Australian Government

The Treasury

24 July, 2009

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
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Dear Mr Hawkins

IMPROVING ACCOUNTABILITY ON TERMINATION PAYMENTS BILL 2009

Thank you for your invitation to provide a submission to the Senate Economics Committee's inquiry on the *Improving Accountability on Termination Payments Bill 2009* (the draft Bill), which was introduced into the House of Representatives on 24 June 2009.

Treasury's submission examines the background and rationale for the provision of termination benefits, provides a summary of the current framework and the need for reform, provides an overview of the key measures in the draft Bill and provides a summary of the key outcomes from the public consultation process.

We would be pleased to further discuss our submission with the Committee if required.

Yours sincerely

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The Treasury

Senate Economics Committee

Inquiry into the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009

Submission by the Australian Treasury

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EXECUTIVE SUMMARY

The key points in our submission are summarised below:

- Termination benefits are a unique component of remuneration which warrant greater shareholder scrutiny and approval, particularly as the company and shareholders generally derive little or no value from such payments. Termination benefits are often considered to be a reward to a departing director or executive for poor performance.

- The current threshold allows up to seven years total remuneration to be paid before shareholder approval is required. This is a very high threshold, and there is a clear need for reform to address this and other deficiencies in the regulatory framework.

- The draft Bill significantly improves the regulation of termination benefits by reducing the threshold for shareholder approval to one year's base salary, expanding the scope of individuals covered by the regulatory regime, expanding and clarifying the meaning of a termination benefit, improving the voting arrangements by excluding directors and executives that hold shares from participating in the shareholder vote, strengthening the penalty provisions and introducing an express requirement to repay an unauthorised termination benefit.

- The draft Bill has been developed in close consultation with stakeholders, and has been subject to a four week public consultation process. Treasury received submissions from a wide range of stakeholders. The submissions were generally supportive of the amendments and recognised the need for reform in this area.

- The Government has been responsive to a number of issues raised by stakeholders as part of the consultation process, and amended the draft Bill to reflect these comments, including retaining the status quo on the timing of the shareholder vote, prohibiting directors and executives from participating in the shareholder vote to approve their own termination benefit, providing greater clarity on the application of the draft Bill to contracts that are varied after the commencement date, and providing clarity and certainty on the meaning of specific terms such as 'base salary'.

- Some stakeholders also argued that the draft Bill would have a potential impact on the competitiveness of Australian companies and the potential to increase base salaries. Treasury does not believe that these perceived impacts are significant, as explained in our submission below. The concerns raised by stakeholders would be more valid if a cap or upper limit on termination benefits was being introduced. However, the proposed reforms do not introduce a cap, but rather allow payments of higher amounts provided that shareholder approval is obtained.

- The Government has also requested the Productivity Commission to undertake a broader review of Australia's remuneration framework. The Australian Prudential Regulation Authority is also progressing work to align risk-taking with remuneration arrangements in financial institutions.

- Overall, Treasury considers that the proposed reforms will strengthen the regulatory framework and supports the draft Bill in its current form.

INTRODUCTION

There is significant community concern about excessive pay practices, particularly in relation to the level of termination benefits or 'golden handshakes' paid to company directors and executives. When such termination benefits are granted during or following a period of poor company performance, the concerns are exacerbated, with claims that management is being 'rewarded for failure'.[1]

While Australia's corporate remuneration framework is generally well regarded internationally, there are aspects of the framework that require strengthening. Under the current law, it is possible for termination benefits to reach up to seven times a director's annual salary before shareholder approval is required. This is a high threshold which provides shareholders with little or no power to restrain excessive termination benefits paid to departing directors and executives.

On 18 March 2009, the Government announced that it would take action to empower shareholders to curb excessive termination benefits. The reforms are being progressed through the ***Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009***, which was introduced into the House of Representatives on 24 June 2009.

This submission will examine the background and rationale for the provision of termination benefits, provide a summary of the current framework and the need for reform, provide an overview of the key measures in the draft Bill and provide a summary of the key outcomes from the consultation process.

TERMINATION BENEFITS – BACKGROUND AND RATIONALE

Generally, termination benefits are given to a director or executive at a time when their contribution to the company ceases. The amount of the termination benefit is often determined in advance and generally, it is not related to the value that the individual has delivered to the company and the shareholders. Such payments cannot influence future company performance and are often perceived as being a reward to departing management for poor performance. As such, they provide little or no benefit to the company, and it is therefore appropriate that such remuneration (unlike other components of remuneration) be subject to greater scrutiny and a binding shareholder vote.

