Business Council of Australia

Submission

to the

Productivity Commission Discussion Draft on Executive Remuneration in Australia

November 2009

Table of Contents

Foreword

The Business Council of Australia (BCA) welcomes the opportunity to make a submission in response to the Productivity Commission's Discussion Draft, *Executive Remuneration in Australia*, September 2009.

The BCA represents the chief executives of over 100 of Australia's leading companies. On behalf of its members, the BCA develops and advocates public policy reforms that seek to position Australia as a strong and vibrant economy and society. Our member companies are very large businesses; they account for significant domestic sales and economic activity, a substantial share of Australia's trade and investment flows, and collectively employ nearly one million people domestically.

Background

In its initial submission to the Inquiry on Director and Executive Remuneration in Australia, the BCA outlined its positions regarding the role of the inquiry and the way forward in terms of executive remuneration policies and practices. Key points included the following.

- The Productivity Commission has an important role to play in ensuring that public debate and potential policy decisions are based on a thorough understanding of the facts and an objective assessment of the potential costs and implications of policy responses.

- Policies that support and enable a productive, competitive and innovative business sector in Australia are very much in the community interest, while policies that work against this will come at a significant long-term cost.

- Executives are globally mobile and Australia's large listed companies need to be able to compete on equal footing for skilled and experienced executives.

- Remuneration practices among Australia's large listed companies already reflect best practice well. For example, there is:

    - significant disclosure;
    - a clear focus on long-term incentives in remuneration; and
    - listed companies are required to report against good governance criteria, including whether they have a remuneration committee comprised of a majority of independent directors.

- Remuneration outcomes have largely reflected market factors and the changing nature of executive roles (increasing complexity, shorter tenure, etc.).

- Recommendations flowing from the inquiry should adopt a principles-based approach that will enable listed companies to adapt and respond in ways that best suit their company-specific circumstances and shareholder interests, with a focus on:

  - clear board responsibility for remuneration strategies and outcomes;
  - strong remuneration disclosure;
  - retaining the non-binding shareholder vote and encouraging boards to be more responsive to voting outcomes; and
  - the avoidance of prescriptive, regulatory responses.

Response to the Discussion Draft

HIGH-LEVEL FINDINGS

The BCA believes the Productivity Commission's discussion draft makes an important contribution to public understanding and debate on executive pay in Australia. The discussion draft comprehensively analyses available data and research and draws a number of conclusions which the BCA believes are significant.

The BCA welcomes the commission's conclusion that there is not a general system failure in terms of executive remuneration governance across Australia's listed companies. The draft findings establish that Australia's framework for governance of executive remuneration has worked well (see Exhibit 1).

EXHIBIT 1: AUSTRALIA'S CORPORATE GOVERNANCE RATES WELL

- Australian boards are generally smaller than US boards, with few dual CEO/chairs (particularly for larger companies), and a higher proportion of non-executive directors (NEDs) and 'independents'. Independent NEDs comprise a majority of most ASX300 company boards.

- Most large Australian companies have remuneration committees – around 75 per cent of remuneration committees in larger companies comprise only NEDs, and most remuneration committees in the top 400 companies comprise mainly *independent* NEDs, and have an independent chair.

- Each year listed companies must produce a remuneration report with pay details for top executives. Shareholders have a non-binding vote on this report.

Discussion Paper, Box 3, page XXIII

The BCA agrees with the Productivity Commission's conclusion that *"globalisation, increased company size, and the shift to incentive pay structures have been major drivers of executive remuneration increases"*.[1]

[1] Discussion draft, page XIV.

The discussion draft notes that consistent with the increasing link between pay and performance, there has been a decline in executive remuneration during the recent period of economic slowdown. And, *"in 2007–08, real total CEO pay fell across ASX300 companies, especially for the top 100 (which have proportionately more pay linked to company performance)."*

Recognising that there is not a systemic failure of the governance frameworks for executive remuneration, the BCA welcomes the conclusion that the *"way forward is not to by-pass the central role of boards in remuneration-setting through prescriptive regulatory measures such as pay caps."*[2]

The BCA strongly supports the recognition of the central role of boards in determining executive pay. Australian listed companies need the flexibility to attract and retain skilled and experienced executives in a competitive global market. This means that remuneration structures need to be company and context specific. Determination of executive remuneration is therefore best left to boards, which are in turn answerable to shareholders.

