

15 July 2009

The Secretary  
Senate Economics Legislation Committee  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

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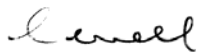
**Re: Inquiry into the Corporations Amendment (Improving Accountability on Termination Payments) Bill**

Insurance Australia Group (IAG) welcomes the opportunity to provide comment on the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009*.

Please find attached a copy of IAG's submission to Treasury in relation to the exposure draft of the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* which highlights in particular the amended termination cap provisions will result in a far wider impact on directors of subsidiary boards both in Australia and overseas.

IAG would be happy to discuss this submission and to assist in any way we can. If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Adviser, Economics and Policy on (02) 9292 8593 or me on 9292 8026.

Yours sincerely



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4 June 2009

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## **Re: Corporations Amendment (Improving Accountability on Termination Payments) Bill**

### **Introduction**

Insurance Australia Group (IAG) welcomes the opportunity to provide comment on the exposure draft of the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009*.

### **Who is Insurance Australia Group?**

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than \$7.8 billion of premium per annum. It employs more than 15,000 people of which around 9,500 are in Australia. IAG operates some of Australia's leading insurance brands including NRMA Insurance, CGU, SGIO, SGIC and Swann Insurance. IAG also distributes insurance in Victoria through the RACV brand. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

IAG has a crucial interest in the long-term viability of insurance as a product valued by the Australian community. IAG believes that there are four principal ways in which the insurance industry can best meet these objectives. These are:

- Providing affordable products that price the risks underwritten realistically.
- Promoting risk awareness and risk reduction both for policyholders and in the community generally.
- Investing in robust risk control frameworks and management mechanisms that reduce operating expenses, make claims costs more predictable and facilitate sustainable profitability for shareholders.
- Committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that ensures that customers understand what they are buying when they purchase a policy and protects policyholders against financial failure of an insurer.

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## Specific Comments

We wish to raise the following issues relating to the draft Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009. The provisions of this Bill will, amongst others, amend the termination cap provisions in the Corporations Act such that termination payments exceeding one year's base salary (previously seven times a director's total average remuneration) will require shareholder approval ("amended termination cap provisions").

For the reasons more fully described below, we consider that, if enacted, the amended termination cap provisions, will have the following consequences for Insurance Australia Group Limited (IAGL). It would appear that such consequences may be unintended. The impact on IAGL includes:

- A reduction in available pool of suitably qualified directors to serve on the boards of subsidiary companies both in Australia and overseas;
- For corporate superannuation trustee boards<sup>1</sup>, an inability to obtain suitably qualified employees (members of the Plan) to fill the role of director at the risk of their contractual termination entitlements being subject to an approval by IAGL shareholders;
- Pressure to increase remuneration in order to attract and retain executives and senior managers;
- An inability to attract talented people to fill senior managerial roles in overseas jurisdictions in which IAGL operates, where these roles also require individuals to be directors of boards of IAGL subsidiary companies. This results from the termination cap provisions in these jurisdictions being more generous than in Australia eg. United Kingdom.

The amended termination cap provisions are one part of a wider package of executive remuneration reforms currently being considered by three arms of government; Treasury, the Productivity Commission and APRA. Proposed amendments to the taxation of employee share schemes, which form an important and integral part of executive and director remuneration were also announced in the 2009 Federal Budget. In order to ensure the effectiveness of the oversight, accountability and transparency of executive remuneration practices going forward it is important that these four streams are drawn together as an integrated and consistent package of reforms. This co-ordination is particularly important to ensure any regulatory response takes into consideration the likely costs and benefits of any actions including the potential costs and benefits of unintended consequences.

We note that the Productivity Commission has sought submissions in relation to a number of specific questions including "the effectiveness of international responses to remuneration issues arising from the global financial crises and their potential application domestically". IAGL is surprised that the Government has decided to proceed with the proposed amendments to the termination cap provisions before the Productivity Commission's report on this and other key questions in relation to executive remuneration.

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<sup>1</sup> Where there are subsidiary companies of Australian public listed companies as is the case for IAG & NRMA Superannuation Pty Limited

## Impact on membership of Subsidiary Boards

We acknowledge that parent companies and subsidiary companies are currently subject to the requirements of the termination provisions under Part 2D.2 of the Corporations Act. However, the amended termination cap provisions will result in a far wider impact on directors of subsidiary boards both in Australia and overseas. This impact results from the reduction in the cap on termination payments from effectively 7 years to 1 year, the new definition of Base Salary and revision to permissible termination benefits and the proposed requirement that termination benefits paid to directors of subsidiary companies of domestic listed companies require approval of shareholders at general meetings of the listed company.

