

THE EXECUTIVE REMUNERATION REPORTER

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Via email: corporations.amendments@treasury.gov.au

Dear Mr Woods

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

Thank you for the opportunity to comment on the proposed exposure draft of the amending bill. My comments relate to three proposed amendments to s 300A

- 1 Proposed s 300A(1)(ca) to include a total amount of remuneration with a breakdown over three time periods based on the time of grant and time of payment (remuneration outcomes)
- 2 Proposed s 300A(1)(ea) on benefits given in connection with the person's retirement from an office or position of employment with the company (total payments on retirement)
- 3 Proposed s 300A(1)(i) on clawback of payments where there is a material misstatement or omission in the financial statements over the previous three years (clawback)

1 Remuneration outcomes

The policy decision to introduce an amendment to require clear disclosure of the remuneration outcomes for the financial year is welcome. Currently companies are reporting the 'statutory requirements' to comply with s 300A and regulation 2M.3.03 *Corporations Regulations 2001* (Cth). These disclosures include a fair valuation of any share-based payments over the period of vesting in accordance with the accounting standards.¹ It is the share-based payment disclosures, together with the disclosures of accrued liabilities for annual leave, long service leave and, to a lesser extent (although this can depend on the particular executive), the superannuation component of the post-employment remuneration that bulk out the 'total' figure currently reported. Companies have responded to this situation by disclosing a table showing 'realised remuneration' earlier in the remuneration report.²

¹ AASB 2, Share-based Payment.

² Some recent examples show the difference between these two disclosures and these are appended as a pdf file for your convenience. The supplement to this submission identifies within each example the features of the disclosures made as they relate to the realised versus statutory remuneration debate.

There is a balance that needs to be achieved between what the executive pockets within the year and ensuring shareholders are kept aware of the total remuneration cost. After all, the accrued amounts of annual leave and long service leave can amount to a tidy sum, as the recent remuneration report from QBE Insurance Group Limited illustrates.³

The policy proposal for a total figure for remuneration is sound. The issue appears to be how this total figure is to be determined.

As the drafting presently stands, the figure is to be broken into three separate classifications

- A. granted in prior year + paid in current year;
- B. granted and paid in current year;
- C. granted in current year + to be paid in future year.

As the supplement to this submission illustrates, there is a problem with the current practice of splitting 'realised remuneration' from 'statutory remuneration'. 'Realised remuneration' would include A and B; remuneration for the current year of performance reflects B; while future payments (which will include deferred STI components where vesting is time based, together with LTI components where vesting is conditional on performance) is captured by C. In other words, there is not a 'neat' translation between what a number of companies currently do voluntarily and what this legislative amendment will require.

To support the current drafting of proposed section 300A(1)(ca), Treasury should also amend reg 2M.3.03 to include a separate table with these amounts OR to include three separate totals within the statutory remuneration table and to give an example of how this may be done.

One remuneration table – realised remuneration

I understand from comments reported in the media that a number of submissions already made to the Treasury on this item are seeking for only one amount to be included as 'total remuneration', being 'realised remuneration' (or A and B above). I agree with this view subject to one caveat: the information on accruing liabilities must also be included somewhere within the annual report, together with information on the grants of share-based payments.

Disclosures need to enable easy monitoring of the pay for performance link. Share-based payments that vest a number of years after the initial date of award, together with the emerging practice of deferred STI payments vesting typically one and two years after the year in which they were awarded (to reflect that year of performance) are not always easy to track within the company's remuneration disclosures.

The Financial Reporting Council (UK)'s lab project released a report on disclosing a total figure for remuneration in early March 2013. Page 4 of that report sets out a helpful table on how to measure each of the five remuneration elements within the UK reporting scheme (salary, benefits, pension, annual variable element and long-term incentives).

³ See QBE Insurance Group Ltd, 2012 Annual Report, pp. 93 and 97 for Mr FM O'Halloran. The true size of the long service leave payment is revealed in the explanatory notes to the notice of meeting for the AGM on 27 March 2013 (resolution 4).

2 Total payments on retirement

This is an essential amendment to the remuneration report disclosures in section 300A. The proposed drafting incorporates the same concepts as used in chapter 2D.2 of the *Corporations Act 2001* (Cth).