The discussion paper in fact highlights that *"Australian boards have … been made increasingly accountable on remuneration matters through disclosure requirements and the (non-binding) shareholder vote on the remuneration report"*.

The BCA welcomes the rejection of a binding shareholder vote on the remuneration report and the commission's reasoning behind this, including acknowledgement of the complexity and breadth of the remuneration report and that such a vote would *"compromise the board's authority to negotiate with executives"*.[3] Likewise, the recognition of the impracticalities and significant adverse consequences of arbitrary pay caps for executives is noteworthy.

DRAFT RECOMMENDATIONS IN GENERAL

Many of the recommendations put forward in the discussion draft reflect best practice and seek to enhance the adoption of best practice approaches in a manner consistent with company-specific circumstances, for example by strengthening or clarifying the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

The BCA endorses this approach, which builds on practices currently in place in many large listed companies, and supports many of the recommendations proposed (to varying degrees and subject to the detailed comments below) including in particular draft recommendations 2–10, and 13.

A number of the draft recommendations (11 and 12) are unlikely to cause significant concern, but are of questionable benefit and are likely to impose unnecessary cost.

Two of the draft recommendations, 1 and 15, are strongly opposed by the BCA.

---

[2] Discussion draft, page XXV.

[3] Discussion draft, page XXV.

In considering the draft recommendations put forward by the Productivity Commission the BCA has sought to reflect on the intention of the recommendations as well as the likely practical implications of the measures proposed in terms of effectiveness, benefits relative to cost, and the potential for unintended consequences.

The importance of remuneration issues relative to the overall responsibilities of the board should also be taken into account. While remuneration decisions are rightly given significant consideration, many other board decisions will potentially have a greater bearing on a company's long-term performance and shareholder returns. Any regulatory or compliance obligations should reflect this and not place an unduly high burden on remuneration-related matters.

The BCA recommends that the draft proposals should be assessed in totality, to ensure the cumulative burdens of the package of reforms are known and that unintended consequences can be avoided. For example, this submission highlights that if "associates" are included in draft recommendation 4, this may have unintended consequences for voting on remuneration reports under draft recommendation 15. Accordingly, it is important that these reforms, taken together, do not lead to unanticipated detrimental consequences for companies.

The BCA's detailed comments on each of the Productivity Commission's recommendations are outlined below, in order of priority for the BCA.

DRAFT RECOMMENDATION 15

The Corporations Act 2001 should be amended to require that where a company's remuneration report receives a 'no' vote of 25 per cent or higher, the board be required to report back to shareholders in the subsequent remuneration report explaining how shareholder concerns were addressed and, if they have not been addressed, the reasons why.

If the company's subsequent remuneration report receives a 'no' vote above a prescribed threshold, all elected board members be required to submit for re-election (a 'two strikes' test) at either:

- *an extraordinary general meeting or*
- *the next annual general meeting.*

RESPONDING TO A SIGNIFICANT 'NO' VOTE

The BCA supports efforts to assist and encourage boards to be more open and transparent about executive remuneration and to more effectively communicate remuneration strategies and goals. The BCA believes that where a significant 'no' vote has been cast against a remuneration report, boards should be encouraged to respond to shareholders in a cost effective and timely way. It is currently good practice for boards to consider a large 'no' vote and to address those concerns accordingly.

That said, the BCA believes that there are significant practical difficulties associated with a prescriptive legal requirement for the company to report back to shareholders in a subsequent remuneration report where a 'no' vote of 25 per cent or higher on the remuneration report has been received.

The recommendation assumes boards will receive clear indications of specific 'shareholder concerns'. But it will not always be clear what shareholder concerns are and/or whether there is a strong consistency of view regarding specific concerns.

It is also important to acknowledge that in some cases, votes against the remuneration report reflect a broader dissatisfaction or 'protest vote' rather than concerns regarding particular remuneration strategies or outcomes.

By including a legal requirement in the Corporations Act for companies to report back to shareholders, there is a risk that companies will be unable to comply with – or inadvertently breach – the law because they cannot ascertain the appropriate information about which shareholders are interested. It is also difficult to imagine how the appropriate regulator would effectively (i.e. in a way that is meaningful in a qualitative sense) administer and enforce compliance with this reporting requirement.

