CFMEU Submission to the

Productivity Commission Review

Into The Regulation of Director and Executive Remuneration in Australia

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Introduction

This submission of the Construction, Forestry, Mining and Energy Union, (CFMEU) is made on behalf of all three divisions of the CFMEU namely the Mining and Energy Division, Forestry and Furnishing Products Division and the Construction and General Division.

We represent approximately 110,000 members in these industries. Our members work for some of Australia's largest employers, hence the CFMEU has a particular interest in this Review. The CFMEU is pleased to have the opportunity to make a submission to this important Review.

Response to the Commission's Terms of Reference

For ease of reference this submission is structured in accordance with the Commission's terms of reference. This submission addresses 1, 2 and 7 of these.

TOR1. ***Consider trends in director and executive remuneration in Australia and internationally, including among other things,***

1. the growth in levels of remuneration,

2. the types of remuneration being paid, including salary, short-term, long term and equity-based payments and termination benefits and;

3. the relationship between remuneration packages and corporate performance.

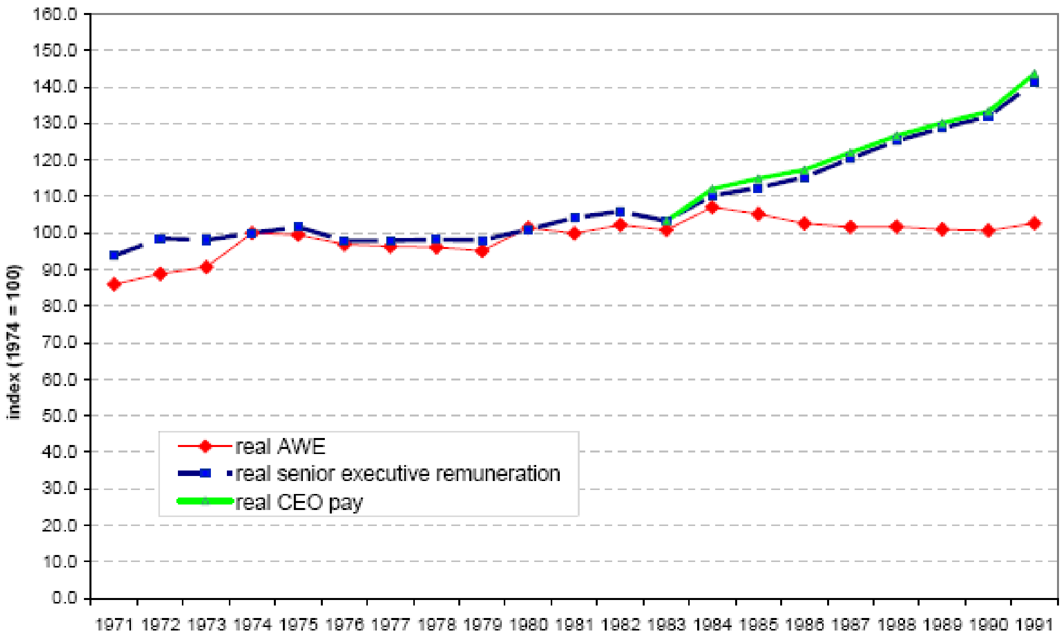
The growth in levels of remuneration

In considering trends in director and executive remuneration this submissions draws on the work of two Australian academics John Shields[1] and David Peetz[2]. The three graphs below from Peetz show an increase in executive and CEO remuneration, beginning in 1984, that diverges increasingly sharply from average weekly earnings.

[1] Shields, J., (2003), Setting the Double Standard: Chief Executive Pay the BCA Way, Journal of Australian Political Economy, No.56.