I refer to the example of QBE Insurance Group Ltd 2012 annual report in the attached supplement. On retirement a total of US\$7,406,000 either was paid or the company intends to pay. This amount is broken down as follows

- (1) Fixed remuneration to the date of termination⁴
- (2) Payment of accrued but untaken annual and long service leave entitlements (AUD\$2,285,645 gross)
- (3) A pro-rata 2012 QIS-cash award (STI scheme)⁵ of AUD\$1,236,662 based on the half yearly results to 30 June 2012...when none of the other group KMP received a cash STI award based on the full year results.⁶
- (4) A pro-rata 2012 QIS-DEA (deferred equity under the STI scheme)⁷ of AUD\$989,330 gross in lieu of conditional rights (so not the rights, but a cash payment).⁸
- (5) Early release of grants under the 2009 DCP and 2010 QIS-DEA scheme plus the release of 253,196 unexercised options (currently 'under water' as the exercises prices ranging from AUD\$17.57 to AUD\$32.68 are higher than the group's current share price). The 'early release of grants' under the condition rights scheme means that the rights are exchanged for ordinary shares in the company;⁹ and
- (6) Subject to shareholders passing resolution 4 at the upcoming AGM (27 March 2013), a retirement allowance of AUD\$2,340,000;
- (7) In addition to the amounts 'paid', additional 'value' was given to the former group CEO in the form of interest not charged on a loan (US\$24,000). Details of the loans can be found on pages 165-166 of the QBE's 2012 Annual Report.

What is not disclosed anywhere is the amount of superannuation that has accrued to the former CEO over a long period of tenure at QBE Insurance Group Ltd.

Taking this example and applying it to the proposed drafting would mean that payments would be reported as follows

- Under s300A(1)(ea)(i) – long service leave and annual leave
- Under s 300A(1)(ea)(ii) – **accrued** superannuation, early release of grants, STI award¹⁰ and the retirement allowance
- Under s 300A(1)(ea)(iii) – a consultancy arrangement commencing after the employment arrangement has terminated is disclosed in the group's announcement on 15 August 2012. The group's disclosures

⁴ Refer to QBE Insurance Group Ltd's 2012 Annual Report, p. 97 for this amount (US\$73,000)

⁵ The short term incentive scheme at QBE Insurance is a cash based scheme with a separate deferred share scheme.

⁶ Refer to the statutory table of remuneration on page 96 of the 2012 annual report.

⁷ Per page 90 of the 2012 annual report, QIS-DEA is a 'deferred equity award of conditional rights, subject to a three and five year tenure hurdle'. One of its guiding principles is that 'it retains and motivates'.

⁸ Refer to page 93 – 'The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the executive is not subject to disciplinary proceedings or notice to terminate employment on that date.' Of course, this term refers to the payment which occurs on 'vesting' ('Shares will vest if the individual has remained in service throughout the three or five year vesting period.').

⁹ Refer to page 161 of the 2012 annual report, note 31(B)(ii): 216,899 conditional rights vested and were transferred in the year.

¹⁰ The basis for including these amounts here reflects the terms of these plans and the terms of the service agreement with Mr O'Halloran as disclosed in QBE Insurance Group Ltd's 2011 Annual Report, p. 81.

in the explanatory notes to resolution 5 at the upcoming AGM (27 March 2013) indicate that no amounts have been claimed by Mr O'Halloran for the services he has provided under this arrangement.

To support this amendment, Treasury should consider amending reg 2M.3.03 to recommend some kind of table structure for reporting these amounts. Having a 'mandatory table' seeks to ensure some uniformity of reporting as between companies.

3 Clawback of payments due to a material misstatement

This proposed amendment is also essential to ensure standard reporting by companies on this important remuneration matter. It reflects the integrity of the company's remuneration governance practices for the Board to report the outcomes that arise from applying the company's remuneration policies. A clawback policy is part of that policy framework.

As the drafting currently stands, it limits the required disclosure of clawed back arrangements to amounts clawed back when a material misstatement in the financial statements has occurred over the past three years. While it would be a short-sighted Board of Directors which adopted a clawback policy restricted to just these circumstances, Treasury should be aware that this may be one of the consequences of specifying a limited circumstance (material misstatement of the financial statements) and mandating companies disclose whether they have clawed back an amount in response to this circumstance or explain 'if not, why not'.

Final comments

Should you require any further clarification on the matters raised in this submission or in the supplement to this submission, please contact me on 0414 062 788 or via email –

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Yours sincerely

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