The operation of the amended termination cap provisions are not limited to companies incorporated in Australia. Under the Corporations Act, a related body corporate is defined by the relationship between two companies not by the place of incorporation. In IAG's case, the parent company Insurance Australia Group Limited (IAGL) is incorporated in Australia and listed on the Australian Stock Exchange. IAGL has a large number of subsidiary companies incorporated in both Australia and overseas jurisdictions<sup>2</sup>.

Subsidiary companies within the IAG Group which are not licensed insurers often have directors who are employees with specialist skills relevant to the business or operations of the subsidiary companies. Examples of the activities of such companies include investment management, trusts for superannuation and pension funds, employee share plans, financing, road service, information technology, property and technology services. These subsidiary companies are in addition to those IAGL companies that undertake underwriting and insurance product distribution activities<sup>3</sup>.

Employees do not normally receive any separate remuneration for their membership of the subsidiary boards as this is an activity related to their role. These employees are in the main not key management personnel whose remuneration and entitlements are required to be disclosed within the Remuneration Report. Under their employment contracts these individuals are entitled to termination benefits which may exceed the amended termination cap. The reduction in the termination payments and the requirement to seek the approval of members at general meetings of IAGL are likely to be a strong disincentive for many employees to serving on such subsidiary boards resulting in a significant reduction in the pool of individuals with the required skills, knowledge and experience to fill such positions and undermine the effective corporate governance of these companies.

The case of the Trustee of the IAG & NRMA Superannuation Plan, a wholly owned subsidiary of IAGL, illustrates some of the unintended consequences of the amended termination cap provisions. The directors on this board consist of an independent chair, management appointed directors and member elected directors. The Superannuation Industry Supervisory Act (SIS Act) requires equal representation on the Board of the Trustee for such corporate superannuation plans. Employee elected directors are drawn from the employees of IAG and

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<sup>2</sup> There are some specific governance requirements for licensed insurance companies in Australia under APRA prudential standards and in some overseas jurisdictions such as United Kingdom. We discuss the potential impact on the overseas subsidiaries below.

<sup>3</sup> As noted above, specific governance requirements apply to licenced insurance companies under the APRA Prudential Standards. Directors on these Boards are NEDs and senior executives.

NRMA and it is not necessary for such directors to hold a senior or managerial role. Non executive employees of IAG in Australia are entitled to a maximum termination benefit of 87 weeks of salary under the IAG Enterprise Agreement, these employees would suffer detriment if they were to serve as member elected directors of the Trustee of the IAG & NRMA Superannuation Plan. The extension of termination cap provisions to directors of the Trustee Company may be a significant disincentive to employees being prepared to seek election as a director and undermine the objectives of the SIS Act.

For overseas subsidiaries of IAGL there are also issues of the potential conflict between the regulatory requirements of their home jurisdiction and those under the Australian law. We understand that the EU is considering caps on termination payments at two years salary. This difference in the levels of termination payments is likely to have an adverse impact on the recruitment of appropriately qualified individuals in these jurisdictions. It may also drive behaviours such as individuals seeking to increase their base salary as a means of achieving some parity in terms of entitlements on termination.

We understand the objective of seeking greater transparency and disclosure of termination payments through the scrutiny of members in a general meeting. However, in the case of directors of subsidiary companies which often have limited visibility to members (particularly small retail shareholders) it may be difficult for such members to form a view about the appropriateness of such payments for the individuals concerned. This is exacerbated where the subsidiary company is an overseas company and the individuals concerned may be unknown to the members.

### **Impact on Base Salary**

The new definition of Base Salary excludes termination benefits such as bonus or incentive payments and options. In our view the very narrow definition of Base Salary will drive restructuring of remuneration packages which may have the following adverse and potentially unintended consequences:

- Base salaries are likely to be increased to compensate new employees for the risk of termination and the loss of incentives or bonus payments or options on such termination
- An increase in base salaries is a direct cost to the company and replaces a contingent liability for termination entitlements
- Restructuring of remuneration packages with the reduction or removal of options, incentive or bonus payments may remove opportunities for actively rewarding appropriate behaviours in employees
- Undermine the effectiveness of proposed APRA prudential standards relating to having a remuneration policy that aligns remuneration arrangements with the long-term financial soundness of the institution and its risk management framework.

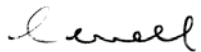
Again, thank you for the opportunity to provide comment on the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009*. If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Adviser, Economics and Policy on (02) 9292 8593 or me on (02) 9292 9835.

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