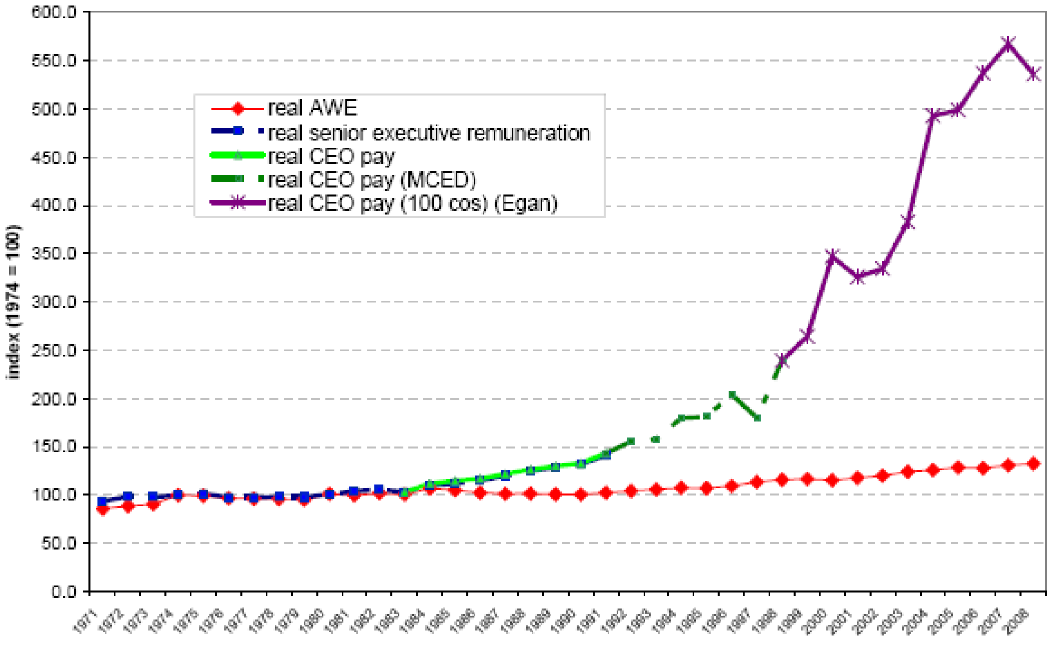
[2] Peetz, D., (2009) Submission to Productivity Commission Review Into The Regulation of Director and Executive Remuneration in Australia.

Figure 1: Real executive remuneration and average weekly earnings, indexes, Australia, 1971-1991



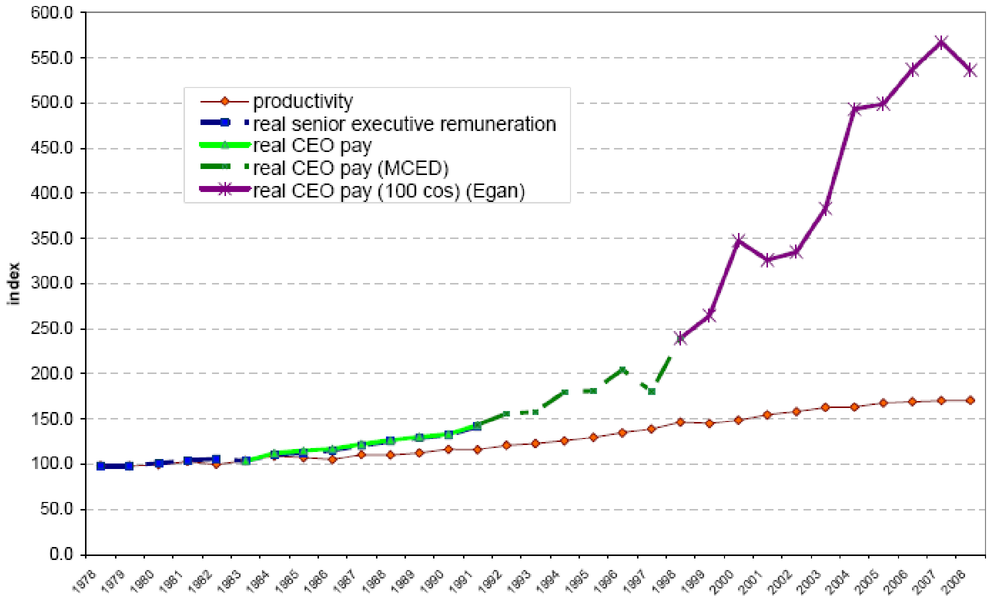
Sources: Noble Lowndes Cullen Egan Dell 1992, Australian Bureau of Statistics 6302.0, 6401.0.

