Investment & Financial Services Association Ltd
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15 June 2009

Mr Gary Banks AO
Chairman
Productivity Commission
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Collins Street East
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Email: exec_remuneration@pc.gov.au

Dear Mr Banks

Re: IFSA submission on the regulation of Director and Executive remuneration in Australia

Thank you for the invitation to provide input on Productivity Commission's issues paper regarding the regulation of Director and Executive remuneration in Australia. We welcome Government's current review of industry practices and regulations in this area and we greatly appreciate the extension of time during this busy period to lodge the submission.

IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 145 members who are responsible for investing over $1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes is actively monitored and ensures the promotion of industry best practice.

Australia continues to be well regarded in the region for the strength of its regulatory regime underpinning the remuneration of Executives and Directors. The application of sound corporate governance practices relating to remuneration increase confidence in the integrity and efficiency of the Australian capital market. The current governance regime over remuneration in Australia has experienced no systematic failure even in the recent market turbulence. Evidence is growing that the current regime is adjusting of its own accord to the changing financial environment.

IFSA members, both as the custodians and managers of other peoples' money and as institutional investors in their own right, have a vested interest in ensuring that there is an alignment of remuneration with risk management both in their own operations and the companies in which they invest.

As major shareholders, IFSA members are in a position to promote the adoption of prudent governance practices which influence the design of remuneration of Executives and Directors. While shareholders are not involved in the day to day management of companies, the Corporations Act, ASX Listing Rules and industry best practice provide many opportunities for shareholders to monitor and influence company decision-making which drives ultimate company performance.

IFSA has two specific Guidance Notes on remuneration: Guidance Note No. 12 - Executive Equity Plan and Guidance Note No. 13 - Employee Share Ownership Plan. These Guidance Notes were developed in conjunction with a number of key stakeholders including the Australian Institute of Company Directors, the Australian Shareholders Association and the Australian Employee Ownership Association.

IFSA's Guidance Note No. 2 - Corporate Governance: A Guide for Fund Managers and Corporations (IFSA Blue Book) also provides guidance on board and executive remuneration policy and disclosure. These Guidelines were launched in 1995 and have become widely accepted by the investment and corporate community as providing guidance for corporate governance in Australia. IFSA's Blue Book is currently being updated and a forward confidential copy has been separately attached for your reference.

Compliance with Guidance Notes is voluntary but strongly encouraged and widely promoted as industry best practice. IFSA's Guidance Notes are publicly available on IFSA's website (www.ifsa.com.au) and IFSA members encourage all Australian listed companies to comply with these Guidance Notes.

- Current regulation of executive remuneration in Australia

While we acknowledge there are concerns over corporate excesses and the current regulation of remuneration, we strongly believe it is the ultimate responsibility of the Board of Directors to approve the design of all equity plans and take specific responsibility for hiring key executive staff and approving the terms of their employment. We also believe that transparency, accountability and fairness are all key principles that should guide companies when designing equity plans for Executives and Directors.

IFSA Members consider that Australian listed companies must be able to attract and reward superior executives (via equity plans) within a competitive global environment. There is also an opportunity to ensure that some components of key executives' remuneration remain directly aligned with the fortunes of the company over the medium to longer term.

Nevertheless, remuneration must be reasonable in light of the circumstances of the company and should be adequately disclosed to shareholders. Companies can assist in overcoming the perception that remuneration is overly generous by taking a leading role in disclosing all components of remuneration and the way in which executives are rewarded for performance.

In reviewing the regulation of remuneration we believe there is a need to avoid unintended results which operate against good governance practice and Australia's competitiveness. The regulatory framework underpinning remuneration should not unduly restrict companies' flexibility or ability to attract, motivate and retain the highest quality executives that are capable of driving improved company performance.

- IFSA's approach

As currently outlined in the Corporations Act, ASX listing rules and industry guidelines, the basic principles to be applied when developing executive equity plans are:

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- Equity plans should be clearly linked to performance against appropriate performance benchmarks that should be capable of providing appropriate remuneration outcomes in a variety of economic and market conditions.

- The executive's remuneration as a whole should be reasonable and comparable with industry standards. The structure and level of their remuneration should also take into account the performance objectives set for the executive, their position and responsibilities.

- The individual elements of each executive's remuneration should be clearly identified and disclosed to shareholders. This should include the components of fixed remuneration; variable remuneration; and details of any equity plans designed to promote medium-term and long-term company performance.