Studies have highlighted that there have been several instances of large termination payments being made following a period of very poor corporate performance. As Stapledon observes:

> ***In 2002 five senior executives of AMP departed with close to $12 million, despite the fact that they had been in office while AMP lost more than $13 billion of its market value. Similarly in 1999 CEO George Trumbull received a $7.5 million termination payment following AMP's disastrous hostile takeover of GIO. In 2003, Southcorp's CEO, Keith Lambert, departed with a termination payment of $4.4 million, even though during his 19 months at the helm, Southcorp's shares lost 40 per cent of their value.[2]***

A service contract may provide that no termination benefit is payable in cases where the executive is dismissed for cause, for example, in the event of misconduct. However, this

[1] G Stapledon, Termination Benefits for Executives of Australian Companies, ***Sydney Law Review***, 2005, volume 27(4), page 683.

[2] Ibid at p 708.

has not prevented the payment of termination benefits where the executive's performance has been below the expected standard, but not to the extent that it would constitute 'cause'. This has reinforced the perception that termination benefits are a reward for poor performance.

In addition, commentators have argued that termination benefits may cause a 'passive attitude' by directors and executives who know that they will be compensated irrespective of their actions or their performance. As such, termination benefits are often viewed as a contentious component of remuneration packages. Commentators have also argued that a quality candidate, who has a lengthy and successful tenure, should be rewarded for their performance during their tenure, not necessarily upon their departure through a large termination benefit.

On the other hand, termination benefits can legitimately represent compensation for breach of contract. Termination benefits will not necessarily always be a reward for failure, but can sometimes arise due to a restructure or some other unforseen event. In such circumstances, it is arguably appropriate to permit the innocent party to receive compensation for the breach of contract provided that this compensation is not excessive. The draft Bill achieves this objective by allowing the payment of a reasonable amount (one year's base salary) and stipulating that any amounts in excess of this will require shareholder approval.[3] In addition, commentators have noted that termination benefits may also provide a measure of objectivity during negotiations surrounding a merger or takeover, as directors and executives may be less concerned about losing their position with any associated change in management.[4]

Division 2 of Part 2D.2 of the ***Corporations Act 2001*** (the Corporations Act) outlines the circumstances when shareholder approval is required before a benefit may be given to a director in connection with their retirement from 'board or managerial office'.[5] These requirements are discussed further below.

CURRENT FRAMEWORK AND THE NEED FOR REFORM

Current framework

Currently, section 200B of the Corporations Act provides that shareholder approval for termination benefits is required unless an exception applies. Section 200F of the Corporations Act currently provides that shareholder approval is not required for a payment that could be characterised as damages for breach of contract, or a fee agreed to before the director joined the company as part of consideration for agreeing to hold the office, unless the payment exceeds a certain threshold. Section 200G relies upon the same threshold for a termination payment that can be characterised as a payment for past services where the director has worked for at least three years.

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3 Alternatively, if a court ordered an amount of compensation greater than this threshold, it would not require shareholder approval pursuant to s 200F(1)(aa).

4 ASX listing rule 10.18 prohibits entering into an agreement to provide or increase termination benefits on a change of shareholding or control.

5 ASX listing rule 10.19 also provides that shareholder approval is required if total termination payments to officers exceed five percent of total share capital reserves. A recent study suggests that this threshold is generally higher than the threshold contained in the Corporations Act — see Sheehan K and Fenwick C, '***Seven: The Corporations Act, Corporate Governance, and Termination Payments to Senior Employees***', Research Report, University of Melbourne, 2007.

The threshold depends upon the remuneration and number of years of service of the director, and is calculated by reference to the following formula:

$$\frac{\textit{(Total remuneration in last 3 years) x (years of relevant period or 7 years (whichever is lesser))}}{\textit{3}}$$

Where 'total remuneration' is defined as the amount of total remuneration of the person from the company and related bodies corporate during the last three years of the relevant period; and

the relevant period is defined as the period that a person has held an office in relation to a company either throughout a period or a number of periods.

As a result of this formula, it would be possible for a director with at least seven years service to receive a termination benefit seven times their annual salary before shareholder approval is required. For example, a person with seven years service and an annual average salary over the last three years of $10 million would be entitled to receive a termination payment of up to $70 million without seeking shareholder approval. A person with five years service and an annual average salary over the last three years of $5 million would be entitled to receive a termination payment of $25 million without seeking shareholder approval.

