CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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The Treasury

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Dear Mr Rogers

Corporations Amendment (Improving Accountability on Termination Payments) Act 2009: Review

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals in Australia. It is the leading independent authority on best practice in board and organisational governance and risk management.

Our members have primary responsibility to develop and implement governance frameworks in public listed, unlisted and private companies, and not-for-profit and public sector organisations.

CSA welcomes the opportunity to comment on the review of the Corporations Amendment (Improving Accountability on Termination Payments) Act 2009 (the Act).

General comments

CSA Members are of the view that the Act has fulfilled the policy objectives of addressing community and political concern with excessive termination payments provided to departing executives. The considerable disquiet that shareholders could experience in those instances when termination payments were granted during or following a period of poor company performance has been tempered by the introduction of a limit in relation to termination payments, and payments beyond that limit being subject to shareholder approval.

However, CSA is strongly of the view that the extension within the Act beyond the key management personnel (KMP) of the parent company — those whose termination payments were the focus of community and political concern — to a wide range of executives, does not fulfil the policy objectives of the legislation. The legislation captures a much wider range of executives than the KMP, as it also captures any executive serving as a director on a subsidiary company. This extension of the legislation beyond the group whose remuneration and termination payments are of interest to shareholders creates very real practical difficulties for individuals and companies without achieving any benefit to shareholders.

We set out our concerns in more detail below.

Do you consider that the reforms in the Act achieved its objectives?

CSA Members recognise that the previous '7 x total remuneration' regime could result in excessive termination benefits being paid to departing executives without shareholder approval of such payments. As executive remuneration levels increased and within the context of a few instances of 'golden handshakes' after a period of poor performance, shareholder and community concern with such termination payments grew.

As noted earlier, the Act has achieved the policy objective of addressing community and political concern with excessive termination payments provided to departing executives.

Notwithstanding this, we remain of the view that the '1 x base cap' is not comparable to similar jurisdictions such as the United States, the United Kingdom or Canada, and as such it has the potential to limit Australian companies' competitiveness when accessing the international talent pool. Each of the jurisdictions mentioned above has particular market practice in relation to remuneration. When an Australian parent company has subsidiaries in these or any other jurisdiction, any executive serving as a director on the board of the subsidiary is captured by the Australian legislation and limit. These executives, as well as executives appointed as directors on Australian subsidiaries, are not necessarily being paid a fee to serve as a director, yet they are captured by the termination provisions of the Corporations Act. The wide pool of individuals to whom the legislation applies can therefore severely restrict a company's ability either when recruiting in Australia or other jurisdictions or when making any payment to a departing employee. This is despite the fact that the Corporations Act requires companies to report on the remuneration of KMP, reflecting shareholder interest in the remuneration of and termination payments of executives who have the ability to affect the direction of a company, rather than the remuneration of non-KMP executives serving as directors on subsidiary boards, whose remuneration is not material to shareholders.

Under the proposed amendments to the Corporations Act contained in the Corporations Legislation Amendment (Remuneration and Other Measures) Bill 2012, from 2014 companies will be required to report in their remuneration reports on termination payments to KMP. This confirms that is the remuneration of the senior management of the parent company in whom shareholders are interested, rather than middle management employees appointed to subsidiary boards and to which the position of director usually forms a de minimus part of the employee director's role and whose remuneration is not material to shareholders.

The result of this is that a number of companies have sought shareholder approval to make payments to middle management executives under existing remuneration arrangements, which in turn has caused confusion for shareholders, who query why such matters relating to employees who are not at the senior management level are put before them at a general meeting when they have no interest in them.

There is, of course, also an additional compliance burden placed on companies as they must review any termination payment to *any* executive serving on a subsidiary board globally on a continuing basis, to ensure that all termination payments above the cap are put before shareholders. This can occur despite the fact that underlying remuneration structures have not changed.

What do you consider to be the main impacts of the reforms, both direct and indirect? (for example, enhanced engagement between boards and shareholders in relation to the determination of termination payments.)

The main impacts of the reform are both positive and negative.

Positive impact

The positive impact is that there has been increased engagement between boards and shareholders, particularly when seeking shareholder approval for a termination payment to KMP. There has also been increased engagement between boards and proxy advisory firms on these matters.

Negative impacts

Unfair treatment of non-KMP directors
The disadvantage to executives in Australia and other jurisdictions who are offered board positions on subsidiary boards is significant. In many instances, the executive is assisting the company by taking on a board position on a subsidiary board.

The reasons behind a request for an executive to consent to act as a director can be either as a consequence of local law, the desire to 'upskill' an executive or a combination of both.

For example, foreign local company law may require a director who ordinary resides in the local jurisdiction. While companies are aware that the role needs to benefit the individual as well as the company, these executives are not necessarily remunerated for taking on the position of director. In Australia, depending on specific industry requirements, executives with particular skills (such as real estate) may be requested to act as directors on subsidiary companies to enable a corporate group to comply with relevant state legislation.

Initiatives by companies to improve gender balance at senior executive and board level can also include the appointment of women to subsidiary boards, and these initiatives may also be hindered by the termination payment provisions.

Many companies have been keen to progress gender balance at senior levels by offering female executives a position as a director on a subsidiary board. In many instances, the executives are in middle management and are being offered an 'upskilling' opportunity — they are business unit managers and not senior at the scale of the parent company itself. The board position provides them with access to the next level of management. This in turn provides an opportunity for women to develop board-level skills, which over time increases the pool of female talent available for board positions generally.

