Manager
Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

15 March 2013

Dear Manager

Re: Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012

Thank you for the opportunity to provide a submission.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing $2 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to discussing the contents with you. I can be contacted on 02 9299 3022.

Yours sincerely

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FSC SUBMISSION –

CORPORATIONS LEGISLATION AMENDMENT (REMUNERATION DISCLOSURES AND OTHER MEASURES) BILL 2012

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This submission outlines the FSC's views on:

1. *Context*

As the representative of long-term active investors, the FSC has a well-established history and culture of working with the government to improve corporate governance in Australia. This has included working to improve disclosure, transparency and consistency of company reporting and developing self regulation such as the Blue Book and ESG reporting guide for Australian companies.

FSC also participated in a number of recent inquiries such as the 2009 Productivity Commission review into Executive Remuneration in Australia and more recently the CAMAC inquiry into improving shareholder engagement in Australia.

Consistent with this ethos we are pleased to provide a submission to Treasury on this exposure draft.

As an overarching point, we strongly recommend that a Regulatory Impact Statement (RIS) is undertaken on these proposals prior to moving to release final legislation to present to Parliament.

RECOMMENDATION Undertake a RIS on the proposals in the draft Bill.

In summary, our submission outlines our:

- Concern that the proposed disclosure requirements will lead to less consistent, transparent and comparable remuneration reports
- Preference for clawback measures to be dealt with in the ASX Corporate Governance Principles.

2. *Improving disclosure requirements in the remuneration report*

FSC supports the principle of a remuneration governance framework covering key management personnel (KMP).

The Bill proposes the following amendments to the Corporations Act to require:

1. Disclosing entities to disclose the "remuneration governance framework"
2. Disclosure of the value of lapsed options, the number of those options and the year in which options were granted (Item 6)
3. For each KMP, listed companies must disclose (Item 8):
    a. "Retirement" benefits
    b. Retirement benefits if the failure to give the benefit would not constitute a breach of law in Australia
    c. Post retirement benefits
4. For each KMP (Item 5):
    a. The total amount of remuneration granted before this year but paid in the year
    b. The total amount of remuneration granted and paid this year
    c. The total amount of remuneration granted but not paid this year

There are largely three issues with the proposals:

- The proposed rules will not replace existing disclosure requirements, and so the size of remuneration reports will increase;
- The current disclosure requirements already cause confusion on levels of remuneration. By adding another form of disclosure requirement, we risk adding to existing confusion;
- Known problems with the variable application of existing disclosure requirements have not been addressed, so remuneration reports will continue to be internally inconsistent and incapable of ready comparison with reports of other disclosing entities.

An existing issue with remuneration reports is that they often fail to tell shareholders 'why' remuneration is structured the way it is and 'why' this is an appropriate use of shareholder capital, giving a fair 'pay' that attracts, retains and motivates the executives and directors to manage the company in the best interests of shareholders.

Remuneration reports often lack comparability (due mainly to different interpretations of what needs to be included and different interpretations as to how any values should be calculated and presented).

Confusion also arises as disclosure may not be in a form which reflects how companies/boards manage remuneration. Currently disclosure of remuneration is in accordance with the requirements of AASB 2.

Such disclosure should be made in the remuneration report itself. Where the disclosure occurs in another section of the financial report a reference to where it is disclosed should be made in the remuneration report.

This can be particularly problematic in respect of long term incentives (LTI) where AASB 2 applies for a number of reasons:

1. The amount shown as remuneration for long term incentives is a combination of amortised values of long term incentives granted in the current and past years. Disclosure under the accounting standard does not provide clarity around the value of LTI granted during the reporting year or the value of LTI that has vested during the reporting period;
2. Further, under AASB 2, when valuing equity instruments vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at grant date. Therefore instruments that have accounting performance measures such as earnings per share are measured on a different basis.

Therefore, the FSC believes that the current disclosure requirements under AASB 2 already provide confusing information to investors and other users of the remuneration report.

What investors need to know is more information on the value of remuneration and in particular, performance based remuneration, at both grant and vesting dates. The difference between the two should be explained clearly in the remuneration report.

In their report to the Parliamentary Secretary to the Treasurer in 2011, CAMAC stated that:

> CAMAC sees remuneration reporting as a dynamic process, which needs to reflect evolving remuneration practices. Companies should be allowed to develop their response to this changing environment without simultaneously having to come to grips with wide-ranging new reporting requirements. Evolving remuneration reporting practice, and ideas for simplification of remuneration reports, may provide the basis for a fresh non-prescriptive legislative approach to remuneration reporting at some future time.[1]

Although we agree with the sentiment that companies ought to have some flexibility in their public disclosures to meet varying company structures and needs (such as those matters dealt with under the ASX Corporate Governance Principles), we believe that remuneration disclosure calculations require more prescription. This is because without comparability, remuneration reports are largely undermined as a useful tool for investors.

Issue with the use of the word "paid"

The legislation as proposed does not define what is meant by the word "paid". This is quite problematic in respect of proposed section 300A(1)(ca). Where for example market options with an exercise price equal to the market price at grant date, vest, there is often a period after the vesting date where the owner of the option can exercise the option. So is the option "paid" at the vesting date or exercise date?