Need for reform

In 2004, the Parliamentary Joint Committee on Corporations and Financial Services reviewed the draft Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 and noted its concern with the relatively high threshold:

> ***The difficulty for the Committee is in endorsing the threshold set by the proposed legislation. It is concerned that the provision sets down a formula that establishes a relatively high benchmark — a payment above this point requires shareholder approval, a payment below it is exempt from approval. The benchmark appears to be set at quite a high level and in effect appears to sanction or even encourage termination payments that would fall just below this level.***

In addition, Labor's minority report noted that:

> ***The Labor members take the view that termination payments for executives and directors exceeding 1 year's salary should be subject to shareholder approval.***

Recent academic studies have noted that the current thresholds are so high that they are rarely triggered. For example, Fenwick and Sheehan analysed a sample of termination benefits and found that most payments would fall comfortably within the legislative thresholds. The authors observed that:

> ***the statutory thresholds before which shareholder approval is required are very generous…The authors' view of the generosity of the thresholds is in one sense confirmed by the fact that so very few examples of companies seeking approval under s 200E were identified.***[6]

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[6] Fenwick C & Sheehan K, Share-based remuneration and termination payments to company directors: What are the rules? ***Companies and Securities Law Journal***, 2008, vol 26, page 88.

More recently, RiskMetrics released a survey in November 2008 which found that of a sample of 33 CEOs, only two (or approximately six per cent) sought shareholder approval for termination payments.

In addition, there is a need to address other deficiencies in the regulatory framework. Currently, the regulatory regime only applies to directors, and does not extend to executives (unless they act as a director). The draft Bill extends the scope of the regulatory regime to apply to the key management personnel and the five mostly highly remunerated officers (if different) for companies that are a disclosing entity. This ensures that the proposed new laws apply to the key individuals named in the remuneration report.

Furthermore, there is currently some legal ambiguity as to whether certain types of payments are considered to be a termination benefit requiring shareholder approval. To address this, the draft Bill contains a regulation making power to create regulations which prescribe things to either be a benefit, or not to be a benefit. The Bill also provides a regulation making power to create regulations which prescribe certain types of benefits that are taken to be given in connection with a person's departure from office. The draft regulations will offer guidance and certainty, by providing a non-exhaustive list of specific examples of payments that will require shareholder approval.

Currently, there is no express requirement for a recipient of an unapproved benefit to repay the benefit. The draft Bill strengthens the regulatory framework by introducing an express obligation on the recipient to immediately repay a termination benefit that was given in contravention of the requirement to seek shareholder approval under the Act. In addition, the Bill provides that the benefit is a debt due to the entity which may be recovered by the entity. This is intended to better facilitate recovery of benefits that have been given in contravention of the Act. The draft Bill also retains the requirement for the recipient of an unauthorised benefit to hold the benefit on trust for the entity. This is intended to impose an additional level of accountability on the recipient, particularly where they have failed to repay the benefit immediately.

In addition, Treasury believes that the current penalty provisions do not provide a sufficient deterrent to giving an unapproved termination benefit. The Bill significantly strengthens the penalty provisions associated with giving a benefit that has not received the necessary approval by shareholders in contravention of the Act. The penalty units in sections 200B, 200C and 200D have been increased to 180 penalty units for a natural person and to 900 penalty units for a body corporate, whilst retaining the option of six months imprisonment. In addition, the offences will remain strict liability offences. This represents a substantial increase to the penalty provisions and is intended to reflect the seriousness of giving a termination benefit where it has not been approved by shareholders in accordance with the Act, and to provide a sufficient deterrent to prevent such unauthorised benefits.

OVERVIEW OF PROPOSED REFORMS

An overview of the key measures contained in the draft Bill is set out below.