The intent to 'upskill' these women, as well as non-KMP men being offered subsidiary board positions either in Australia or overseas, can be hampered by the application to these executives of the termination payment provisions. That is, even though their potential termination payment is not at a level that would concern the company's shareholders or the community, the nature of the definition of benefits in the legislation means that the calculation of termination payments to these middle managers could result in a payment greater than the '1 x base cap'.

The executive may have been with the company for some years and have built up equity over time. Should that executive's position be terminated, any termination payment beyond the '1 x base cap' is subject to shareholder approval, even when the quantum of payout is not material to shareholders. When this is explained to executives, many, quite understandably, refuse the board position in order not to place themselves at risk of having a potential termination payment subject to shareholder approval (particularly when this is at odds with local laws and practice). They are therefore disadvantaged as they are not able to take up the opportunity to develop senior-level executive and board-level skills, despite the fact that their remuneration and any potential termination payment is not material to shareholders, whose primary concern is with the KMP of the parent company.

The calculation of the ‘1 x base cap’ payment is, naturally, subject to the previous year’s remuneration experience of the executive. However, the mechanism used in Part 2D.2 to calculate the ‘1 x base cap’ has the inadvertent result of penalising those employee directors who serve on the board of a subsidiary for less than 12 months. In such circumstances, rather than grossing up the base cap, the legislation limits that person’s base cap to the period in which they were a director (regardless of whether they have been employed with the organisation for more than 12 months). If, for example, a female executive accepts a board position on of a subsidiary after a period of maternity leave and her position is terminated, the payment limit is calculated on her six months’ remuneration post-maternity leave — not a full year’s remuneration — which reduces the base for calculation significantly. Other executives, male and female, who are on a subsidiary board, but then go on unpaid leave (for example, parental leave or study leave) but choose to remain on the subsidiary board during that time, are penalised by the calculation mechanism used in Part 2D.2, because it focuses on remuneration received during that time, and as such, these employees would have a lower base threshold.

Other executives may have been sent offshore and be asked to serve on a subsidiary board. They may resign from their position after a period, and due to being on the subsidiary board, their termination payment will be subject to shareholder approval. That is, the mechanism for calculating the ‘1 x base pay’ limit particularly disadvantages executives whose role has been made redundant and who have served on a subsidiary board for less than 12 months.

The disadvantage to such executives, whose remuneration is not material to shareholders, is massive. Many companies have found executives in other jurisdictions unwilling to serve on subsidiary boards as a result of being captured by the Australian legislation.

Negative impact for shareholders

There are also disadvantages to shareholders. The reluctance of middle management or other non-KMP executives in taking up ‘upskilling’ opportunities reduces the pool of talent available internally for senior executive roles.

In particular, with the desire for companies to increase the number of female executives in senior positions, the hampering of women in taking up subsidiary board appointments in Australia and other jurisdictions restricts efforts by companies to improve gender balance. This is not to the advantage of shareholders.

In other instances, a role may be made redundant, but the executive is retained as a non-executive director position on a subsidiary board, due to the depth of knowledge they bring and which the company does not wish to lose. Any fees paid to the non-executive director are potentially included in the calculation of ‘1 x base pay’. The executive will step down from the board rather than breaching the cap. This is detrimental to the business, as the expertise and knowledge that individual brings to the board is lost. CSA Members are of the view that this disadvantages shareholders.

Are you aware of any examples where a board was required to obtain shareholder approval for a termination payment? If so, what was the outcome?

A number of CSA Members have experience of their company seeking shareholder approval for termination payments, in the following forms:

- a generic pre-approval for affected classes of persons under company-wide remuneration practices as disclosed in the remuneration reports (generally for three years)

- pre-approval for specific individuals under company-wide remuneration practices as disclosed in the remuneration reports (generally for three years), and
- specific approval for individuals under particular circumstances of those people's departures.

In relation to the third instance of approval being sought, CSA Members have experience of having to seek shareholder approval of payments to executives in other jurisdictions who served on subsidiary boards, but whose remuneration and termination payments were not material to shareholders, yet who were caught by the legislation. In each instance, shareholders have queried why the termination payment was put before them. Shareholders continue to confirm that their interest in termination payments is limited to KMP and does not extend to executives serving on subsidiary boards in other jurisdictions.

Have there been any unintended consequences as a result of the Act?

The Act applies to persons holding a 'managerial or executive office' with a company. This applies to all persons whose details are included in the remuneration report (the KMP), and extends to persons who have at any time in the previous three years held a 'managerial or executive office' in a company or a related body corporate.

Large listed companies can have over 100 subsidiaries in Australia and overseas. These companies are subject to the legislation in respect of the subsidiary directors and executives both in Australia and overseas.

As noted above, the main unintended consequence is that executives serving on subsidiary boards of the Australian parent company are captured by the Act, and this has seen middle management, particularly female middle management, disadvantaged in relation to being able to take up 'upskilling' opportunities. This is despite the fact that there is no public benefit to shareholders in capturing payments made to middle management in the parent company, or external nominee directors of subsidiary companies. CSA Members are of the view that, ultimately, shareholders are disadvantaged as their companies cannot develop executives internally to the degree that would be of benefit to their investors.

CSA strongly recommends that the Act be amended to apply only to the KMP on a consolidated basis, that it, it should apply only to the KMP of the parent company and would no longer extend to directors serving on subsidiary boards.

In preparing this submission, CSA has drawn on the expertise of the members of our two national policy committees. We would be more than happy to meet with you to discuss our comments.

Yours sincerely

Tim Sheehy

Tim Sheehy
CHIEF EXECUTIVE