Additionally, the requirement might encourage a 'compliance culture' where more timely, innovative methods of communication such as media releases, website posts or direct communication with shareholders are no longer considered adequate or appropriate from a legal/compliance perspective.

The BCA considers that this part of draft recommendation 15 should be referred to the ASX Corporate Governance Council for consideration as a good practice recommendation rather than enabled through legislation.

An 'if not, why not' reporting trigger could provide guidance on the different types of 'reporting' and communication that companies can undertake, without being prescriptive about the form of communication. This would retain the flexibility for companies to respond to shareholders in a timely manner suitable to their own circumstances and is likely to produce a more effective outcome in practice in terms of quality and cost.

As it is already common practice for large shareholders to engage directly with boards on serious remuneration concerns and for companies to respond fully to those concerns, an 'if not, why not' reporting requirement reduces the risk of excessive compliance burdens for business.

THE 'TWO-STRIKES' TEST

While acknowledging that the 'two-strikes' test is a compromise or alternative to a 'binding-vote' against the background of demands for shareholders to have a more significant 'say on pay', the BCA is strongly opposed to this draft recommendation.

The proposal elevates the issue of the remuneration report above other key strategic issues to be decided by the board. The recommendation puts inappropriate power in the hands of minority shareholders and could be used for ulterior motives. These concerns are particularly acute should a low threshold be adopted for the second 'trigger'. The BCA notes that it is inappropriate for a minority of shareholders to be able to spill the board when individual directors require a majority vote to be elected to the board.

The potential for minority shareholders to wield undue/disproportionate influence is reduced (but not eliminated) if thresholds are high and based on 'no' votes as a proportion of total shares on issue (rather than votes cast).

Consequences of the 'two strike' test, and potential power that this could provide to minority shareholders, include:

- One shareholder or only a few acting together could cause all directors to be up for election every year once the first trigger is passed.

- Minority shareholders might use the provision to spill boards and replace boards with directors that represent their interests.

- The threat of a 'no' vote or a stacked board could be used to intimidate directors away from performing their fiduciary duties in interests of the company as a whole and rather towards the interests of particular minority shareholders. If the minority shareholders are, for example, from competitor companies, this might have damaging consequences for the operations of the organisation.

Whilst the proposal is intended to provide a framework around executive remuneration so that shareholders can be assured of an "able and trustworthy" board, the proposal is likely to have significant unintended consequences which will act to the detriment of the company and shareholders:

- Boards could become 'distracted' from important strategic decisions that act to the benefit of the company, and focused more on issues of executive remuneration.

- A 'no' vote or the threat of a 'no' vote can place the company in considerable uncertainty, which could lead to a detrimental share price reaction.

- A 'no' vote or the threat of a 'no' vote might potentially subject boards to undue shareholder influence on a range of issues put forward by minority shareholders that are not related to executive remuneration.

- The risk of a board spill and subsequent instability would affect access to and the cost of capital and the preparedness of investors to hold the company's stock.

- The 'two strikes' proposal would take Australia's corporate governance system well beyond frameworks overseas with attendant risks in terms of competitiveness (particularly in capital markets – effectively this creates an additional risk premium).

- Where a board is spilled, the company may lose the experience, skills and the corporate knowledge of the directors that have been serving on the board. This is especially the case where board members who have been 'spilled' may be understandably disenfranchised and reluctant to stand for re-election.

- If the board were to be spilled, the executives upon whose remuneration the shareholders had voted would in any event remain employed by the company and would in fact assume the responsibilities of the board until such time as a new board is elected.

- Sufficient time would need to elapse between the board spill and any election of a new board, which would contribute to uncertainty and in all likelihood significant share price weakness (possibly to the benefit of minority shareholders seeking to increase their stake in the company).

Some have argued that perhaps the chair of the remuneration committee or the chair of the board, rather than the entire board, could be subject to the 'two-strikes' rule. This is inconsistent with the central role and responsibility of the board as a whole in approving remuneration strategies and outcomes. In a practical sense for example, it may be increasingly difficult to attract individuals to chair boards or remuneration committees, particularly in the absence of significant compensation to address the higher risk attached with this position relative to others on the board.