New law	Current law
Termination benefits for directors and executives exceeding one year's base salary is subject to shareholder approval	Termination benefits can reach up to seven times a recipient's total annual remuneration before shareholder approval is required
Scope of the regulations is expanded to include senior executives or key management personnel of the entity, where the company is a disclosing entity.	Requirements relating to termination benefits apply only to company directors.
The definition of a termination benefit has been clarified and expanded. The Bill requires a broad interpretation of the term benefit and requires that the substance should prevail over its legal form. The Bill also includes a regulation making power to specify whether certain types of payments are a termination benefit or not.	There is currently some legal ambiguity as to whether certain types of payment meet the definition of a termination benefit, and therefore require shareholder approval.
Unauthorised termination benefits must be repaid immediately. Any unpaid benefits will continue to be held on trust for the company.	There is no express requirement to repay an unauthorised termination benefit. The benefit is required to be held on trust for the benefit of the company.
Retirees, that hold shares in the company, can no longer participate in a shareholder vote on their termination benefit except when acting as a proxy.	All shareholders are able to participate in a vote on termination benefits.
The penalty provisions have been strengthened to 180 penalty units for a natural person and 900 penalty units for a body corporate, whilst retaining the option of six months imprisonment.	The penalty provisions for breaches of sections 200B, 200C and 200D are currently 25 penalty units for natural person and 150 penalty units for a body corporate, together with the option of six months imprisonment.

The new arrangements will not apply retrospectively to existing contracts. The new arrangements will apply to contracts that are entered into, renewed, extended or substantially varied after the commencement date.

Treasury believes that the amendments will strengthen the existing regulatory framework applying to termination benefits by better empowering shareholders to disallow excessive termination benefits, improving the accountability of company management in setting remuneration, and promoting responsible remuneration practices.

Practical impact of the proposed reforms

Research released by RiskMetrics Australia in November 2008 indicates that the average CEO received just over $3.4 million as a termination benefit, which equated to 201 per cent of their annual salary. The study was based on entities in the S&P / ASX 100 in the previous three years.

Treasury has analysed RiskMetric's findings and determined that, of the 33 CEOs included in RiskMetric's sample, 20 would exceed the proposed new threshold of one year's base salary, which amounts to approximately 60 per cent of CEOs in the sample that would be affected by the proposed reforms. This amount is expected to decline for smaller companies which typically have less complex remuneration packages and may provide lower termination benefits.[7]

Based on this research, it would appear that between approximately 50 to 60 per cent of termination benefits would be captured by the new threshold, which Treasury considers to be an appropriate level. This assumes that the level of termination benefits remains constant, although in practice, there is expected to be a decline in the levels of termination benefits provided, consistent with the Government's intention to curb such payments. Treasury also believes that the new threshold will provide a significant improvement on the existing threshold, which resulted in very few payments requiring shareholder approval.

OUTCOMES OF PUBLIC CONSULTATION PROCESS

The draft Bill has been developed in close consultation with stakeholders, and has been the subject of a four week public consultation process. Treasury received submissions from a wide range of stakeholders. The submissions were generally supportive of the amendments and recognised the need for reform in this area.

Key changes made as a result of the public consultation process

The key differences between the exposure draft and the current draft Bill are outlined below. Several of these changes have been made to reflect the comments received as part of the public consultation process.

Timing of the shareholder vote

Currently, the shareholder vote on a termination benefit can occur at any point in time before the benefit is given. The exposure draft included a proposal to change the timing of the shareholder vote to require it to take place after the departure of the director or executive. As part of the public consultation process, concerns were raised with the proposal to change the timing of the shareholder vote. A significant number of stakeholders opposed this measure and identified practical difficulties with it. In particular, stakeholders noted that this measure would:

- create uncertainty and affect the negotiation of new contracts, as any termination benefits in excess of one year's base salary would be dependent on shareholder approval. That is, adequately designed termination benefits which have been agreed

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[7] Riskmetric's survey relied upon the CEO's base salary in the final year of employment, whereas the draft Bill uses the average base salary over the last three years. While this is not a perfect comparison, is does provide a general indication of the number of CEO's that will be captured by the proposed reforms.

in advance could not be offered with certainty unless they were below the threshold of one year's base salary;

- have the effect of prohibiting termination benefits in excess of one year's base salary, as shareholders have little incentive to approve the termination benefit (no matter how legitimate) some time after employment has ceased;

- unreasonably delay access to retirement benefits, redundancy payments and compensation for the loss of income and employment by up to 12 months;

- delay shareholders' decisions, which may cloud their judgment with issues beyond the control of the departed officer, particularly where market conditions or shareholdings have changed; and

- increase the need for former directors or executives to obtain an order of a court to receive a termination benefit in excess of one year's base salary.

The Government has responded to these concerns by deciding not to change the timing of the shareholder vote. The current draft Bill retains the status quo which allows the shareholder vote to be held at any time prior to the termination benefit being paid to the director or executive.

