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6 November 2009

Executive Remuneration Inquiry
Productivity Commission
Locked Bag 2, Collins St East
Melbourne VIC 8003

Dear Sirs

**Productivity Commission Discussion Draft: Executive Remuneration in Australia: Ernst & Young submission**

Ernst & Young is pleased to provide this submission to the Productivity Commission ("PC" or the "Commissioner") in response to the PC Discussion Draft. We believe that the draft recommendations predominately balance the need for shareholder influence with the commercial necessity for Boards to be able to set pay structures and quantum. We observe that the draft recommendations are, for the most part, consistent with the comments we made in our public submission (and the more detailed private submission). This third submission provides comment on the key areas where we believe further consideration by the PC is justified, as follows:

- **Simplifying disclosure:** We suggest that the Remuneration Report disclosure requirements be simplified to focus on the information shareholders need in order to evaluate companies' remuneration approaches (recommended framework included);

- **Facilitating effective use of remuneration advisors:** We suggest that the Commissioner's recommendation be worded slightly more explicitly and supplemented by guidelines to ensure that the implementation of the Commissioner's recommendation would not result in Boards having less access to quality advice and information that is held by management;

- **Remuneration report voting implications**: We do not believe that the application of the advisory vote needs revision. However, should the Commissioner retain the recommended changes, we believe a majority of "no" votes should be required, rather than allowing the minority to drive the agenda; and

- **Clarifying termination payment reforms**: We suggest that the Commissioner recommend revisions to the definitions in the Regulations to resolve the issues companies are facing when interpreting and applying the draft legislation (even if the present draft is passed prior to the release of PC's final report).

We have not commented on the taxation of employee share plans as our views are contained in our submission to the Board of Taxation (dated 6 October 2009) and prior submissions to Treasury and the Senate Economics Committee.

In terms of the structure of the final report to Government, we suggest that the Overview chapter contain the rationale for each of the recommendations (as contained in Chapter 11 and the rest of the report) and page references to the relevant sections of the report. The current separation of the draft recommendations from the rest of the Overview chapter is such that the recommendations are brief and could be subject to misinterpretation. For example, it is not clear from the overview alone how Draft Finding 1 (the "disclosure checklist") relates to the recommendations or how the Commissioner intends it to be implemented.

# 1. Simplifying disclosure

The Commissioner acknowledges a general view that users of Remuneration Reports, and in particular shareholders, find Remuneration Reports lengthy and complex. To help make the reports more useful, the Commissioner has recommended several additional disclosures, including those to be contained in a "plain English statement" and a requirement to disclose "actual" remuneration values. While we believe that most of the recommended disclosures will add useful information, they will also lengthen the Remuneration Report. Additionally, the new disclosures may conflict with existing disclosures (e.g., "actual" remuneration values versus accounting values, as discussed in more detail later) and thus may cause confusion.

In not recommending any reduction to the disclosure requirements, the Commissioner notes that different shareholders will have different information needs and argues that potential reductions to the disclosure requirements would not significantly reduce the compliance burden of companies. However, Ernst & Young believes that the focus should be on making the Remuneration Report easier for shareholders to understand (preferably without increasing the compliance burden). Several areas of the current disclosure provide little increment to shareholder understanding. Removal of these disclosures will simplify the Remuneration Report and lead to greater understanding of a company's remuneration approach.

We suggest that the Commissioner conducts a complete review of disclosure rather than being confined to the existing structures. Our concern is that the ever-increasing length and complexity of Remuneration Reports will make the report less accessible (particularly to retail shareholders), make the more relevant information harder to find and potentially engender mistrust by shareholders, making voting on remuneration matters less informative.

To this aim, we have detailed on the next page an "ideal" Remuneration Report. The topics listed would be detailed in approximately one page each (eight pages in total). In our experience, these areas are crucial to providing shareholders with an understanding of the company's remuneration approach. While it may be impractical to mandate the structure / length of the Remuneration Report, the disclosure requirements could be amended to prompt companies to capture these areas (the specific changes we recommend are detailed in Appendix A). In order to achieve this, some current aspects would need to be added, some expanded / modified and others removed. Further, complex accounting disclosures would need to be moved to the Notes to the Annual Financial Report.