Accordingly, the BCA does not support the argument that the chair of the board or remuneration committee should stand for election after two 'no' votes. This is inconsistent with the principle of collective board responsibilities.

It is also worth noting that the Corporations Act allows shareholders to call an extraordinary meeting (where certain thresholds are met) and to put resolutions, including in relation to election of directors. Where meetings are requisitioned by shareholders under the Corporations Act, the issues of concern are clear. In contrast, 'no' votes against the remuneration report provide relatively less information regarding the nature of shareholder concerns.

DRAFT RECOMMENDATION 1: 'NO VACANCY RULE'

The Corporations Act 2001 should specify that only a general meeting of shareholders can set the maximum number of directors who may hold office at any time (within the limits in a company's constitution).

The BCA fully supports efforts to increase diversity on boards and initiatives to encourage the appointment of more female directors. Additionally, efforts to encourage the nominations committee to actively consider the diversity of the board when making director recruitment decisions are also welcome.

In the context of executive remuneration, it is not clear how draft recommendation 1 dealing with the so called 'no vacancy' rule is linked to improved remuneration strategies and outcomes. The draft recommendation relates to the number of directors only and not to their skillset, experience or for that matter diversity.

The recommendation suggests, although it is unclear, that all boards be required to fill all vacancies up to the maximum (unless shareholder approval is given for an alternative number). This thereby eliminates the board's flexibility to vary the number of directors from time to time up to the maximum specified in the company's constitution to meet the changing needs of the company.

It is unclear how allowing boards to have the flexibility to determine the number of board members (within the scope of the constitution) has contributed to poor executive remuneration policies or to poor governance in other respects.

Additionally, allowing boards to have this flexibility does not impede any validly nominated candidate from contesting elections whenever director elections occur (within the number of vacancies declared by the board).

Typically, corporate constitutions provide for a minimum and maximum number of directors, and allow boards to decide how many directors are appropriate within the

constitutional scope. Many boards choose to appoint fewer than the maximum allowed and may vary this decision from time to time depending on circumstances/needs at the time. There are many good reasons for boards to choose to appoint less than the maximum number of directors. For example:

- The board may wish to limit its expenses.

- The maximum number of directors allowed in the constitution may be too large to enable effective decision making on a regular basis.

- The board may wish to maintain space to allow for recruitment of highly skilled directors as they become available (and before they take up other opportunities). This also allows for the appointment of specially qualified directors to meet emerging company needs. For example, a foreign director may need to be appointed if the company is venturing into offshore markets. During a takeover, it might be useful or necessary to appoint a director from the board of an acquired company to provide continuity without the need to call for a shareholder meeting.

The BCA does not support the draft recommendation dealing with the so called 'no vacancy rule'. It is not directly related to improving executive remuneration policies set by boards and is unlikely to enhance board diversity in and of itself.

There is already a high degree of visibility regarding the lack of diversity on public company boards, for example because of EOWA reporting, and scope for many boards to appoint additional candidates. But this has not driven a significant improvement in board diversity on public company boards (on the contrary the trend has worsened). Against this background it is hard to see how draft recommendation 1 would achieve better outcomes. In practice, the draft recommendation may have the perverse impact with companies responding by formally reducing the maximum size of their board.

The BCA also notes that the amendments to the Corporations Act would apply to all companies, not just public companies. This would include companies limited by guarantee, the structure often used by charities and not-for-profit organisations. Any unintended consequences for companies that are not public companies should therefore also be considered.

DRAFT RECOMMENDATIONS 10 AND 11: REMUNERATION CONSULTANTS

Draft recommendation 10: *The ASX listing rules should require that, where an ASX300 company's remuneration committee (or board) makes use of expert advisers, those advisers be commissioned by, and their advice provided directly to, the remuneration committee or board, independent of management.*

The BCA agrees with efforts to ensure that where the board considers executive remuneration issues, it should do so without undue influence from executives. The BCA therefore supports this intent of the draft recommendation, but considers that it would be more useful as a 'if not, why not' reporting requirement under the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations. In contrast with an ASX Listing Rule (where no data can be collected) this would allow, companies to explain their practices and use of consultants. Such an approach is more likely to provide useful information and data, which could in turn improve shareholder

understanding and the promulgation of best practice. Care should also be taken to ensure that any proposals do not discourage boards from seeking advice.

