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**EXPOSURE DRAFT – CORPORATIONS AMENDMENT (IMPROVING  
ACCOUNTABILITY ON DIRECTOR AND EXECUTIVE REMUNERATION) BILL  
2011**

Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the *Exposure Draft – Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011*.

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than \$7.8 billion of premium per annum. It employs more than 12,700 people of which around 9,000 are in Australia. IAG operates some of Australia's leading insurance brands including NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and The Buzz. IAG also distributes insurance in Victoria through the RACV brand. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

IAG supports a regulatory framework that promotes transparency and accountability on remuneration practices, however it does not support the "no vacancy" and "two strikes and you're out" proposals outlined in the exposure draft.

**No Vacancy**

IAG believes the proposal relating to requiring shareholders approval for declarations of "no vacancy" at an Annual General Meeting (AGM) has the potential to cause unnecessary and unwarranted restrictions on the flexibility of Boards.

IAG believes Boards are best placed to determine the size and composition of the Board to reflect the scale and complexity of the business. Boards of Directors need to be able to flexibly respond in a timely way to market circumstances. If such flexibility is constrained by prescriptive regulation or unworkable shareholder voting approval requirements, Australia's ability to attract and retain high talent individuals will be significantly constrained. This will in turn affect the competitiveness of Australian companies in global markets.

The exposure draft of the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* does not make it clear how the transitional proposals apply, in the circumstances where a company has determined, prior to 1 July 2011 a Board size which is less than the constitutional limit. For example, IAG's Board currently consists of

eight Directors while the constitutional limit is 12 Directors. By default the IAG Board will have a limit of eight Directors. In the case of IAG, does this limit require approval at the first AGM held after the 1 July 2011 (ie, at the AGM to be held on the 26 October).

Section 201R of the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* appears to ignore votes cast directly by members who do not appear in person at the AGM or do not cast a proxy vote. Clarification would be appreciated in relation to this issue.

### **Two-strikes Test**

Corporate governance frameworks are designed to facilitate and protect the exercise of shareholders' rights amongst other things. This is based on the premise that shareholders have the right to contribute to, and to be sufficiently informed on, decisions impacting significantly on corporate performance. Effective and robust corporate governance depends in the long term on corporate culture which values and rewards accountability and transparency and has in place strong and well understood checks and balances.

Regulators can and should prescribe minimum standards but they cannot mandate culture or behaviour. Ultimately, Boards and management are responsible for their own cultures and behaviour, and for openness in company governance. Moreover, remuneration policies and practices should be consistent with effective risk management. For this reason there is concern about the unintended consequences of the proposed "two strikes and you're out" policy which would force Boards to face re-election if shareholders vote against company remuneration reports in two successive years.

Concerns particularly relate to the practical problems that may flow from any "two strikes and you're out" policy. As the Business Council of Australia (BCA) outlined in its submission to the Productivity Commission Discussion Draft on Executive Remuneration in Australia (November 2009):

*“..the proposal is likely to have significant unintended consequences which will act to the detriment of the company and shareholders:*

- *Boards could become 'distracted' from important strategic decisions that act to the benefit of the company, and focused more on issues of executive remuneration.*
- *A 'no' vote or the threat of a 'no' vote can place the company in considerable uncertainty, which could lead to a detrimental share price reaction.*
- *A 'no' vote or the threat of a 'no' vote might potentially subject boards to undue shareholder influence on a range of issues put forward by minority shareholders that are not related to executive remuneration.*
- *The risk of a board spill and subsequent instability would affect access to and the cost of capital and the preparedness of investors to hold the company's stock.*
- *The 'two strikes' proposal would take Australia's corporate governance system well beyond frameworks overseas with attendant risks in terms of competitiveness (particularly in capital markets – effectively this creates an additional risk premium).*
- *Where a board is spilled, the company may lose the experience, skills and the corporate knowledge of the directors that have been serving on the board. This is especially the case where board members who have been 'spilled' may be understandably disenfranchised and reluctant to stand for re-election.*
- *If the board were to be spilled, the executives upon whose remuneration the shareholders had voted would in any event remain employed by the company and*

would in fact assume the responsibilities of the board until such time as a new board is elected.

- *Sufficient time would need to elapse between the board spill and any election of a new board, which would contribute to uncertainty and in all likelihood significant share price weakness (possibly to the benefit of minority shareholders seeking to increase their stake in the company).”(BCA submission, November 2009).*

The practical problems that may flow from any “two strikes and you’re out” policy in relation to IAG would be as follows:

If at a “spill” general meeting, the Managing Director plus the three Directors with the highest number of votes essentially constitute the continuing Board (in IAG’s case this would imply that four Directors have been voted off the Board). This would mean that:

- The governance burden (membership of prudentially regulated entity and subsidiary Boards, Audit and Remuneration Committees) will be borne by three non-executive independent directors until new appointments were made - the remaining non-executive directors may just not have the capacity, knowledge or expertise to take on this additional workload.
- The mix of skills on the remaining reduced Board may be significantly impacted. The remaining Directors may, as a result of a relatively arbitrary process where continuing Directors are “elected” by the highest number of votes, have, for example limited or no insurance expertise.
- There would also be the challenge of finding suitable replacements within a timeframe that would allow the Board to appoint new Directors to fill the vacancies created before the next AGM.
- When the “two strikes and you’re out” requirements are considered in the context of the “no vacancy” requirements, a risk for the Board is that, if it does not find suitable candidates to appoint to fill the vacancies, outside nominees who are not suitable will be appointed to the Board

IAG believes the current non-binding vote on the remuneration report has worked well. IAG has experienced strong shareholder support for its remuneration reports. The percent of votes which have been cast against IAG’s remuneration reports over the last three years have not exceeded 5%.

The IAG Board takes shareholder concerns very seriously and has responded to shareholder concerns expressed in those votes. Requiring a Board to formally explain and respond to shareholders after a 25% vote against – the ‘first strike’ – is merely codifying something that currently most Board’s undertake. However, the “two strikes and you’re out” approach would make a second vote against the remuneration report effectively a vote against the entire Board and could give that power to a minority of shareholders. There is also the potential for shareholders to use the vote on the remuneration report as a vote of no confidence on matters unrelated to executive remuneration.

#### **Other Issues:**

##### **Cherry picking**

In relation to proxies, the proposed amendment will not capture directed votes held by a proxy holder who does not attend the meeting. In these circumstances, and for the legislation to be fully effective, the Chairman should be deemed as the alternate proxy holder for the absent proxy holder.

## **Prohibiting KMP from voting on remuneration matters**

KMP's will include the Chairman and other Directors who generally hold most open proxies. At the IAG 2010 AGM the Chairman held around 20 million out of 1,000 million open, useable proxies a relatively small number. Under the proposed amendment these will not be cast by the Chairman. However under ASX listing requirements, the Chairman could not vote open votes in respect of a resolution the outcome of which he/she has an interest in unless the member consented. Clarification would be appreciated in relation to this issue.

The proposed amendment will also prohibit KMP (and their closely related parties) that hold shares from voting on their own remuneration arrangements, as part of the non-binding vote. It is not clear how a share registry will be able to identify proxy holders who are members of the closely related party of the KMP and therefore not include any open votes cast by that party in relation to a 'qualifying resolution' - given the nature of relationships, many spouses/dependents do not have the same name/addresses.

IAG does not believe that evidence has been provided to suggest there is widespread or systemic failure in relation to executive remuneration outcomes for listed companies in Australia. More prescriptive, regulatory responses should be avoided.

If you wish to discuss this matter or make further inquiries please contact David Wellfare on (02) 9292 8593.

Yours sincerely

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