While companies would face an initial task of familiarising themselves with the changed requirements, we believe the changes would not increase the ongoing compliance burden. Importantly, our approach would not require a separate "plain English statement" to provide crucial information to shareholders. Rather, the removal of complex accounting disclosures would make it easier to use plain English throughout the report.

### The "ideal" remuneration report

We believe the following information, as it pertains to Key Management Personnel ("KMP"), should be disclosed.

| Topic | Contents |
|---|---|
| **Part A: Executives** | |
| 1. Overview / summary | ▸ Description of the company's executive remuneration framework in terms of fixed remuneration, short-term incentives ("STI") and long-term incentives ("LTI"), noting any key changes to the framework in the current year<br>▸ Key details of current year approach in terms of STI and LTI outcomes and rationale, termination payments and rationale, details of any one-off payments<br>▸ Details of any expected reviews of, or changes to, remuneration plans in future years |
| 2. Remuneration strategy | ▸ Remuneration objectives, approach to quantum, approach to remuneration mix, key objectives and design features of each remuneration element (e.g., fixed, STI, LTI), details of any significant changes |
| 3. Short-term incentives ("STI") | ▸ Detailed plan description, including performance measurement approach<br>▸ Details of any equity grants associated with STI deferral (i.e., grant and vesting details, but not the value of the awards) |
| 4. Long-term incentives ("LTI") | ▸ Detailed plan descriptions including performance measures and vesting schedules (to include retention plans and "medium-term" incentives)<br>▸ Details of grants made in current year (i.e., grant and vesting details, but not the value of the awards) |
| 5. Contractual arrangements | ▸ Notice periods, sign-on arrangements, termination entitlements and details of any guaranteed payments<br>▸ Details of termination payments made in the current year |
| 6. Remuneration outcomes | ▸ Current year and prior year individual remuneration data using "actual" values (see below) |
| 7. Performance and reward link | ▸ Commercial rationale for the selection of performance measures (included here rather than in section 3 and 4, which describe the practical operation of incentive plans)<br>▸ Current year STI payment and LTI vesting by executive relative to maximum opportunity and rationale<br>▸ Historical STI payment and LTI vesting relative to key financial measures and rationale<br>▸ Fluctuation in value of each executive's company shareholding over the year (including any unvested equity awards) |
| **Part B: Non-executive directors ("NED")** | |
| 8. NED policy and outcomes | ▸ Description of the company's NED remuneration framework in terms of policy base fees, committee fees, benefits and participation in equity plans, noting any key changes to the framework in the current year<br>▸ Current year and prior year remuneration data using "actual" values |

The above would be supplemented by the Notes to the Annual Financial Report, which would include details of the aggregate accounting value of KMP remuneration outcomes and a description of the fair valuation methodology used for share-based payments.

### Actual remuneration disclosures

We support the disclosure of "actual" remuneration values for the reasons outlined in our prior submission. However, we caution that "actual" needs to be defined and, for consistency, we suggest that all remuneration values (not just share-based payments) be disclosed on an "actual" basis.  To the extent that definitions for each element are not specified, there is the risk that inconsistencies in approaches will lead to a reduction in comparability of amounts disclosed by different companies.  This has already been evidenced by the difference amongst companies who have voluntarily disclosed this information.

We propose the following definitions:

| Remuneration element | Definition |
|---|---|
| Fixed remuneration | Fixed amounts (i.e., salary, superannuation and other benefits) for the 12-month period[1] |
| STI | Cash bonuses in relation to service over the year (i.e., excluding any deferral) |
| Cash STI deferral | The cash value that vested during the year |
| Share-based payments | The cash gain available to executives in relation to equity awards that vested during the year (i.e., the cash gain to the executive, before tax, net of any exercise price, if they were to have sold the equity at the time it vested) |
| Cash LTI | The cash value that vested during the year |

*Note that all values are pre-tax.*

Determining the "actual" value of termination payments will require further consideration as the amount currently disclosed in the "Termination" column of the Remuneration Report does not correspond with the value requiring shareholder approval. Accordingly, we have recommended additional termination payment disclosures (refer Appendix A and section 4).