Excluding directors and executives from participating in the shareholder vote

Currently, the Corporations Act does not prevent a director or executive, that also holds shares in the company, from participating in the vote to approve their own termination benefit. As part of the consultation process, stakeholders identified a real, as well as a perceived, conflict of interest that exists with directors and executives voting on their own remuneration, including their own termination benefits. The current draft Bill addresses this issue by prohibiting a retiree from participating in the shareholder vote to approve their own termination benefit, except where they cast a vote as a proxy on behalf of another person or where the regulations provide otherwise. This will eliminate the conflict of interest that exists with directors and executives voting to approve their own termination benefits.

Broad interpretation of 'termination benefit'

The Government's announcements on these reforms on 18 March 2009 stated that the Government would "broaden the definition of termination benefit to catch all types of payment and rewards given at termination". To implement this reform, the current draft Bill also includes amendments to clarify that termination benefits are to be given a broad interpretation and that the substance of the transaction should prevail over its legal form. This is intended to prevent any attempts to subvert the law by claiming that a particular type of benefit is not a 'termination benefit' requiring shareholder approval. It will also provide a clear statement of the Government's intention to adopt a broad interpretation of the term 'benefit'. This is consistent with the approach used in other parts of the Corporations Act, such as section 229.

In addition, the draft Bill contains regulation making powers to clarify the meaning of a 'termination benefit' and to deem that certain types of benefits will (or will not) require shareholder approval.

Application of draft Bill

The exposure draft provided that the reforms would apply prospectively to contracts entered into or extended after the commencement date. A number of stakeholders requested clarification on whether the reforms would apply to contracts that have been varied after the commencement date. The current draft Bill clarifies this issue, by providing that reforms also apply to cases where a condition of the contract has been varied. This will ensure that, where an essential term of the service contract has been varied (including terms relating to remuneration), the contract will be subject to the proposed new laws.

Draft regulations

The draft regulations will also address a number of issues identified in the public consultation process, including clarifying the meaning of 'base salary' and 'deferred bonus', as well as providing greater certainty on the treatment of consideration given for entering into restrictive covenants or restraint of trade clauses. The draft regulations will be the subject of further targeted consultation before being finalised.

Australia's international competitiveness

A number of stakeholders argued that lowering the threshold to one year's base salary would adversely affect the ability of Australian companies to attract executive talent in an international market. We do not believe that the draft Bill will have the stated impact on the competitiveness of Australian companies.

Globally, there are no consistent requirements relating to the payment of termination benefits. Internationally, requirements on termination payments can range from up to three years annual salary to an outright ban for top executives in companies receiving government assistance.

Additionally, research commissioned by the Australian Council of Superannuation Investors (ASCI) in June 2009 suggests that executives are more likely to leave a company because they have retired or been dismissed, rather than been poached by a foreign company. The research examined 333 executive appointments and 230 departures at 50 of Australia's biggest listed companies between 2003 and 2007. It found that only three companies, or 4.3 per cent, believe the CEO was poached by a foreign organisation. As noted by ACSI, this evidence does not provide compelling evidence to justify pay increases for senior executives on the basis of a 'global war for talent'. Treasury believes that the draft Bill will ensure that Australia's regulatory framework continues to remain at the forefront of international best practice.

The concerns raised by stakeholders would be more valid if a cap or upper limit on termination benefits was being introduced. However, the proposed reforms do not introduce a cap, but rather allow payments of higher amounts provided that shareholder approval is obtained.

Base salary

The proposed threshold is determined by reference to base salary rather than total remuneration. Most executive's contracts represent a mixture of base salary and performance pay, with anecdotal evidence suggesting that base salary often comprises about one third to one half of total remuneration. In 2003, the United Kingdom Parliament's Trade and Industry Committee released a discussion paper on termination benefits entitled ***Rewards for Failure***.

The report suggested that a key reason for the increase in termination benefits was that performance pay is increasingly being included in the calculation of a termination benefit. The report noted that:

> ***"more and more elements of the remuneration package – such as bonuses and perks – are being included in the calculations for determining them. This is clearly a matter of concern and risks undermining the improvements made in other areas"***

As such, the paper concluded that performance related elements of the remuneration package should not be included in the calculation of a termination benefit where an executive is removed for underperformance:

> ***"If the targets upon which bonuses are based are set at a sufficiently challenging level, and an executive is being removed for underperformance, we cannot see how significant performance-related elements of the remuneration package can legitimately be included in the severance package".***

