Business Council of Australia

Submission to the Treasury regarding the Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012 Exposure Draft

MARCH 2013

EXECUTIVE SUMMARY

This is the Business Council of Australia (BCA) submission to the Treasury regarding the exposure draft of the Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012.

The exposure draft includes a number of proposed amendments, including most notably requirements for:

- listed disclosing companies to disclose details of present pay, future pay, and past pay for key management personnel (KMP)
- listed disclosing companies whose financial statements have been materially misstated to either disclose whether any overpaid remuneration to KMP has been 'clawed back', or if no reduction, repayment or alteration of overpaid remuneration has been made, an explanation of why not.

Our comments on the exposure draft concentrate on these two amendments. In summary, we do not support the Bill in its current form based on a number of concerns that we hold in relation to these requirements. Notwithstanding the worthy aim of the Bill to bring greater clarity to remuneration reporting, it is our assessment that:

- **The requirement for disclosure of past, present and future pay is likely to increase compliance burden, without providing additional clarity for investors**: the new remuneration disclosure requirements will not simplify or bring greater clarity to the reporting of executive remuneration as intended. In reality, they will add a new layer of reporting, while potentially increasing shareholder confusion and compliance burden for companies.
- **Reporting of past, present and future pay has not been thoroughly tested with stakeholders**: remuneration disclosures were examined by both the Productivity Commission and the Corporations and Markets Advisory Committee in 2010 and 2011 respectively as part of broader inquiries into executive remuneration. As far as the BCA is aware, since this time there has been no consultation with stakeholders or more detailed analysis of specific remuneration reporting options to advance the findings of these reports. The Explanatory Memorandum for the Bill suggests that the measures contained in the Bill are minor and machinery in nature, with no compliance cost impact. Therefore, no regulatory impact statement has been prepared. However, preliminary feedback from BCA members suggests that at a minimum there will be up-front costs for many companies in understanding the requirements and making necessary adjustments to produce a remuneration report that complies with the past, present and future pay requirements.
- **Clawback provisions would be better dealt with outside legislation**: The BCA supports the principle of clawing back overpaid remuneration where financial statements are found to be subsequently materially misleading. However, this requirement would be better dealt with in the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, rather than in legislation. This is especially the case since the clawback requirements in the draft Bill are couched as an "if not, why not" disclosure requirement, the very foundation on which the Corporate Governance Principles and Recommendations are built.

On the basis of these concerns, we recommend that:

- For the time being, the government remove the proposed amendments for companies to disclose present, future and past pay for KMP. If the government does want to legislate to simplify and increase the transparency of executive remuneration reporting to meet the interests of both companies and shareholders, then the best prospect of this succeeding would be through a thorough and broad process of consultation, similar to that undertaken by the Financial Reporting Laboratory in the United Kingdom. In the absence of a thorough process of consultation and undertaking a Regulatory Impact Statement or options analysis, it is our belief that attempts to legislate in this area are likely to do more harm than good for both shareholders and companies.
- The government request that the ASX Corporate Governance Council address the issue of clawback of overpaid remuneration due to financial statements being materially misstated, in the forthcoming update of its Corporate Governance Principles and Recommendations.

Nature of current disclosures and the regulatory environment

As a starting point, it is imperative to understand the current nature of remuneration disclosures by leading Australian companies. The average length of remuneration reports for the top 20 ASX companies in 2012 was around 14,000 words.

The considerable focus on remuneration disclosures is also reflected in the board's use of time, with an Australian Institute of Company Directors survey finding that almost 50 per cent of directors listed the remuneration report as amongst the most time consuming disclosures for boards. This is despite the fact that less than 10 per cent of those surveyed felt that it should consume the majority of the board's time and focus.

The complexities associated with reporting modern, sophisticated incentive payment structures present significant challenges for prescriptive legislative approaches in dealing with these issues. Effective company-specific approaches that emerge need to be supported, not discouraged or constrained by new regulations.

On this basis, a principles-based approach to remuneration reporting is often preferable, with boards determining the most appropriate and meaningful information that enables investors to make an informed assessment of remuneration practices.

Where the government is intent on legislating corporate governance practices such as remuneration reporting, then there is a need for a detailed and rigorous process including consultation with both companies and shareholders. This is the best way to increase the likelihood that the proposal actually meets the intended outcomes for shareholders without distorting the focus of company boards, introducing unnecessary costs or having unintended consequences.

