CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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Geoff Miller
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The Treasury
Langton Crescent
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By email to: CFScomments@treasury.gov.au

Dear Mr Miller

Non-recourse loans provided to executives

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We represent over 8,000 governance professionals working in public and private companies, all of whom are involved in governance, corporate administration and compliance with the Corporations Act (the Act). We have drawn on their experience in our submission on the adequacy or otherwise of the regulations governing the use and disclosure of non-recourse loans as part of executive remuneration.

CSA recommendation

CSA recommends Option 1 (page 9 of the discussion paper) to Treasury, that is, maintain the status quo.

The reasons for our support of Option 1 are that the current regulatory framework:

- requires disclosure in the annual report of non-recourse loans used as part of remuneration packages for executives, who are 'key management personnel' or in the top five most highly remunerated officers; and to the extent that the disclosure is material requires immediate disclosure under ASX Listing Rule 3.1
- also requires shareholder approval where companies provide executives with financial assistance to purchase shares (s 260A (1)), and in the case of an executive director, confer a financial benefit on a related party (unless an exception applies)
- also requires shareholder approval under the Australian Securities Exchange Listing Rules of the issue of shares exceeding 15 per cent of capital (and many companies adopt the practice of obtaining shareholder approval under an exemption to this requirement on a three-year basis for issues under share plans to executives and employees)

- permits a reasonable balance between shareholder protection and providing the board with the flexibility to make a commercial decision with regard to the company's circumstances.

CSA notes that the provision of non-recourse loans to executives is not unregulated at present.

Under the current regulatory framework:

- board accountability on remuneration is embedded in both the fiduciary duties of directors and the requirement to report to shareholders in the remuneration report
- shareholders have the opportunity to be involved in the remuneration framework through the disclosures of the remuneration report and the non-binding vote on that report.

An effective board is one that discharges its duties imposed by law and adds value to the particular company's circumstances. A key responsibility is to review and challenge the performance of management, and remuneration of executives is an integral aspect of this responsibility.

CSA believes that generally boards do take their responsibilities in relation to executive remuneration seriously. Great care is taken to select executive remuneration schemes that meet the specific needs of the company. Non-recourse loans are not widely used or abused and where utilised are transparent and required to be reported to shareholders via the remuneration report.

Option 2: Greater shareholder oversight of non-recourse loan schemes

CSA does not support Option 2.

The current regulatory framework governing executive remuneration does not regulate the types of remuneration packages that boards may structure for executives. Remuneration decisions are viewed as commercial decisions taken by a board.

CSA notes that corporations legislation recognises the role directors play as agents for shareholders, with their fiduciary duties to act in the best interests of the company as a whole encompassed by statute and common law.

CSA notes that governance bodies, including proxy advisory services, examine closely the remuneration schemes of companies. A company's remuneration scheme, including its employee share ownership scheme, must be able to be justified and defended, with the rationale behind it made clear to shareholders.

Accordingly, there is already market scrutiny and pressure in relation to the setting of appropriate remuneration structures.

Option 3: Banning non-recourse loans

CSA does not support Option 3.

CSA does not believe that regulators should second-guess commercial decisions designed to attract and retain executive staff.

Boards need to consider what is appropriate in terms of performance requirements when structuring executive remuneration. Over time, what is appropriate may change and views of shareholders and governance organisations also change. This is reflected in the current debate regarding what might be regarded as meaningful and relevant performance hurdles for the vesting of options and performance rights — there was a growing trend to adopt total shareholder return, but there are now questions about the appropriateness of this as a universal measure.

If a loan plan is regarded as the most appropriate plan in the company's circumstances there are various ways in which it might be structured. However, banning non-recourse loans and leaving only full-recourse loans may not present the same level of incentive to executives, when the plan is intended to be structured to reward. Some companies have introduced performance hurdles in order for the loan repayments to be made through the application of dividends. The other point to bear in mind is that, while described as non-recourse, technically the loans are limited recourse, as there is recourse to the underlying shares.

Conclusion

CSA recommends that the current regulatory framework be maintained, that is, Option 1. Our comments are offered within the context of seeking a framework that balances shareholder engagement and participation with a structure for efficient management and decision-making in a company.

In preparing this submission, CSA has drawn in particular on the expertise of its national Legislation Review and Corporate and Legal Issues Committees.

Yours sincerely\

Tim Sheehy

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CHIEF EXECUTIVE