We support this view, and consider that the threshold should be determined by reference to base salary rather than total remuneration. The inclusion of performance pay has the potential to significantly increase the threshold for shareholder approval, potentially by millions of dollars, which would undermine the purpose of the proposed reforms. For example, Stapledon examined the case of Toll Holdings, where shareholder approval was sought in 2004 for the CEO's termination benefit which comprised of fixed remuneration plus an amount relating to short term incentives. Stapledon noted that, in 2004 dollar terms, this short term incentive component could have added as much as $2.07 million to the CEOs payout.[8]

During the consultation process, some stakeholders suggested the proposed reforms would have the effect of increasing base salary levels. However, there is greater transparency and accountability with respect to the payment of base salary during the tenure of the director or executive. Such payments are required to be disclosed in the company's remuneration report, and the company is required to clearly explain the policy for determining the nature and amount of remuneration, and a discussion of the relationship between such policy and the company's performance. These requirements operate to provide a measure of accountability and transparency, particularly if a company seeks an unjustified increase in base salary. Shareholders also have the opportunity to cast a non-binding vote on the company's remuneration policies and anecdotal evidence suggests that companies are increasingly responsive to the non-binding vote.

The use of base pay rather than total remuneration is also consistent with best practice guidance developed by industry. For example, in 2005, ACSI released guidelines which recommended that shareholder approval be sought for termination benefits in excess of one year's <u>base</u> salary.

It is also noted that the relative composition of pay, including the relationship between pay and performance is a broader issue, which has been included within the Productivity Commission's terms of reference for its review on Australia's remuneration framework.

Another issue raised by stakeholders related to the calculation of 'base salary'. The definition of base salary is currently the subject of further targeted consultation. The definition will be contained the regulations accompanying the Bill. This will provide

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[8] G Stapledon, Termination Benefits for Executives of Australian Companies, ***Sydney Law Review***, 2005, volume 27(4), page 710.

flexibility for the law to respond to, and to quickly address, any attempts to manipulate the definition.

OTHER REVIEWS

Productivity Commission review

On 18 March 2009, the Government also announced that it has requested the Productivity Commission to undertake a review of Australia's remuneration framework. This will be a broad-ranging inquiry that will examine the existing regulatory arrangements that apply to director and executive remuneration for companies which are disclosing entities regulated under the ***Corporations Act 2001***. The review will examine shareholder voting, the role of company boards, disclosure requirements and the role of institutional investors such as superannuation funds. The inquiry will also examine international trends and responses to the problems of excessive risk taking and corporate greed.

The inquiry is being led by the Chairman Gary Banks and Professor Allan Fels AO has been appointed as an Associate Commissioner to assist with the inquiry.

The Commission's terms of reference includes examining the role of, and regulatory regime governing, termination benefits. The Commission has recently conducted public hearings, and is expected to release a draft report in September 2009 with the final report due in December 2009.

APRA's prudential standards for sound compensation policies

To ensure the stability of the financial system, the Government has also asked APRA to align risk-taking with remuneration arrangements in financial institutions in October 2008. Regulated institutions which fail to meet APRA standards will be subject to greater supervisory requirements.

APRA released a discussion paper on 28 May 2009 detailing the prudential standards for sound compensation policies in APRA-regulated entities.

These standards aim to align remuneration arrangements with the long-term financial soundness of regulated institutions and to remove any compensation incentives which focus on short-term revenue at the expense of long-term profitability. The period of consultation ends on 24 July 2009.

These prudential standards are consistent with the principles developed by the Financial Stability Forum (now the Financial Stability Board) to guide global reform in this area. The FSF report was endorsed by the G-20 Leaders at the London Summit on 2 April 2009. The standards:

- require boards of prudentially-regulated institutions to take an active role in formulating sound compensation principles and guiding and monitoring their implementation;

- require compensation incentives arrangements to reflect the risk profiles including time horizon imposed on the institutions (including through appropriate vesting of share incentives); and

- cover both executives and senior staff whose activities have a material impact on the profitability of the institutions.

The focus of the APRA's role is on supervision, ensuring that institutions comply with the standards. There are penalties for non-compliance, including through increased capital charges if necessary.

CONCLUSION

Australia's current regulatory regime for termination benefits requires strengthening. The proposed reforms will improve the framework relating to termination benefits by ensuring that shareholders have the power to reject excessive termination benefits that are not in the interests of the company or the shareholders. The reforms will also ensure that company directors are accountable to shareholders for termination benefits above the threshold. Treasury supports the draft Bill in its current form.