Figure 2: CEO pay series and AWE, indexes, Australia, 1971-2008



Sources: Egan 2009a, Kryger 1999, Noble Lowndes Cullen Egan Dell 1992, Australian Bureau of Statistics 6302.0, 6401.0.

Figure 3: CEO pay series and GDP per hour worked in the market sector, indexes, Australia, 1978-2008



Sources: Egan 2009a, Kryger 1999, Noble Lowndes Cullen Egan Dell 1992, Australian Bureau of Statistics 5206.0.

The next table from Shields looks at the remuneration of CEOs whom are members of the Business Council of Australia, the remuneration of this smaller group of CEOs mirrors the outcomes for the larger group considered in the graphs above. It also shows that over the period 1990-2005 full time adult weekly earnings in the private sector increased by 85% while over the same period BCA CEOs' remuneration increased on average 564%.

Table 1: BCA CEO Cash Remuneration, Shareholder Return and Adult Earnings: Trend Comparisons, 1990-2005

Year	Number of BCA firms in annual sample	Average BCA CEO total cash remuneration ($AU million, unadjusted)	Full time adult total earnings, private sector, (May Quarter, seasonally adjusted & annualised) ($AU, unadjusted)	Ratio of CEO remuneration to average earnings
1989-90	30	514,433	29,198	18:1
1990-91	30	560,667	30,040	19:1
1991-92	35	597,857	31,184	19:1
1992-93	33	631,364	31,798	20:1
1993-94	31	934,355	33,067	28:1
1994-95	34	1,008,735	34,928	29:1
1995-96	34	1,148,421	36,494	31:1
1996-97	38	1,234,625	37,170	33:1
1997-98	39	1,363,144	38,745	35:1
1998-99	47	1,464,324	39,816	37:1
1999-00	45	1,744,988	41,371	42:1
2000-01	42	2,041,921	43,414	47:1
2001-02	46	2,363,594	45,087	52:1
2002-03	45	2,343,796	48,896	48:1
2003-04	46	2,813,377	50,393	56:1
2004-05	49	3,420,507	54,080	63:1
Gross increase (non-inflation-adjusted) 1990-2005		564%	85%	
Average annual growth (non-inflation-adjusted) 1990-2005		13.5%	4.2%	

Sources: Company Annual Reports; *Connect4* Database; S&P/ASX200 Accumulation Index, Reserve Bank of Australia; Australian Bureau of Statistics: Average Weekly Earnings, Australia (6302.0).

The types of remuneration being paid

In terms of the second sub point in this TOR, Shields shows in the table below that from 1990 to 2005 cash bonuses and incentives in the BCA CEO group increased from 42% to 60%. It is unfortunate that data in this area does not exist prior to 1999-00 to better assess the long term trend in this respect.

Table 2: Components of Cash Remuneration of BCA CEOs, 2000-2005 (Annual Averages in $AU million, Unadjusted)

Year[1]	Number of BCA firms in annual sample	Base salary	Cash bonuses/ incentives[2]	Total cash remuneration[3]	Bonuses as a proportion of total
1999-00	45	878,192	733,335	1,744,988	42%
2000-01	42	1,074,956	1,041,293	2,041,921	51%
2001-02	46	1,107,661	1,182,325	2,363,594	50%
2002-03	45	1,111,009	1,130,961	2,343,796	48%
2003-04	46	1,218,859	1,324,742	2,813,377	47%
2004-05	49	1,363,769	2,056,738	3,420,507	60%

Notes:
1. Components of cash remuneration were not reported prior to 1999.
2. Includes cash payments/bonuses under short-term incentive plans.
3. Includes base salary, cash bonuses/incentives, company superannuation contributions, cash allowances, cash value of non-cash benefits, directors and other fees, and other accrued benefits paid, but excludes designated termination payments.

Sources: Company Annual Reports; *Connect4* Database.

In this respect the Finance Sector Union's submission[3] to this Review shows the predominance of short term incentives for finance sector executives and CEOs in Australia's five largest banks.