Draft recommendation 11: *The ASX Corporate Governance Council should make a recommendation that companies disclose the expert advisers they have used in relation to remuneration matters, who appointed them, who they reported to and the nature of other work undertaken for the company by those advisers.*

The BCA agrees that boards could be encouraged to report in more detail, and with more useful information, the types of issues and advice they considered when making executive remuneration decisions. The ASX Corporate Governance Council's Corporate Governance Principles and Recommendations are the best method of achieving that guidance, and enabling companies to make disclosures that are suitable to their own circumstances and useful for shareholders and the public.

The BCA is concerned about the potential for draft recommendation 11 to be overly prescriptive and to require disclosures that potentially undermines the usefulness of the information for shareholders. For example, the BCA opposes the requirement for boards to disclose the names of expert advisers and any specific details of the advice provided by those remuneration consultants. There are inherent problems with such a requirement including:

- Boards should not feel compelled to follow expert advice, yet reporting the names of advisors may be taken to imply that the board had followed the advice provided. Naming consultants may imply that the board's remuneration policies and decisions are endorsed by the named consultants and this will not always be the case.

- Advisers may not wish to be named, particularly if boards have not followed their advice or the adviser doesn't agree with the approach taken by the board. This may lead to confidentiality issues (particularly in respect of legal advice) or a reluctance of boards to seek expert advice. Specific confidentiality carve-outs would be required to allow boards not to disclose, if they are legally prohibited from doing so.

- Advice may be sought by a board from several experts. Many companies use a range of remuneration consultants for different purposes (benchmarking, incentive pay scheme design, equity-based pay valuation) and use different advisers for different categories of executives. Disclosure in these cases would be prolific and may add little value for shareholders. Boards should be able to retain the discretion to determine what information is useful for disclosure in these circumstances.

- Remuneration reports are already complex, and disclosing the 'nature of the work' undertaken by each remuneration consultant could increase the amount and complexity of information in the report – with little benefit to shareholders.

It is up to boards – and not consultants – to set remuneration policy and make remuneration decisions, and therefore the responsibility for the remuneration report and executive pay decisions rests with the board. Disclosure that the board makes about advice that they have received should be limited to what the board believes in its discretion is useful for shareholders to know.

The BCA therefore in principle endorses draft recommendations 10 and 11, but suggests a more appropriate place for both proposals would be through the ASX Corporate

Governance Council's 'if not, why not' guidelines. It is important to ensure that any guidance is practical, workable, retains the board's discretion on executive pay decisions and elicits useful information for shareholders.

DRAFT RECOMMENDATION 12: REQUIRE INSTITUTIONAL INVESTORS TO DISCLOSE

Institutional investors should disclose, at least on an annual basis, how they have voted on remuneration reports and any other remuneration-related issues. How this requirement is met should be at the discretion of institutions.

In general, the BCA has concerns about whether this proposal is able to be implemented from a legal and practical perspective. Some issues that arise with respect to this draft recommendation are:

- Annual disclosure is not timely or useful in a practical sense, for example, the investor may have sold the shares long before the disclosure.

- How is the term 'institutional investors to be defined? Does it, for example, mean all large shareholders? Is there a size cut-off? Or is it only institutions who manage money on behalf of others?

- It is unclear why an institutional shareholder should not have a right to privacy in respect of their voting, or should be treated differently than other shareholders. Their clients may have a different perspective on this.

- It is possible that such a disclosure requirement will inhibit rather than encourage institutional holders from voting or voting against board-supported resolutions. Institutional investors may wish to avoid public conflict or the need to articulate reasons publicly from voting at all or from voting against board-supported resolutions.

- Institutions are quite capable of communicating their concerns about remuneration policies directly to boards, privately and in a timely manner, without legal requirement to do so.

The BCA therefore believes this proposal imposes an administrative compliance burden on investors with little or no likely benefit in terms of executive remuneration policies or shareholders more generally.

