures which could be considered are to make the voting threshold 75% of issued shares or have a simple majority threshold of votes cast in line with general voting practice.*

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Recommendation 9: *That an appropriate authority consider the operation of the clawback provision in the periodic review of the corporations act remuneration disclosure provisions.*

About the Author

Peter Armstrong is a Director of the Corporate Services Group at D H Flinders and consults on remuneration and HR governance issues to Bendigo and Adelaide Bank and other clients. Peter has worked for a number of major corporations including BlueScope Steel, Southcorp Packaging and BOC. Peter is a Fellow of the Australian Institute of Management and a member of the Australian Institute of Company Directors.

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