Target STI and LTI payments to bank CEO's in 2008

Bank	STI %	LTI %	Base Salary %	Target STI payment based on salary
ANZ	33%	33%	33%	$3.27 million[2]
CBA	55%	17%	28%	$6.13 million
NAB	30 – 40%	30 – 50%	25 – 35%	$2.35 – $4.38 million[3]
SUN	150% of base salary	No LTI target	Unable to calculate	$2.85 million
WBC	40%	30%	30%	$4.07 million[4]

Target STI and LTI payments to bank executives in 2008

Bank	STI %	LTI %	Base Salary %	Target STI payment based on average of top 5 base salaries
ANZ	45%	18%	37%	$0.47 million
CBA	60%	10%	30%	$0.66 million
NAB	25 – 50%	15 – 35%	25 – 40%	$0.74 – $2.39 million
SUN	100 or 150% of base salary	No LTI target	Unable to calculate	$0.78 – $1.17 million[5]
WBC	50%	20%	30%	$0.41 million

[2] Annualised figure based on CEO departure during the reporting period.
[3] Target remuneration is expressed in percentage ranges. This figure represents the possible range of payments.
[4] Annualised figure based on CEO departure during the reporting period.
[5] Target remuneration is expressed in percentage ranges. This figure represents the possible range of payments.

Shields' research found that in terms of termination payments for BCA CEOs the average for 1991-99 was $2.34 million rising to $3.26 million for the period 2001-05.

The relationship between remuneration packages and corporate performance

In respect to this, in a 2004 paper Shields et al[4] found the following with respect to corporate pay and performance;

> *"…the performance-optimal range for executive remuneration of between 17 and 24 times average wage and salary earnings, beyond which the performance of a company begins to deteriorate. It is also a range broadly consistent with the*

[3] Finance Sector Union, (2009), Submission to Productivity Commission Review Into The Regulation of Director and Executive Remuneration in Australia.

[4] Shields, John, Michael O'Donnell, and John O'Brien. "The Bucks Stop Here: Executive Pay and Company Performance.", Proceedings of the 18th AIRAANZ conference, 2004.

opinion of the late management academic Peter Drucker, that CEO remuneration should be no more than 20 times that of the rank and file worker in the company (interviewed in Schlender 2003)…"

In 2005 Shields et al[5] looked specifically at this issue with respect to the banking industry and found that "*the rise and rise of bank CEO pay is both performance insensitive and perverse."* Clearly then executive remuneration in Australia lies well outside the range that is performance-optimal.

Shields also found that even within companies there is a realisation that CEO remuneration is out of control;

> *"…it seems that many non-executive directors still do not feel sufficiently empowered to resist CEO demands. A large proportion also believe that CEO remuneration is excessive. According to a recent survey of 121 directors, most of them members of the boards of S&P/ASX 200 companies, 52 percent believed that the current CEO remuneration levels are excessive, with 70 percent of these believing that CEOs were overpaid between 20 and 50 percent (Buffini and Pheasant, 2005)."*

TOR2. Consider the effectiveness of the existing framework for the oversight, accountability and transparency of director and executive remuneration practices in Australia including:

1. **the role of boards and board committees in developing and approving remuneration packages,**
2. **the role of executives in considering and approving remuneration packages,**
3. **the role of, and regulatory regime governing, remuneration consultants, including any possible conflicts of interest**

The above three sub points from this term of reference are addressed cognately in Peetz's findings below. The graphs below and his quote following these shows the prevalence of a form of comparative wage justice and leapfrogging by executives and CEOs in the setting of their remuneration.

