

Rudd Government Enquiry

into Director and Executive Remuneration

by John Egan

While there has been focused comment on termination payments in recent times, the media has commented extensively on the recent announcement by the Rudd Government to task the Productivity Commission with examining Australia's framework for the remuneration of directors and executives, including the appointment of Professor Allan Fels as an Associate Commissioner to assist in their enquiry.

In the Government's media release it also announced reforms to the regulation of termination payments or 'golden handshakes'. The Government indicated that increased focus on executive pay is a global phenomena with significant community concern being expressed about excessive pay practices at a time when many countries are in recession.

The Government specifically stated that it was determined to ensure regulation of executive pay kept pace with community expectations, particularly as job losses increased as a result of the global recession.

One concern reflects regulation embedded in the Corporations Act which allows termination payments up to seven times a director's total annual remuneration without requiring shareholder approval.

A degree of clarity was provided in an opinion piece prepared by Nick Sherry, the Federal Minister for Superannuation and Corporations Law on Monday 23rd March. Reflecting the intent of the Government, there is an awareness of the contractual environment which is required to be managed by boards and that incentives earned as a result of achieving shareholder approved performance considerations would retain their validity.

The Government pronouncements also recognised that changes to the law cannot apply retrospectively and acknowledged that the announcement would not prevent existing contracts on termination payments from proceeding.

It is our judgement that the published response by the Minister, while indicating the Government's intention, also reflected the basis of their concern which had legitimacy.

The recent announcements of the Government have, however, not allayed concerns in the minds of executives or boards in responding to the foreshadowed reforms.

The essence of the reforms in relation to termination incorporate the following:

- termination payments will be capped at twelve months' base salary unless shareholder approval is obtained;
- the cap will apply for all executives named in a company's Remuneration Report, that is all directors including the CEO, other executives who are key management personnel and the five highest remunerated company and group executives (collectively, **senior executives**).

The initial response from directors is one of seeking clarity in relation to the management of existing arrangements. A number of companies at the time of the announcement were clearly engaged in negotiations to appoint one or more senior executives to their management team.

The foreshadowed reforms appear to remove the opportunity for the payment of ex gratia amounts upon termination which have traditionally been used to manage exit outcomes without undue conflict or potential litigation.

The data and the observations made by the Government in reaching their decision to appoint the Productivity Commission to undertake a thorough review over the balance of the 2009 calendar year is irrefutable. That is, over the past decade or more during an extended period of buoyancy on the stock markets and continued global growth, fostered in part by growth in China, India and other developing countries, has led to a continuous increase in executive reward and reward opportunity.

Recent events have brought an abrupt halt to that environment, with governments and the private sector generally having to adjust to the new economic climate and establish, as appropriate, new principles which reflect adaptation to a challenging period ahead, the length of the economic downturn at this stage being indeterminate.

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We note that the Rudd Government, in preparing themselves to respond to global considerations and manage the regulatory and legislative environment to the extent it requires change in Australia, have established a scope of review for the Productivity Commission under the stewardship of its Chairman, Gary Banks.

We note that in undertaking the review the Commission are required to:

1. Consider trends in director and executive remuneration in Australia and internationally, including among other things, the growth in levels of remuneration, the types of remuneration being paid, including salary, short-term, long term and equity-based payments and termination benefits and the relationship between remuneration packages and corporate performance.
2. Consider the effectiveness of the existing framework for the oversight, accountability and transparency of director and executive remuneration practices in Australia including:
 - the role, structure and content of remuneration disclosure and reporting;
 - the scope of who should be the subject of remuneration disclosure, reporting and approval;
 - the role of boards and board committees in developing and approving remuneration packages;
 - the role of executives in considering and approving remuneration packages;
 - the role of other stakeholders, including shareholders, in the remuneration process;
 - the role of, and regulatory regime governing, termination benefits;
 - the role of, and regulatory regime governing, remuneration consultants, including any possible conflicts of interest;
 - the issue of non-recourse loans used as part of executive remuneration; and
 - the role of non-regulatory industry guidelines and codes of practice.

3. Consider, in light of the presence of large local institutional shareholders in Australia, such as superannuation funds, and the prevalence of retail shareholders, the role of such investors in the development, setting, reporting and consideration of remuneration practices.
4. Consider any mechanisms that would better align the interests of boards and executives with those of shareholders and the wider community, including but not limited to:
 - the role of equity-based payments and incentive schemes;
 - the source and approval processes for equity-based payments;
 - the role played by the tax treatment of equity-based remuneration;
 - the role of accelerated equity vesting arrangements; and
 - the use of hedging over incentive remuneration.
5. Consider the effectiveness of the international responses to remuneration issues arising from the global financial crisis, and their potential applicability to Australian circumstances.
6. Liaise with the Australia's Future Tax System Review and the Australian Prudential Regulatory Authority in relation to, respectively, any taxation and financial sector remuneration issues arising out of this Review.
7. Make recommendations as to how the existing framework governing remuneration practices in Australia could be improved.

The Commission is to undertake an appropriate public consultation process, including the invitation of public submissions.

Within a short period of the Government's announcement of the Productivity Commission's enquiry the Australian Shareholders' Association published their updated perspective on retail shareholders' expectations in relation to executive pay.

The link below will take you to their website.

[Link to Australian Government Productivity Commission website](#)

In February the Australian Institute of Company Directors published guidelines for listed company boards in determining executive remuneration.

[Click to view AICD guidelines](#)