### Audit of Remuneration Reports

The Remuneration Report contains many disclosures that are qualitative in nature, or are quantitative but not calculated on an accounting basis. As the audit is completed with reference to Accounting Standards, this makes the Remuneration Report difficult to audit. If accounting disclosures are restricted to the Notes to the Annual Financial Report, as per our recommendations, we believe the Remuneration Report in its entirety would no longer need to be audited[2].

[1] Due to the complexity associated with valuing benefits (e.g. accruals to defined benefit pension funds), we suggest that the components of fixed remuneration be determined in accordance with AASB124.
[2] We note that the components of fixed remuneration (determined in accordance with AASB 124) would need to be audited.

# 2. Facilitating effective use of remuneration advisors

Ernst & Young generally supports the Commissioner's recommendation that where the Board makes use of external remuneration advisors, those advisors report directly to the Board (independent of management) and that the Board disclose the name of the advisor and the nature of the advice.

However, we suggest that the recommendations regarding disclosure be made more explicit to ensure the requirements can be implemented in a correct and consistent manner. We also suggest that the recommendations be supplemented with supporting guidelines to ensure that their implementation would not result in Boards having less access to quality advice and information that is held by management.

## 2.1 Disclosure of remuneration advisors

Companies should only be required to disclose remuneration advisors where the Board "*relied on*" the advice, rather than simply "*used*" the advice, to avoid potential misinterpretation of the consultant's role or services. In some cases, companies may commission external advice without actioning it. Our suggested change will help ensure that remuneration advisors are not connected with remuneration arrangements that they advised against.

## 2.2 Guidelines for the use of remuneration advisors

To ensure effectiveness of the recommendation regarding advisors reporting directly to the Board, we recommend that the following good remuneration governance practices be incorporated in corporate governance guidelines:

### Definition of "independent"

The term "independent" has several connotations and should be defined further. In our view, an advisor is independent from management if they are retained by the Board and report to the Board. The advisor should also have a mandate to work with management. Under this approach, the advisor is retained by and reports to the Board, but works closely with management in order to obtain the information and understanding required to develop advice, undertake analysis and/or develop recommendations.

Under this approach, it is critical that there is clarity from the outset of the engagement on the extent to which the advisor should have access to and/or provide advice to management. The process by which information or recommendations relating to executive remuneration are communicated to the Board, and the manner and extent to which such information should be communicated to management, should be agreed up-front.

### Strengths of this approach

We believe this is the most appropriate approach as it:

- Is consultative and, as such, is generally more likely to result in effective decision-making. The advisor will be able to obtain a thorough understanding of the relevant business issues as well as incorporate the input of relevant internal experts in undertaking analysis or developing proposals.

The consultative approach also allows management to raise any cultural implications or impacts that proposals may have.

- Avoids the potential additional cost, duplication of work, or conflicting advice that may occur when the Board and management engage separate advisors.

### Accountabilities of the Board and management in remuneration matters

Ernst & Young believes that the main area where conflict of interest arises is when remuneration advisors report to management regarding management remuneration. Accordingly, companies should be provided with guidelines regarding accountabilities on KMP remuneration matters.

- **The Board:** Should be accountable for guiding the design of KMP remuneration (in terms of its nature and amount), as well as ensuring that incentive plans are supporting the right behaviours and outcomes. The Board should also initiate any reviews of executive remuneration. We believe this enhanced accountability of the Board is necessary to restore the wider community's confidence in the corporate governance system. Management should not initiate reviews of executive remuneration, as this is where conflicts of interest may arise.

- **Management:** May develop proposals and commission advice in relation to the implementation and regulatory implications of approved KMP remuneration designs (e.g., on specific taxation issues). If a review of management proposals is required, the Board should commission an independent advisor. In cases where management perceive there to be an element of remuneration that is not serving its intended purpose (i.e., a *design* issue), management should bring this to the Board's attention and, if the Board agrees that a review is warranted, then the Board should initiate a review.

For remuneration below KMP level, we believe that management should be accountable for designing and reviewing the remuneration approach, while the Board should be accountable for the approval of remuneration design.