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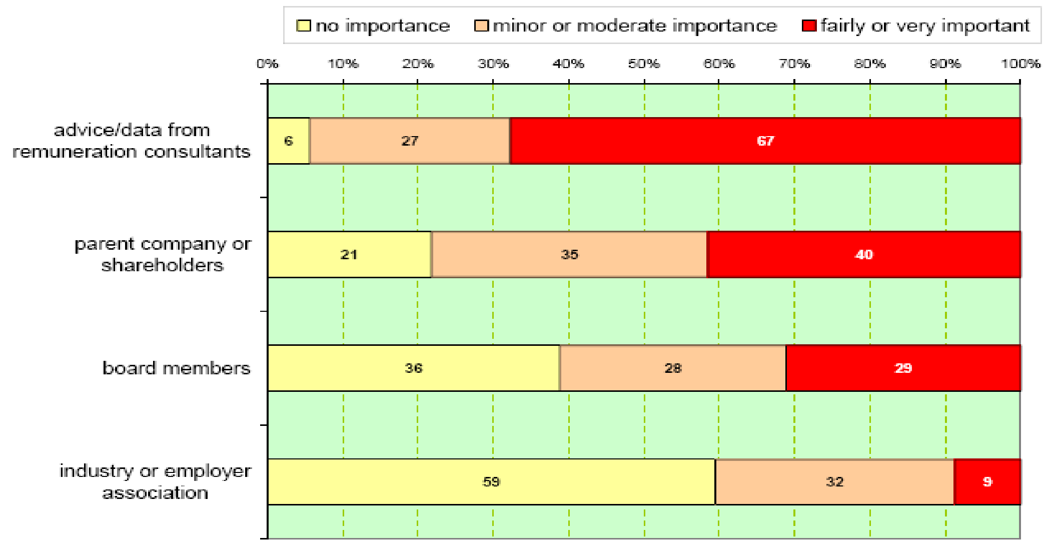
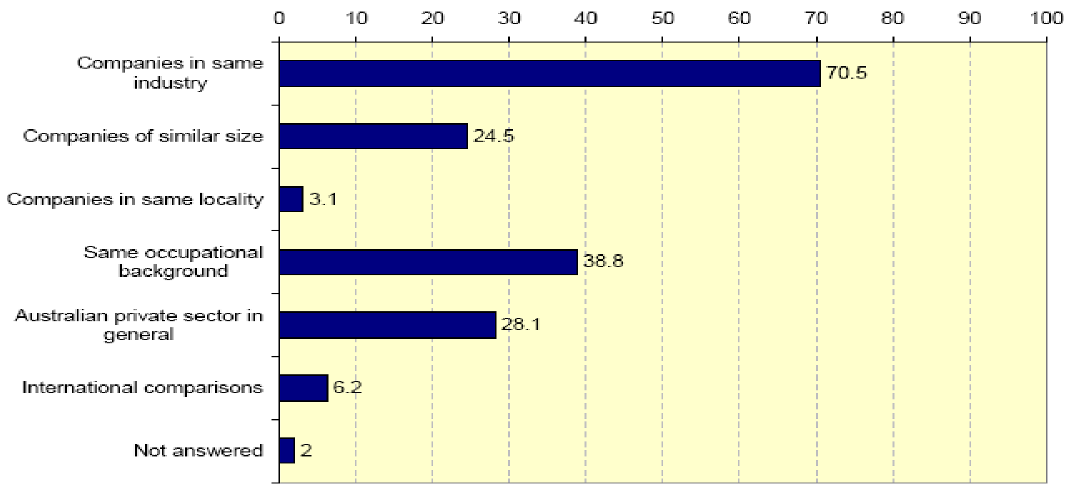
[5] Shields, John, Michael O'Donnell, and John O'Brien. "Laughing all the way: Executive pay company performance and corporate governance in the Australian Banking Industry, Proceedings of the 19th AIRAANZ Conference, 2005.

Figure 4: How important is each of the following as a source of information, advice or direction on pay levels for senior executives, Australia, 1991.



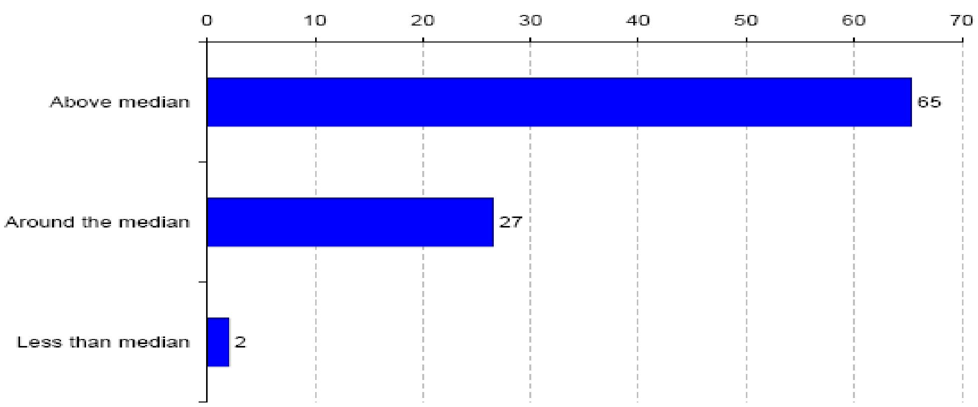
Source: Noble Lowndes Cullen Egan Dell 1992

Figure 5: Taking into account where you typically attract senior executives from, and where they go to when any leave the company, how best would you describe their comparative remuneration market?