DRAFT RECOMMENDATION 8: ADDITIONAL REMUNERATION REPORT DISCLOSURES

Section 300A of the Corporations Act 2001 should be amended to specify that remuneration reports should additionally include:

- *a plain English summary statement of companies' remuneration policies*

- *actual levels of remuneration received by executives*

- *total company shareholdings of the individuals named in the report.*

Corporations should be permitted to only disclose fair valuation methodologies of equity rights for executives in the financial statements, while continuing to disclose the actual fair value for each executive in the remuneration report.

On the face of it, much of draft recommendation 8 is able to be supported in principle, particularly where the requirements are likely to increase the useful information for shareholders and facilitate greater understanding of the executive remuneration report.

Once again, however, the BCA has some concerns about how such a legal requirement will be adhered to and monitored effectively in practice and the relative costs and benefits.

- Past experience has demonstrated that adding reporting requirements can instead increase the complexity and number of pages of reporting. For example, concise annual reports have proven to have varying degrees of success, as they have been seen to add an additional layer of reporting burdens and costs and have not necessarily benefitted shareholders.

- Companies will most likely have to obtain legal advice to ensure that they have drafted a 'plain English' summary. It is difficult to see how the concept of 'plain English' can be appropriately defined in the law or how companies will comply with the requirement from a legal perspective.

- Does the summary document have the same auditing requirements under the accounting standards as the bulk of the remuneration report? Even if auditing is not legally required, most companies will feel compelled to seek auditor sign-off to ensure consistency with the full remuneration report, thereby adding compliance effort and costs to annual remuneration reporting.

- Actual remuneration received by executives will often be delayed, for example, by a year following the remuneration report because determination of bonuses and long-term incentives may not be settled by the time the remuneration report is published.

- Current laws appropriately require full disclosure of unvested shares and options issued to key management personnel. Disclosure of company shareholdings of individual executives (other than executive directors) is unnecessary and unrelated to remuneration. Executives are entitled to purchase shares in the company and should be encouraged to do so. However, such acquisitions are a private matter for individuals and should not be required to be made public. Requiring the publication of such information may perversely discourage executives from holding shares in the company.

- Aggregated shareholdings are, likewise, irrelevant to remuneration matters and provide little useful or relevant information to shareholders. For example, retirement of one executive who holds a lot of shares will cause the aggregate to go down. Unless explained in detail, shareholders might be misled into thinking that the executive team, as a whole, was reducing their holdings in the company.

Ultimately, the ability for companies to implement this recommendation, and the usefulness of the additional information for shareholders, will depend on the detail of the

requirements and the definitions contained in the requirements. Care must be taken to ensure that additional reporting burdens are not overly prescriptive, will benefit shareholders and will not impose undue costs or burdens on business.

DRAFT RECOMMENDATION 9: CONFINE DISCLOSURE TO KEY MANAGEMENT PERSONNEL

Section 300A of the Corporations Act 2001 should be amended to reflect that individual remuneration disclosures be confined to key management personnel. The additional requirement for the disclosure of top five executives should be removed.

The remuneration report currently requires the disclosure of the remuneration of the five most highly paid executives and key management personnel. As stated in the Productivity Commission's discussion draft, the inclusion of the five most highly paid executives is an historical "legacy" that arises from a time when *"there was no coherent interaction between the Corporations Act and Australian Accounting Standards"*.[4]

The BCA strongly endorses the draft recommendation 9 to confine remuneration disclosure requirements to the CEO and key management personnel (in conformity with the key management personnel definition in the Australian Accounting Standards), on the basis that this recommendation:

- reduces some excessive and outmoded remuneration disclosures;
- introduces some clarity and transparency to remuneration reporting;
- reduces upward pressure on remuneration outside key management personnel ranks;
- reduces business compliance burdens, especially on smaller companies; and
- ensures that disclosure focuses on individuals who, by virtue of their role, are able to influence their own pay or materially affect the management of the company.

However, the BCA does not believe that reporting 'other' key management personnel collectively in bands (especially if that requirement goes beyond the definition of key management personnel in the Australian Accounting Standards Board standard 124) would benefit disclosure or shareholders.[5]

Such an approach would undermine the benefits to be gained from modernising and enhancing the disclosure requirements by removing unnecessary disclosures (as outlined in the dot points above). The Productivity Commission's discussion draft found that participants signalled *"little interest in remuneration details beyond the CEO"*. Accordingly, there appears to be little reason for requiring disclosure of remuneration for personnel who are not of specific interest to shareholders and who are unable to influence their own pay or materially affect the management of the company.

