



Investment & Financial Services Association Ltd

ABN 82 080 744 163

30 July 2009

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr Hawkins

Re: IFSA submission on the Senate's inquiry into termination benefits

Thank you for the invitation to provide input on the Senate Economics Committee's current inquiry into the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009*. We greatly appreciate the extension of time during this busy period to lodge our submission.

IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 145 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

IFSA members, both as the custodians and managers of other peoples' money and as institutional investors in their own right, have a vested interest in ensuring that there is an alignment of remuneration with risk management both in their own operations and the companies in which they invest.

As major holders of listed capital in Australia on behalf of superannuation funds and investors, we remain concerned that proposed reforms to termination benefits will have the unintended consequences of changing remuneration structures by further encouraging short term actions, rather than longer term planning and incentives.

In order to attract and retain executives, companies may consider increasing or changing the composition of benefits paid during the life of the employment relationship and reducing that which is paid on or after termination. Undesirable consequences may include higher base salaries and an increase in the use of cash remuneration. We submit that this is inconsistent with recently stated Government policy and regulatory approaches internationally.

In providing for prescriptive regulation of remuneration we believe there is a need to avoid unintended results which operate against good governance practice. We strongly believe it is the ultimate responsibility of the Board of Directors to approve the design of all equity plans and take specific responsibility for hiring key executive staff and approving the terms of their

employment. We also believe that transparency, accountability and fairness are all key principles that should guide companies when designing equity plans for Executives and Directors.

We submit that listed entities are already subject to considerable regulatory requirements that create a more transparent environment, in particular the non-binding vote of shareholders on the remuneration report at a company's annual general meeting. Further, along with IFSA's Guidance Note No. 2 (titled: 'Corporate Governance: A Guide for Fund Managers and Corporations'), the ASX Corporate Governance Guidelines recommend that listed entities establish a remuneration committee responsible for overseeing a company's remuneration policy and making recommendations to the full Board of Directors. The majority of top ASX listed entities comply with the ASX Corporate Governance Guidelines in this respect.

IFSA's Guidance Note No. 2 - Corporate Governance: A Guide for Fund Managers and Corporations ('IFSA Blue Book') also provides guidance on board and executive remuneration policy and disclosure. These Guidelines were launched in 1995 and have become widely accepted by the investment and corporate community as providing guidance for corporate governance in Australia.

Compliance with Guidance Notes is voluntary but strongly encouraged and widely promoted as industry best practice. IFSA's Guidance Notes are publicly available on IFSA's website (www.ifsa.com.au) and IFSA members encourage all Australian listed companies to comply with these Guidance Notes.

In reference to the draft legislation, we welcome further consideration of the following matters:

- Base salary threshold

We note that the Exposure Draft proposes to limit termination benefits to one year's average base salary compared to the current maximum limit of seven times total annual remuneration. Many remuneration structures for executive provide that base salary is less than 50 per cent of total remuneration, with the balance of remuneration being performance-based.

In these cases, the proposed legislation effectively limits termination payments to less than six months total remuneration. The consequence of this will be to require shareholder approval for a greater number of individuals than may have been intended.

As far as we are aware, there is no comparable jurisdiction that has a prescribed shareholder approval as low as one year base pay. IFSA believes that remuneration arrangements for executive talent need to be globally competitive. If the Exposure Draft is enacted as currently drafted, IFSA considers it will be increasingly difficult for Australian companies to compete for high performing executives in the global market. The proposed base salary threshold in Australia will be out of step with most other developed countries which either do not impose caps, or where caps do exist, they are generally only applied to the Board and most senior executives and are frequently based on total remuneration rather than base salary.

It is important Australia remains in step with other comparable jurisdictions in order for our potential as a financial services hub to be realised, an initiative currently sponsored by the Government

IFSA recommends that any reduced threshold be consistent with other comparable jurisdictions and applied to total remuneration rather than base salary. A broad definition should include common elements of salary packages such as cash wages or salary, superannuation contributions, non-monetary benefits (e.g. motor vehicles, office equipment and child care), salary sacrifice arrangements (e.g. novated lease arrangements, employee shares, child care

payments) and commission payments provided for under the terms of employment (as distinct from discretionary performance based payments and benefits).