## 2.3 Remuneration advisor code of conduct

The Financial Services Authority ("FSA") has initiated a review of corporate governance in the UK financial services sector – the Walker review. The consultation document titled, 'A review of corporate governance in UK banks and other financial industry entities', published in July 2009, outlines a draft code of conduct for remuneration consultants in the UK. The code states that "executive remuneration consultants…should comply with the fundamental principles of transparency, integrity, objectivity, competence, due care, and confidentiality." The consultation document recommends that the finalised code be published on a website, along with the names of remuneration consulting firms that have committed to the code. The consultation document also recommends that remuneration committees engage advisors who have committed to the code.

We believe that a similar code may be useful for Australian remuneration advisors, and may enhance the public's understanding of the role of remuneration advisors, and also improve perceptions. Further, the code also provides good practice guidelines for how the code's principles should be applied. We support the current drafting of the Walker review code.

# 3. Remuneration report voting implications

The PC's recommended two-strike rule, whereby all directors would face re-election upon two consecutive significant votes[3] against the Remuneration Report, could result in considerable upheaval for what may only be a minority shareholder view. While we believe that the Commissioner's approach is an interesting compromise for those seeking a binding vote, we urge the Commissioner to further consider whether the current advisory vote needs to be strengthened and, if so, the potential consequences of the recommended approach.

## 3.1 Is an explicit consequence required?

In our experience, and as acknowledged by the Commissioner, most companies already take action to address high "no" votes. Several companies (of the few with votes in excess of 25%) have approached us to understand the reasons for their high "no" votes and the ways of better meeting shareholder needs. Even companies with "no" votes below the proposed threshold of 25% take the advisory vote very seriously and frequently consult us regarding ways to increase the effectiveness of their communications with shareholders. In our view, the current advisory vote provides the appropriate balance between shareholder influence and director accountability and does not require strengthening. While we see no harm in requiring a formal response to shareholders where votes against the Remuneration Report are greater than 25%, more severe penalties are, in our view, unwarranted.

Our analysis of the ASX 300 indicates that in 2008 only four companies would have been captured by a threshold of 25% in both years[4], representing approximately one third of the companies with a "no" vote greater than 25% in 2007. An additional four companies would have been captured by this rule in year-to-date 2009. There have yet to be any companies with three consecutive "no" votes greater than 25%. This not only illustrates that companies already respond to "no" votes, but also that few companies would be affected by the proposed legislation. Consequently, and as the recommendation has been the cause of considerable contention, the rule may not warrant the government resources required to make it law.

## 3.2 The proposed approach: Facing all directors with re-election

The ability to remove directors is a shareholder protection mechanism for all of the matters over which the Board has oversight. Interfering with this mechanism for only remuneration matters has the potential for the following unintended consequences:

- Following the application of this rule, there may not be another opportunity for shareholders to change their appointed representatives for three years. Shareholders may wish to remove directors in those three years for reasons other than remuneration.
- Small groups of shareholders, or a large minority shareholder, may vote against the remuneration report to put directors up for re-election for reasons unrelated to remuneration, thus biasing the shareholder message regarding remuneration and taking advantage of the rule in a manner not intended by the Commissioner.
- Equally, some shareholders otherwise wishing to remove a director may not do so when the whole Board is facing re-election, for fear of creating instability in the oversight of the company.

[3] Proposed definition is "no" votes greater than 25% in first year, and above a "yet to be defined" threshold in the second year.
[4] Remuneration voting data includes results of AGMs up to 27 October 2009. The ASX 300 was defined at 31 October 2009. Companies not in the ASX 300 in prior years or who did not have a remuneration report resolution were excluded.

- While a majority vote would still be required to remove a board-endorsed candidate, unqualified candidates that might otherwise not have been elected may have an increased chance of election given that shareholders would assumedly still want to appoint several directors.

Note that it would take three years from the remuneration practices being disclosed to the directors facing re-election per the proposed rule. Since directors already face re-election every three years from their date of appointment, shareholders would already have had the opportunity to remove all directors in this time. Thus, the proposed consequence would only serve to align the date of re-election for all directors.