[4] Discussion draft, page 313

[5] Discussion draft, page 313

DRAFT RECOMMENDATION 4: VOTING BY DIRECTORS AND EXECUTIVES

The Corporations Act 2001 should specify that company executives identified as key management personnel and all directors (and their associates) be prohibited from voting their shares on remuneration reports and any other remuneration-related resolutions.

The aim of this proposal is to avoid a conflict of interest associated with directors and executives voting on their own remuneration. The BCA supports the intention of the draft recommendation, as it is already a well-understood principle that directors and executives should not vote on their own remuneration.

However, extending the prohibition from voting on remuneration issues to "associates" of directors and key management personnel could have some significant unintended consequences.

For example, in an organisation in which a major shareholder has appointed a nominee board member, the shareholder may be prohibited from voting on the remuneration report. This risks disenfranchising a major shareholder and giving minority shareholders undue power to vote on remuneration issues. This may discourage investment in Australian companies (whether domestically or from overseas) because of the risk it poses for major shareholders. Major shareholders would expect to have a say on important strategic issues such as remuneration issues.

The risks associated with prohibiting major shareholders from voting on remuneration reports are enhanced when considered in light of draft recommendation 15. For example, if a major shareholder were not entitled to vote, then a minority shareholder's votes may be enough to record a 'strike' under the 'two-strikes' proposal.

DRAFT RECOMMENDATION 6: UNDIRECTED PROXIES

The Corporations Act 2001 and relevant ASX listing rules should be amended to prohibit company executives identified as key management personnel and all directors (and their associates) from voting undirected proxies on remuneration reports and any other remuneration-related issues.

The aim of this proposal is remove the likelihood that directors (for example chairmen) are able to vote undirected proxies on issues where they may otherwise be prohibited from voting.

The draft proposal raises some practical issues in terms of proxy forms and how this would be administered. Complex and potentially confusing wording would be needed in proxy forms. For example:

- Information would be needed in the proxy form highlighting that the chairman, key executives or directors would be unable to vote on remuneration issues unless the proxy is directed.

- The company would need to guide shareholders, by identifying a suitable person that could vote undirected proxies (presumably a person who is not a board member or key management personnel). The company would also need to explain that

nominated person's intentions with respect to voting undirected proxies on remuneration issues.

The effect of this is to introduce unnecessary complexity into the proxy arrangements with little added benefit for remuneration governance.

In addition, there is no clear policy reason for this proposal to be extended to "associates". Accordingly, the policy implications and any possible unintended consequence of the inclusion of "associates" should be carefully considered.

SUMMARY COMMENTS ON THE REMAINING DRAFT RECOMMENDATIONS

The BCA makes the following summary comments in respect of the remaining draft recommendations:

- ***Draft recommendation 2*** proposes that it should be an ASX Listing Rule requirement for all ASX300 companies to have a remuneration committee. The BCA supports the approach of encouraging a broader cross-section of listed companies to establish a remuneration committee. However, if this were to become a Listing Rule then appropriate guidance would need to be considered. Additionally, draft recommendation 2 would need to be made consistent with draft recommendation 3 in terms of the requirements for the make-up of the remuneration committee. In our view, it would be appropriate for the Listing Rule to specify that the remuneration committee should, consistent with the ASX Corporate Governance Council Guidelines:

  - have at least three members;
  - be comprised of a majority of independent directors; and
  - be chaired by an independent director.

- ***Draft recommendation 3*** is supported by the BCA, as it enhances the current 'if not, why not' framework around remuneration committees.

- ***Draft recommendation 5*** dealing with hedging of unvested and vested shares subject to holding locks is supported. This is already recommended in the ASX Corporate Governance Council guidelines and already reflects good practice for large listed Australian companies.

- **Draft recommendation 7** is supported in principle.

- The BCA strongly supports ***draft recommendation 13*** as it:

  - gives boards greater flexibility to award deferred equity incentives;
  - allows post-termination vesting without tax penalty to executives concerned; and
  - is consistent with sensible tax position for all share-based remuneration – shares should not be taxed until final vesting.