

Is what you see... what they get? With remuneration disclosures, almost universally the answer is No

by Lianne Hooper

Shareholders have long complained about lack of transparency and company officers know that compliance does not equal communication and accounting practices do not deliver clarity.

It is accepted that the information disclosed is neither transparent or illuminating when communicating remuneration in its various guises, with a multitude of incentive plans and styles, forms of equity and deferral, with performance hurdles thrown into the mix. Then there is the black box of valuation methodologies (Black Scholes, Binomial, Monte Carlo) and the various discounting rates applied which render amortised equity-based incentive values almost meaningless.

The search for clarity will often lead back to the description of the remuneration policies though very quickly it is apparent that there is a reality gap when trying to match the remuneration dollars by category to a company's disclosed policy.

And this is when the markets are stable! Yet disclosed remuneration values form the basis of a wide range of consulting information, including role-specific competitive market data.

Informing decision makers

Regardless of the lens through which you view the upheaval across the national and global markets over the past 2 years, it is apparent that the information needs of key decision makers in companies, government and the market have shifted.

Changing information needs have resulted from shifts in the regulatory environment (APRA, ASIC, Corporations Act, taxation law, outcomes of the G20, Financial Stability Forum, the Australian Federal Government (Productivity Commission etc) as well as direct feedback from shareholders and governance advisers.

Over the same period, the structure of executive reward has undergone a fundamental shift with a relative fall in the emphasis of 'at risk' long term incentive participation offset by a greater relative opportunity as an outcome of the annual corporate financial and individual executive performance.

This has resulted in not only a shift in remuneration values but importantly a marked shift in the risk profile of executive reward.

Added to this boards are faced with a new environment of heightened scrutiny in every aspect of their dealings with remuneration based issues whether it be governance, setting and applying corporate strategy and policy, or determining individual pay outcomes for CEOs and key executives (including termination arrangements).

A new approach

Egan Associates have been monitoring all of these elements not only as a focus of our advisory practice, but also in structuring our proprietary database and the way our data is both collected and communicated to our clients.

In response to what we believe will be a new era in formulating/reviewing remuneration strategies and practices and the need for clarity in both adviser insights and the data upon which they rely, Egan Associates have refined its database focus commencing with the 2009 financial year.

The result is a unique approach which enables us to:

- Provide the value of the remuneration package allocated to an individual in the financial year (the various reward elements differentiated by risk and time ie deferral), and
- As a counterpoint, provide the value of an individual's reward opportunity comprising the fixed remuneration package and annual cash incentive plus an executive's unvested deferred incentives eg historical grants of equity (LTI etc). This approach recognises the portfolio of reward comprising the annual 'banked' remuneration plus the unvested portfolio of both deferred cash and share-based incentives.

The two approaches are complementary and provide a wealth of information for decision makers anchored in a contemporary market understanding of **competitor policy as it is applied**.

Our approach also captures in a systematic way the many forms of remuneration whether cash or equity based, 'at risk' or 'not at risk', whether paid immediately or deferred.

SERVICES AVAILABLE

Speak to us if you need advice on

- REMUNERATION PLANNING
- BOARD ADVISORY SERVICES
- CEO REWARD STRATEGY
- INCENTIVE PLAN DESIGN
- RETENTION PLAN DESIGN
- EQUITY INCENTIVES
- IPOs

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As a result we can provide customised and broad market research as to:

- ❑ The relative emphasis of cash and equity in executive reward,
- ❑ The risk profile of deferred incentive elements ie whether an incentive has a 'pre allocation hurdle', 'post allocation hurdle' or no hurdle at all,
- ❑ Detailed analysis of each of these incentive categories; their weighting in the overall package, the period(s) of deferral, incidence and type of performance hurdles etc.,
- ❑ The forms of equity used.

This information is in addition to our existing focus on competitive levels of annual salary or package value and annual cash incentives.

A core feature of our data collection is that it is focused on providing a contemporary remuneration value. The equity value in an executives' package is not quantified using accounting methodologies, rather we take the actual equity allocated applying a rationale which is based on the market value of a share (shares and rights) and share price growth assumptions (options) to determine a remuneration opportunity.

In this way we have circumvented the 'black box' of remuneration disclosure and have focused on what has actually been paid and/or allocated to an executive.

Given the market volatility of the 2008 and 2009 calendar years we also ignore underwater securities in determining the current portfolio value of an executive's remuneration opportunity.

2010 Remuneration Reviews

A number of companies will be entering 2010 having frozen or contained salaries in 2009, and will be challenged in determining an appropriate competitive remuneration package in the current review cycle. Many will also be reviewing their remuneration policies in the face of the many issues which have recently emerged surrounding equity based incentives.

In 2010 Egan Associates, will be drawing on our expanded information and analysis capability to provide practical competitive solutions for our clients.

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