## 3.3 The proposed approach: Concerns with a threshold of 25%

As outlined in our prior submissions, the Remuneration Report vote is, by nature, a blunt tool for shareholders to express their satisfaction / dissatisfaction. Shareholders may vote against a remuneration report for a variety of reasons that are sometimes very specific and potentially contradicting. In addressing a "no" vote, the Board will be uncertain as to which aspects of remuneration are contrary to which shareholder's views. Ernst & Young does not believe a threshold below 50% in either the first or second year is appropriate for the following reasons:

- Making changes to the remuneration approach after a minority "no" vote arguably goes against the view expressed by the majority of shareholders and could result in other shareholders being equally dissatisfied.
- Companies impacted will likely incur reputational damage, which would be to the detriment of the majority of shareholders supporting the remuneration approach.
- Boards wishing to avoid reputational damage may take a "safe" approach to remuneration and/or invest greater time in remuneration at the expense of other issues, which may not be consistent with the strategic aims of the company.

Consequently, if the Commissioner proceeds with the recommendation, we propose that the majority of shareholders be required to vote against the remuneration report to trigger board re-election (i.e., greater than 50% in the first and second year).

# 4. Direction on termination payments

Ernst & Young broadly supports the proposed changes to the termination payment approval requirements. However, our work with clients has identified practical issues with the draft legislation. The aspects requiring clarification and the potential for unintended consequences were highlighted in our submissions to Treasury and the Senate. While a number of ambiguities remain, it appears that the legislation will soon be passed. Consequently, we suggest that the Commissioner makes recommendations in the following key areas:

- **Definition of "base salary":** The draft regulations (3 September 2009) specify that share-based payments without performance hurdles are included in the definition of base salary. We understand this inclusion was intended only to capture shares acquired through salary-sacrifice. However, as a result of the terminology used, this definition would also increase the termination payment cap for executives with unhurdled equity awards (e.g., retention awards and options provided at no cost to the executive). We do not believe this is Treasury's intent and suggest the wording of the Regulations be refined.

- **Definition of termination payment:** There remains considerable ambiguity regarding what is included in the definition. The House of Representatives and Senate debates indicate a belief that any non-statutory payment the executive receives following cessation of employment is included (i.e., all cash payments, benefits and equity awards). Representations in the media would suggest the public also take this view. Conversely, Treasury and the Commissioner have stated that few companies will be captured by the legislation and refer mainly to payments of fixed remuneration in lieu of notice and non-compete periods.

  The divergence of views illustrate that the legislation is not clearly drafted or understood. We, along with our clients and the lawyers with whom we work, have found that it is challenging to determine what is and is not included. While we appreciate that it is not practical to provide an exhaustive list of inclusions and exclusions, a more precise definition of "termination payment" in the Regulations would assist implementation and minimise continued misunderstanding by all stakeholders.

- **Principle behind the definition of termination payment**: In addition to the definition of termination payment being unclear, the principle behind the inclusions and exclusions is not transparent. The current draft of the legislation focuses on whether or not payment / vesting have been accelerated.

  In our view, the more pertinent factor is whether or not payment / vesting have been pro-rated for the executive's performance and time served until the date of termination. We believe that only amounts that are not pro-rated should be included in the definition of termination payment. Our rationale is that benefits which have formed part of the executive's ongoing remuneration arrangements (e.g., STIs and LTIs) are not, by definition, associated with their termination.

- **Valuation of termination payment**: As the Regulations do not specify how share-based payments should be valued, it is therefore implied that accounting valuations are to be used (i.e., the un-expensed portion of the total accounting expense associated with the share-based award). The Commissioner acknowledges the misalignment between the accounting valuation of share-based payments and the value received by the executive.

Accordingly, where the definition of termination payment includes share-based payments, the "actual value" should be the value that is compared to the cap. Per section 1 (p.4), we proposed that "actual value" be defined as the cash gain to the executive, before tax, net of any exercise price, if the executive were to have sold the equity at the time it vested.

