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The Market's Up and So Is Pay

by John Egan

A proportion of media comment continues to focus on the global economy, the impact of the global financial crisis (GFC) and its variable impact across western economies. Recent months have revealed that the Australian economy is one of the most robust in the world, albeit relatively modest in scale.

The ASX/S&P index since reaching its lowest point in March 2009 has recovered significantly, a factor which is likely to dampen a degree of criticism which may have arisen from disclosures in Remuneration Reports of some of Australia's leading companies. The data released reflects two broadly consistent factors, clearly with outliers in each respect. Base pay has increased over the 2009 financial year and bonuses have decreased or remained relatively stable. Profits are better than expected twelve months earlier and better than expected at the beginning of the first quarter of the 2009 calendar year. Balance sheets are more healthy than might have been predicted during the GFC and prospects for the Australian economy are between positive and neutral, not negative to neutral.

The Rudd Government's stimulus package has clearly had a positive impact in the short term, though some commentators and economists have commented less favourably on the long term debt implications of the stimulus package. US and European leaders remain concerned about executive reward generally and the potential return of substantial rewards on Wall Street, particularly among the leading investment banks which have benefited from the feverish trading environment and market activity generally arising from the GFS, foreshadowing a sentiment that one year's pain is enough. Leaders of government on the other hand are continuing to discuss mechanisms for containing the perceived pay excesses of the past by foreshadowing of a capping of reward on the one hand and a deferral of bonuses with claw back provisions on the other.

In this setting, by the end of September the Productivity Commission will submit its initial report commenting on the state of play, the historic rate of growth in executive and director remuneration and are likely to also comment on termination provisions, the challenges associated with executive participation in various share plans and the taxation provisions associated with that participation at a time when draft legislation in respect of both employee equity plans and termination has been tabled for consultation.

Challenges for those endeavouring to advise Government on the basis of written material in Remuneration Reports and other documents submitted by companies, including explanatory notes at Annual General Meetings, the shortcomings in many Annual Reports where limited, if any, explanation is offered in support of base remuneration adjustments in the 2009 financial year and the context in which those decisions were made or the response of the organisation to the GFC, the decline in the company's share price, profitability and balance sheet in managing reward moving forward. There is almost a bland adherence to a formulaic approach without explanation which implicitly reveals that the system dictated the outcome. This is clearly the case in relation to performance-tensioned long-term equity-based incentive, though there is limited comment at this stage by organisations which have outperformed the market where executives have received a benefit arising from that accomplishment without acknowledgement that this benefit is arising at a time when shareholders have lost substantial value in their equity holding arising from the GFC.

These might be areas where one would expect a degree of comment from those advising Government and an increased level of engagement by Boards in explaining the positions which they have taken, either by not exercising discretion when it is available to them or simply becoming captive to a formula. The reporting season should also reveal negative comment by a number of Boards arising from the cost imposed on their P&L through executives' participation in equity based long term incentive plans where it is improbable that any benefit will flow to the executives arising from that participation because of the decline in share values or the particular impact of policies enforced by others. These include no retesting and therefore capacity for executives to recover lost benefits in the coming twelve to twenty-four months because of the nominal institutional moratorium on retesting and the impact of compliance with accounting standards.

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