The ultimate objective of a company's executive remuneration policies is to align executive pay with company performance and shareholder value, and communicate this effectively to shareholders. Many companies already provide information such as 'actual remuneration' tables in remuneration reports and seek to outline remuneration in a clear and effective manner.

There are also already strong mechanisms and incentives for companies to do this. For example, there are formal mechanisms such as the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, and best practice guidance and codes of conduct developed by groups such as the Australian Institute of Company Directors and Chartered Secretaries Australia.

Companies and their directors also have a very strong interest in upholding their professionalism and reputation. Scrutiny and analysis of company practices and in particular the remuneration of executives is more intense than ever before with the advent of social media, along with greater financial analysis and commentary. The recently introduced 'two-strikes' policy means that companies also face the prospect of strikes and threats of strikes against remuneration reports.

Australia's corporate governance institutions are relatively well placed to deliver effective corporate governance and constructive shareholder engagement in areas like executive remuneration without the need for legislative intervention. For example, the World Economic Forum places Australia fourth in the world on the efficacy of corporate boards, eighth on the strength of auditing and reporting standards and eleventh on the ethical behaviour of firms.

There has been substantial change to corporate governance regulation over recent years and the BCA is strongly of the view that now is the time for consolidation. This includes consolidating disclosure requirements rather than increasing them.

Past, present and future pay disclosure

The Bill establishes a requirement that listed companies disclose for their key management personnel:

- the amount that was granted before the financial year and paid to the person during the financial year (past pay)

- the amount that was granted and paid during the financial year (present pay)
- the amount that was granted but not yet paid during the financial year (future pay).

The BCA considers that instead of bringing greater clarity to remuneration reporting, this requirement will add a new layer of reporting, while potentially increasing shareholder confusion and compliance burden for companies. In other words, companies will now be required to disclose past, present and future remuneration paid in the reporting period, to supplement rather than replace the existing remuneration disclosures.

Our concerns are that:

- By including two sets of remuneration figures for each executive, it is inevitable that remuneration reports will require further explanatory notes in order to identify the reasons for differences between the two sets of reported numbers. Therefore the length of remuneration reports are likely to increase without providing additional clarity.
- Including future pay in the table with present and past pay will lead to double counting. That is, future pay in one year will be shown as past pay in a later year.
- The requirements separate remuneration disclosure from company performance in the current financial year, by requiring companies to include performance pay in the reporting period in which it is paid, rather than the reporting period in which it is earned. This could exacerbate the perception in some cases that poor current performance is being rewarded, when the reward actually relates to strong historical performance.
- Concepts of ‘paid’ and ‘granted’ are not clear, further underlying the difficulty of applying black-letter law to matters of corporate governance where companies will have different remuneration policies and understandings of these terms.

On the basis of these concerns, the BCA does not support this requirement in the Bill in its current form as there is a significant risk that legislative intervention is likely to do more harm than good, despite the worthy aim of the Bill to bring greater clarity to remuneration reporting.

The process for pursuing reform

If the government insists on legislative intervention to simplify remuneration reporting for the benefit of both shareholders and companies, then there would be a greater likelihood of achieving this outcome by adopting a rigorous, detailed process to consider a range of options and consult with companies, shareholders and other stakeholders. The kind of process adopted by the Financial Reporting Lab in the United Kingdom in pursuing reforms may be a useful benchmark.

In our view, the process employed in developing these amendments has not been geared to achieve the best possible outcome. While detailed reports on executive remuneration have been undertaken by the Productivity Commission (2010) and Corporations and Market Advisory Committee (2011), considerable time has passed since these reports were undertaken.

During this time, as far as the BCA is aware there has been no consultation with stakeholders or more detailed analysis of specific remuneration reporting options to advance the findings of these reports. In the absence of consultation with companies, we question the suggestion of the Explanatory Memorandum that the amendments are minor or mechanical in nature and do not have associated compliance costs. Preliminary consultations with some BCA members regarding these amendments has suggested that at a minimum there will be upfront costs for many companies in understanding the requirements and making necessary adjustments to produce a remuneration report that complies with the past, present and future pay requirements.

Clawback of remuneration

The Business Council of Australia supports the principle of clawing back overpaid remuneration where financial statements are found to be subsequently materially misleading and notes that many companies already have clawback provisions in place. However, this requirement would be better dealt with in the ASX Corporate Governance Council's *Corporate* Governance Principles and Recommendations, rather than in legislation. This is especially the case since the clawback requirements in the draft Bill are couched as an "if not, why not" disclosure requirement, the very foundation on which the Corporate Governance Principles and Recommendations are built.

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