- **Disclosure of termination payments:** To make the approval process more effective, the Remuneration Report and Notice of Meeting should disclose the value of the termination payment in a manner consistent with the final definition / valuation rules. The disclosure should be accompanied by the company's rationale for the payment and would be additional to any amount required to be disclosed in the remuneration tables of the Remuneration Report. The disclosure requirements should be amended accordingly.

Finally, we note that the draft legislation refers to Corporations Act 300A(1)(c) for its definition of the executives covered. The Commissioner has recommended that this section be amended to include only KMP. It should be ensured that the termination payment legislation application is consistent with the application of disclosure requirements.

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If there are any areas of this submission that you would like us to expand upon further, we would be pleased to discuss these with you. We look forward to receiving your final recommendations.

Yours sincerely,

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# Appendix A Suggested changes to Remuneration Report disclosure requirements

The following includes our suggested changes to the current disclosures required by the Corporations Act in respect to the Remuneration Report.

Where no change is noted to a particular section of the *Corporations Act 2001* (the "Act") or regulation of the *Corporations Regulations 2001* (the "Regulations") (together, the "legislation"), we recommend that disclosures be retained.

| Suggested change | Comments |
|---|---|
| 1. Modify | |
| (a) Description of performance and remuneration link<br><br>300A(1)(b)<br>300A (1AA and 1AB)<br><br>AND<br><br>(b) Vesting percentages of bonuses and share-based payments<br><br>2M.3.03 (1) item 12 | It is difficult to specify the precise disclosures that would illustrate how company performance and remuneration are aligned because of differing business strategies for different companies (and therefore differing performance measures and performance periods).<br><br>The specificity of 300A (1AA and 1AB) encourages companies to detail earnings and shareholder returns over the required period in isolation of remuneration outcomes. In most companies' Remuneration Reports, this information does not increase shareholder understanding. We suggest replacing these requirements with a revised requirement, as detailed below.<br><br>The revised requirement should include disclosure of the following:<br>► Commercial rationale for the selection of performance measures and description of how different levels of performance affect the quantum of the incentive payment / award (as required in 300A (1) (ba)).<br>► A table detailing:<br>For cash incentives, as a percentage of maximum incentive opportunity:<br>► % paid in current year<br>► % forfeited in current year<br>► % deferred / unvested<br>► % vested in prior years (only where the award was made in a prior year and not paid in full)<br>For each outstanding share-based payment (including STI deferral into equity), as a percentage of the number of equity instruments granted[5]:<br>► % vested in prior years<br>► % vested in current year<br>► % forfeited in current year<br>► % unvested<br>*The percentages should add up to 100%.*<br>This table would illustrate outcomes under incentive schemes and prompt management to provide a rationale for any misalignment with company performance (i.e., an enhancement of disclosure currently required under 2M.3.03 (1) item 12).<br>► Describe how the past 3 years' executive STI payments (as a proportion of maximum opportunity) compare to the company's performance against key financial measures of the company's strategy.<br>► Illustrate how LTI vesting in the past 3 years compares to the company's performance (over the relevant period) against the measures used to determine vesting.<br>► Total equity holdings (as per the Commissioner's Recommendation 8) and how each executive's wealth fluctuated with shareholder returns during the year; specifically, how the value of their unvested and vested company shares was affected[6]. Disclosure should include and separately distinguish between shares purchased by the executive, unvested company equity awards and vested company equity awards. |

[5] Note that where performance determines the number of awards granted (and not the number that vests), disclose the % granted and vested, the % forfeited and the % unvested.