- Disclosure to shareholders should be driven by the aim of providing them with the necessary information to assess the plan.

These principles have been endorsed by IFSA and are reflected in our current remuneration Guidelines. It is important that any future requirements remain consistent with these longstanding principles.

In reference to the Productivity Commission's issues paper, the submission below comments specifically on proposals and issues that are particularly relevant to our members.

- Terms of reference 1: Trends in Director and Executive remuneration

We believe that the existing regime under the Corporations Act, specifically the coverage of key management personnel under the remuneration report, is adequate.

As outlined above, it is paramount that the levels of remuneration in Australia are internationally competitive in order to attract and retain suitable executives. This, along with transparency and fairness, should be a guiding principle in designing remuneration plans and its regulatory framework in Australia.

Given the characteristics of non-recourse loans, specifically that a lender's recourse to the recipient's assets is limited to the value of the shares and the ensuing risks to the company and shareholders, we believe that there are more transparent and fairer forms of remuneration. Therefore, IFSA does not support the use of non-recourse loans as part of an executive's remuneration package, particularly where the costs and risks have not been adequately disclosed to shareholders.

- Terms of reference 2: Effectiveness of regulatory arrangements

We are supportive of the existing remuneration regulatory arrangements as detailed in the issues paper. Specifically, we acknowledge and strongly support the role of the Board in appointing the managing director and determining the remuneration arrangements.

Given the varying circumstances of particular companies and the need for equity plans to reflect those circumstances, we believe that regulatory arrangements should not specify particular plan structures that may be appropriate. Rather, the emphasis should be on encouraging the development of equity plans that meet the particular needs of the company, and ensure that all aspects of the plans are clearly explained to shareholders.

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For example, our Guidelines stipulate that the Remuneration Committee of the Board, consisting of a majority of independent non-executive directors, should be responsible for approving the design and all offers made to key executives under equity plans. We note that this matter is also included for consideration in APRA's current discussion paper on remuneration.

- Terms of reference 3: The role of institutional and retail shareholders

All shareholders and directors have a major interest in encouraging improved corporate performance and ensuring the equitable sharing of reward between owners and management.

We strongly believe that in the area of shareholder engagement, IFSA members lead the way. Since 1 January 2005, it has been mandatory for IFSA members to comply with IFSA Standard No. 13 - Proxy Voting. Under Standard No. 13, IFSA members are required to vote on all resolutions regardless of the 'materiality' of a resolution or of the size of their shareholding.

More specifically, Standard No. 13 requires retail public offer schemes to publish, at least annually, an aggregate summary of their proxy voting record using the IFSA table prescribed in the Standard.

The Standard also requires schemes to have a formal Proxy Voting Policy setting out the principles and guidelines under which proxies are voted. This policy must also be made available to scheme members – with many such policies publicly available on IFSA member websites.

Furthermore, IFSA's Blue Book encourages fund managers and other institutional investors to establish direct contact with companies including constructive communication with both senior management and board members about performance, corporate governance and other matters affecting shareholders' interests, including remuneration.

In light of the requirements referred to above and high level of engagement between shareholders and senior management and board members we are supportive of the current non-binding vote arrangements.

- Terms of reference 4: Aligning interests

We believe that a company's management practices should be aligned with the interests of shareholders. The granting of a right to equity participation, subject to appropriate performance hurdles, directly assists in aligning the interests of executives and shareholders.

Aligning interests of the company with the wider community is also acknowledged as important consideration. It is now well accepted that issues such as environmental and social issues faced by a company may contribute towards financial performance in the short, medium and long term.

Consequently, we recommend that IFSA members engage companies on their significant environment and social issues that have the potential to impact on company perception and performance. Companies should also be encouraged to explain how they identify and manage their significant environmental and social risks.

These principles are all stipulated in the latest draft of IFSA's Blue Book.

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- Terms of reference 5: International developments

Transparency, accountability and fairness are all key principles that should guide companies when designing equity plans for executives and directors. It is important that the remuneration regulatory framework be seen both in Australia and offshore as a balanced approach and does not limit a companies ability to attract and reward superior executives. Failure to uphold these objectives would not be a good signal in the region and hinder Australia's pursuit to be a regional financial services centre.

We look forward to engaging in further consultation with the Productivity Commission on its review of the regulation of Director and Executive remuneration in Australia. Please feel free to contact myself or Joseph Sorby on 02 9299 3022 if you have any questions with regards to the information provided above.

Yours sincerely

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