- Deferred bonus exemption

IFSA welcomes the inclusion of an exemption from the restrictions for deferred bonuses. However, the term "deferred bonus" will need to be clearly defined in the legislation to avoid uncertainty and any unintended impact on prudent and well balanced remuneration structures. In particular, the definition of "deferred bonus" should include bonuses in the form of equity or other property and bonuses which are subject to retention under vesting or other conditions. We consider it important that investors have the option to have a significant proportion of current year bonus deferred over a vesting period and for a significant proportion of deferred bonus to be invested in equity. This will assist in aligning the interests of employees with the long term interests of shareholders and the company.

IFSA also believes that typical "good leaver" provisions in deferred bonus arrangements should be covered by the same exemption as ordinary delivery of deferred bonus. Examples of this include provision for the early release of deferred bonus in the case of death, disability, illness, redundancy or genuine retirement of an executive. Bonus which has been earned for past performance but is retained for staff retention and alignment purposes should not be deemed to have lost its character as "deferred bonus" where it is released on such grounds. The reason deferred bonus arrangements commonly give the employer the discretion to release bonus in these circumstances is that the retention and alignment objectives of deferral are no longer at issue, and imposition of continued deferral or forfeiture rules would be seen as unfair by other staff and may erode the retention and alignment objectives of the overall scheme. For these reasons, IFSA submits that the definition of deferred bonus should include limited provision for early release of deferred bonus in the above circumstances.

- Superannuation

Like deferred bonus arrangements, superannuation is a mechanism for future delivery of remuneration which has been earned and accounted for in previous years. Rather than a termination benefit provided by the company, superannuation should simply be seen as a pooled savings account into which statutory and non-statutory contributions may be made by an employee, their current employer and any previous or future employer, without threat of forfeiture. IFSA further questions whether there have been any instances of superannuation being used for the purpose cited in the current restrictions, sufficient to justify the application of the proposed broadened restrictions to any superannuation in excess of the statutory minimum level in Australia.

The *Corporations Act* currently treats superannuation as a termination benefit if the company contributed to the superannuation fund "solely for the purpose of enabling or assisting the superannuation fund to give a person a benefit in connection with a person's retirement from an office in the company or a related body corporate" (section 200B(3)(a)). In reality, superannuation contributions are made for the purpose of giving a person a benefit on retirement from any position of employment the person may hold at retirement age, whether that is with the current employer or a different employer. Therefore the sole purpose in this commonplace scenario is arguably not the purpose identified in section 200B(3) and which the proposed new law should focus on.

For these reasons, IFSA considers that all prescribed superannuation fund balances should be excluded from the restrictions.

If the current inclusion of superannuation in the class of restricted benefits is to be maintained, the current proposed carve out for Australian statutory superannuation contributions should be

extended to apply equally to superannuation amounts contributed under any foreign laws. The restrictions should also be clarified to apply only in respect of superannuation contributions made in the period in which a person holds office in the relevant company. Long serving employees should not be restricted from receiving their superannuation contributions from periods of employment which predate their appointment to a senior management position or directorship.

- Transitional provisions

IFSA welcomes the Government's stated intention to avoid retrospectively applying the new restrictions to current employment contracts. However, IFSA is concerned that the transitional relief for existing contracts will be significantly eroded by:

- uncertainty surrounding the distinction between "minor changes" to existing contracts and changes to "essential terms"; and
- the intention to treat any change in remuneration terms (which would include the level of remuneration) as a change to an essential term.

IFSA believes employers and shareholders would have more certainty as to the scope of the transitional relief if it focussed on changes to existing contracts which may increase future retirement benefits. This would avoid the difficulty of applying the somewhat uncertain general law definition of "essential terms" from contract law cases, to an area of regulation with significant criminal sanctions. IFSA also submits that transitional relief should also be provided to previous shareholder approvals granted under section 200B of the Corporations Act.

In summary, Australia continues to be well regarded in the region for the strength of its regulatory regime underpinning the remuneration of Executives and Directors. The application of sound corporate governance practices relating to remuneration increases confidence in the integrity and efficiency of the Australian capital market. The current governance regime over remuneration in Australia has experienced no systematic failure even in the recent market turbulence. Evidence is growing that the current regime is adjusting of its own accord to the changing financial environment.

Please feel free to contact me on (02) 9299 3022 if you have any questions with regards to the information provided above.

Yours sincerely



Joseph Sorby
Senior Policy Manager