| Suggested change | Comments |
| --- | --- |
| (c) Remuneration mix<br><br>300A(1)(e)(i) | Inconsistent information is disclosed. To promote more consistent disclosure, we recommend modifying the requirement to explain the relative proportion of remuneration related to performance under 300A (1)(e)(i) to specifically require disclosure of the following (as a proportion of total *target* remuneration):<br>► Fixed (not-related to performance)<br>► Related to short-term performance (<12 months)<br>► Related to long-term performance[7] (>12 months)<br>Total target remuneration should be defined as the "actual" total remuneration payable at target levels of performance (refer 2a). |
| (d) Presentation of prior year individual remuneration data<br><br>2M.3.03 (1)<br>2M.3.03 (2) items 6, 7, 8, 9 and 11 | Individual remuneration data for the current and prior year should be presented in the same table (some companies currently present two tables) so that the remuneration for each individual can be easily compared to the prior year.<br><br>Executive remuneration (including executive directors) and non-executive director remuneration should be presented in separate tables to simplify presentation and increase shareholder understanding. |
| (e) Share option and right disclosures<br><br>2M.3.03 (1) item 15<br>2M.3.03 (3) | The disclosures specific to share options and rights would be equally relevant for other share-based payment vehicles (e.g., restricted shares and cash payments linked to share price) as all have an associated accounting expense. The wording of these requirements should be modified as such. |
| 2. Add | |
| (a) Actual remuneration outcomes for each KMP (realised values) | Per the PC Recommendation 8 and Ernst & Young prior submissions.<br><br>We caution that "actual" needs to be defined. We propose the following definitions:<br>► Fixed remuneration: Fixed amounts (i.e., salary, superannuation and other benefits) for the 12-month period[8]<br>► STI: Cash bonuses in relation to service over the year (i.e., excluding any deferral)<br>► Cash STI deferral: The cash value that vested during the year<br>► Share-based payment: The cash gain available to executives in relation to equity awards that vested during the year (i.e., the cash gain to the executive, before tax, net of any exercise price, if they were to have sold the equity at the time it vested).<br>► Cash LTI: The cash value that vested during the year<br>*Note that all values are pre-tax.*<br><br>Determining the "actual" value of termination payments will require further consideration as the amount currently disclosed in the "Termination" column of the remuneration table does not correspond with the value requiring shareholder approval. Accordingly, we have recommended additional termination payment disclosures (refer 2c). |

[6] Value to be determined by share price at last day of financial year multiplied by number of equity instruments (less any future exercise price or consideration already paid).
[7] Including exposure to share price volatility (i.e., where the value of the vested award depends on the share price at the date of vesting).
[8] Due to the complexity associated with valuing benefits (e.g., accruals to defined benefit pension funds), we suggest that the components of fixed remuneration be determined in accordance with AASB124.

| Suggested change | Comments |
|---|---|
| (b) Selected items from the Commissioner's disclosure checklist<br><br>Bullets 1, 2, 3 and 5 of the Commissioner's Draft Finding 1. | We suggest that the following disclosures be included in the Remuneration Report (perhaps as guidance for what is intended by 300A (1)(a)(i)):<br>i. Rationale for remuneration policy (in terms of strategy, risk profile and shareholder alignment)<br>ii. Rationale for remuneration mix policy (see also 1b)<br>iii. Details and rationale for remuneration and performance benchmarking comparator groups<br>iv. Details of any mechanisms to guard against extreme incentive payments from formulaic incentive plans<br><br>We suggest that companies disclose points i, ii and iii in the Remuneration Strategy section of the Remuneration Report (see section 1 of this report), alongside the key objective and features of each remuneration element (e.g., fixed, STI and LTI). Point iv should be disclosed in the detailed STI plan description (see section 1 of this report).<br><br>Note that (i) should focus on incentive arrangements as the information companies disclose in relation to fixed remuneration policy tends to be generic and of limited insight for shareholders.<br><br>While we agree that companies should consider the full range of potential outcomes when designing remuneration (bullet points 4, 6, 7 and 8 of Draft Finding 1), we do not believe they should be required to disclose how or whether they have done so, as this would add unnecessary complexity to Remuneration Reports. Guidance regarding recommended design steps (as indicated by these bullet points) could be provided as part of the ASX Corporate Governance Council guidelines. |
| (c) Termination payments | As discussed in section 4 of this report, where termination payments are made during the year, the Remuneration Report and Notice of Meeting should disclose the value of the termination payment (calculated with reference to the definitions in the termination payment approval requirements). The disclosure requirements should be amended accordingly. While the current legislation does not specify a method for valuing any equity awards, the methodology should be consistent with that outlined in 2(a); i.e., "actual" values. The disclosure should be accompanied by the company's rationale for the payment and the proportion of the payment that was pro-rated for performance (typically any STIs or LTIs).<br><br>The disclosures above are additional to any amount required to be disclosed in the remuneration tables of the Remuneration Report (see 2a).<br><br>Where the individual is potentially entitled to payments in future years in relation to their current role (e.g., vesting of LTI awards that are not accelerated and therefore vest per the original grant conditions), the "actual" value of any amounts that are expected to vest / be paid to the individual in future years should also be disclosed[9]. Where the value of the future benefit is not known, the maximum value based on the number of equity awards and the current share price (less any consideration paid or exercise price payable) should be disclosed. |
| 3. Move to the Notes to the Annual Financial Report | |
| (a) Fair valuation methodologies<br><br>(not required disclosure in the Remuneration Report) | Per the PC recommendation 8 and Ernst & Young prior submissions. |