Further in respect of short term incentives (STIs) there is currently inconsistency amongst listed companies on disclosure of STIs. Some listed companies show the STI that has accrued for the current reporting year while others show the amount paid during the year which relates to performance of the prior reporting year. Accordingly, greater clarification around the word "paid" is needed.

Preferred approach

The current reporting requirements and the proposed additional reporting requirements do not achieve what investors seek from a remuneration report. As noted, the current disclosure requirements provide confusing information on executive remuneration.

In moving to new standardised remuneration guidelines, we believe it must become optional for companies to disclose remuneration as per the requirements of AASB 2 in the remuneration report. Instead Companies should be required to disclose under the new proposed guidelines which should replace the AASB 2 requirements in the remuneration report.

In our view, if a company chooses not to make this disclosure in the remuneration report, the disclosure must be made in the notes to the financial statements.

From an investor's perspective, disclosure of executive remuneration should reflect the manner in which companies manage their remuneration. It is also important to note the components of pay which are not based on performance conditions and those components which are subject to meeting performance conditions.

The proposed legislation seeks to disclose present, past and future remuneration. FSC supports this concept but believes the legislation as proposed be re-worked slightly to deliver the following disclosure. In order to understand how a board manages remuneration the following elements of remuneration should be disclosed:

	Fixed remuneration granted and/or received during the reporting year i.e. not subject to any performance conditions *(**present pay** - non-performance based remuneration)*
	Performance based remuneration received and or subject to vesting in respect of annual performance relating to the reporting year with the market/intrinsic value at vesting date disclosed *(**present pay** - performance based remuneration)*
	Performance based remuneration that has vested during the reporting year with a performance period of greater than 12 months. (***past pay** -performance based remuneration)*
	Performance based remuneration granted during the reporting year with a performance period in excess of one year with the market/intrinsic value at grant date disclosed for threshold performance and full vesting. *(**future pay** – performance based remuneration)*

The above components of remuneration are consistent with the objectives being sought by the Government. Disclosure would take the form of four simple tables. This would allow investors to assess each component of pay and make conclusions on the board's effectiveness in managing remuneration.

For any table disclosing performance based remuneration, all performance conditions that have been met or are to be met should be disclosed beneath the relevant table. The proposed disclosure would lead to greater consistency with respect to disclosure of executive remuneration and also allow for more meaningful comparison of remuneration between companies.

There would not however, be a single figure for "remuneration received" in a particular year. This is unachievable due to the complex nature of the components of remuneration.

RECOMMENDATIONS

1. Disclosure of remuneration should be expanded to four categories as explained above.
2. The disclosure requirements under AASB 2 should be relegated to the notes to the accounts and not be required to be disclosed in the remuneration report.
3. A post implementation review should be conducted with a specific direction to assess the comparability and consistency of remuneration reports.

3. Clawback of remuneration

The Bill proposes amendments to the Act which would require entities whose financial statements have been **materially**[2] misstated or bear an omission in the previous 3 years to disclose whether any overpaid remuneration has been clawed back. Where a claw back of remuneration has not occurred and if not, why not, an explanation is required.

Item 9 of the Bill requires that such entities must disclose:

- Details concerning the overpayment to KMP due to misstatement
- Details concerning any reduction or repayment etc
- If no remuneration has been clawed back, an explanation is required

Our concern regarding the proposed legislation is that if a misstatement is material it should, by definition, be disclosed to the market. Based on the experience of FSC members, such

[2] As defined by accounting standards

announcements are extremely rare. Therefore we question the effectiveness of the proposed legislation.

Secondly, although FSC is supportive of the intention to create a disclosure based approach to remuneration clawback where there have been material misstatements, we are concerned about their location.

Further, we firmly believe that these clawback proposals are better suited to a self regulatory approach which presently exists under the ASX Corporate Governance Council principles.

Principle 8 "remunerate fairly and responsibly" has been under review by the Council which is due to release revised principles for public consultation later this year. Principle 8 presently contains the following recommendations for ASX listed entities (from the 2011 principles):

> 8.1 The board should establish a remuneration committee.
>
> 8.2 The remuneration committee should be structured so that it:
> - consists of a majority of independent directors
> - is chaired by an independent chair
> - has at least three members.
>
> 8.3 Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.
>
> 8.4 Companies should provide the information indicated in the Guide to reporting on Principle 8.

The principle is designed to complement the Corporations Act requirements for companies in dealing with remuneration. It contains a significant level of guidance under each recommendation to assist companies in complying with both sets of obligations which are complementary in that the Act sets out hard, prescriptive legal requirements whereas the principals determine the principles-based disclosures.

Clearly, the clawback proposals in the exposure draft are principles-based disclosures. Were the proposals to become law, Australia's remuneration disclosure framework would become fragmented and inconsistent. In this respect we support the ASX Corporate Governance Council's recent correspondence to Treasury on this matter.

RECOMMENDATION
The FSC believes that the proposals in the Bill are principles-based and reasonably moderate which is consistent with the Corporate Governance Principles which is where the clawback provisions would be better suited. FSC is a member of the Council and we support the correspondence provided to the Treasury in respect of this matter.