Source: Noble Lowndes Cullen Egan Dell 1992

Figure 6: In relation to this comparative market, where do you generally aim to position your senior executives' pay?



Source: Noble Lowndes Cullen Egan Dell 1992

"Most relevant, however, was the question on how companies sought to pitch or 'position' their senior executives' pay. Results are shown in Figure 6. Nearly two thirds of companies had a policy of 'positioning' their executives' pay above the median and 92 per cent claimed to set them around or above the median. Only 2 per cent aimed to position their pay below the median. Of course, it is mathematically impossible for all companies to achieve the position they are seeking. By definition, 50 per cent of firms will be paying below the median, not 2 per cent. As virtually all firms attempt to position themselves at or above the median, senior executive remuneration will increase even in an environment of zero inflation and zero productivity gains. A similar pattern was seen in the USA at that time (Crystal 1991)."

It is clear that this way of setting executive and CEO remuneration, in use since the 1980s, has delivered outcomes beyond those which can be justified on either the grounds of productivity or corporate performance.

Renowned US investor Warren Buffett[6] had the following to say about remuneration consultants;

"Too often, executive compensation in the US is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's remuneration. The upshot is that a mediocre-or-worse CEO – aided by handpicked VP of human relations and a consultant from the ever accommodating firm of Ratchet, Ratchet and Bingo – all too often gobs money from an ill-designed compensation agreement."

In the Australian context Michael West[7] writing in The Age last year concurs with Buffett's view;

"If anyone can cite an example of a remuneration consultant which had ever advised that an executive was paid too much, please respond to the email address below. RCs, as they are affectionately known, are lackeys who tell boards what they want to hear. …It is a preposterous notion that someone who is paid a fee to

[6] Buffet, W., (2005), Investor Newsletter.
[7] West, M., (2008), Crunch Time for Executive Pay, The Age, July 15 2008.

tell someone how much money they are worth will come up with the wrong answer."

Clearly the use of remuneration consultants to recommend executive and CEO remuneration is fundamentally flawed. Inherently they operate with conflicts of interest that make their continued use inadvisable.

TOR7. Make recommendations as to how the existing framework governing remuneration practices in Australia could be improved.

Fair Work Act

Since the High Court decision in the WorkChoices case the Federal Government has the power to directly legislate for wages and conditions, which they have done with the *Federal Minimum Wage Order* and the *National Employment Standards* .In this light we make the following suggestions for amendments to the Fair Work Act (FWA). These would end the use of remuneration consultants' reports.

i. Institute a federal maximum wage order. We suggest that the Drucker level of 20 times average weekly earnings could be adopted.
ii. Tie future executive and CEO total remuneration increases to those achieved by their employees through collective bargaining or their award, whichever is relevant.
iii. Make executive and CEO redundancy packages equivalent to those achieved by their employees through collective bargaining or their award, whichever is relevant.

Government Procurement Contracts

i. Legislate to require adherence to Federal Government guidelines on executive and CEO pay restraint as a pre-condition to winning Government contracts.
ii. Extend these provisions to State and Local Government levels via co-operative action of the Council of Australian Governments.

Taxation

i. Introduce new marginal tax rates that progressively increase from 5 times average weekly earnings (roughly $300,000 currently) with the highest level reached at 25 times average weekly earnings, given the deleterious effects on company performance of pay beyond this level.

ii. Abolish the current tax deductibility for CEO pay over a million dollars.

Corporations Law

i. Proscribe all short term incentive equity or cash options, with long term equity redeemable five years after departure, the only option permitted in addition to base salary.

Conclusion

Executive and CEO pay has increased out of all proportion to that justified by their productivity gains or increases in corporate performance. The current situation poorly serves the interests of shareholders, employees and the wider community. Reform is necessary to better align executive and CEO reward with corporate performance and productivity gains. Doing nothing is not an option.