[9] The accounting cost will be captured in the Notes to the Annual Financial Report

| Suggested change | Comments |
|---|---|
| (b) Accounting value of remuneration outcomes for each KMP.<br><br>2M.3.03 (1) items 6 and 11<br>2M.3.03 (2) | Accounting costs (including those associated with share-based payments) should be disclosed only in the Notes to the Annual Financial Report and only in aggregate (i.e., for all KMP). Accounting values are useful to indicate the cost of the company's remuneration approach and are therefore more relevant as a supplement to the financial statements. Individual accounting disclosures for KMP would be unlikely to increase shareholder understanding when "actual" values are already disclosed (see 2a). Disclosure of both accounting values and actual values on an individual basis will result in unnecessary complexity and might encourage comparisons that are not meaningful.<br><br>As aggregate accounting costs of KMP remuneration are already a required disclosure in the Notes to the Annual Financial Report, the requirements to disclose accounting values in the Remuneration Report should be removed and replaced with requirements to disclose actual values. |
| 4. Remove | |
| (a) Methods used to assess performance conditions<br><br>300A (1) (ba) (iii) | The requirement to disclose how the satisfaction of performance conditions is assessed and why it is assessed in this way tends to yield inconsistent information about company *process and approvals*. For example, companies might specify who carries out the calculations and the specific formula used. What is more relevant is information about *vesting schedules*: how different levels of performance affect the quantum of the incentive payment / award (see 1a). |
| (b) Minimum and maximum values of bonuses and share-based awards in future periods<br><br>2M.3.03(1) item 12(h) | The value of deferral into future periods is typically linked to a variable that has no meaningful maximum and cannot be reliably forecasted (e.g., share price). The other requirements of 2M.3.03 already provide sufficient information regarding the impact of current year grants on remuneration in future periods as they require disclosure of the vesting date and relevant vesting criteria. |
| (c) Other accounting disclosures regarding options<br><br>300A (1)(e)(iii), (Iv) and (vi) | The following accounting disclosures provide minimal, if any, increment to shareholder understanding:<br>► Accounting value of options exercised during the year (actual value at vesting and actual value of shareholdings is more relevant - see 1a and 2a);<br>► Accounting value of awards lapsed during the year (percentage is more relevant - see 2c - unless reducing accounting expense, in which case would be captured in 3b);<br>► The percentage of remuneration consisting of options (remuneration consisting of LTIs more relevant - see 2b). |
| (d) Description of LTI plans that do not relate to current year grants<br><br>2M.3.03 (1) item 12 | Descriptions regarding incentive arrangements should only be provided for those under which current year grants were made (or future year grants have been contracted). Disclosure for prior year plans would have been mandated in the relevant year and can detract from current year information.<br><br>For completeness, there should be a reference directing the reader to the relevant year's remuneration report for further detail on legacy plans. |
| (e) Individual disclosures for the five-highest paid executives if they are not KMP.<br><br>300A(1)(c)(iii) and (iv) | Per the PC recommendations and Ernst & Young prior submissions.<br><br>In response to the Commissioner's request for input on further reducing disclosures (e.g., to "top KMP"), we note that a clear definition would be required (e.g., Executive Directors). In our view, it is relevant to disclose information for all KMP as these are the individuals who have the ability to make decisions on behalf of the company and its shareholders. Consequently, it is for these individuals that shareholders require information to assess the extent to which remuneration is aligned with their interests. |