AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr. John Hawkins
The Secretary
Senate Economics Legislation Committee
Parliament House
CANBERRA ACT 2600
E-mail: economics.sen@aph.gov.au

Dear Mr Hawkins,

Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009

The Australian Bankers' Association (ABA) welcomes the opportunity to make a short submission to the Senate Economics Committee inquiry into the terminations payments legislation.

While the ABA understands that there is community concern over examples of where non-performing executives have received large termination payments, this does not itself, in our view, justify a very significant modification to the law which will potentially impact on many senior executive employees and companies.

The fundamental principle operating here is that a bank board is expected to be fully responsible and accountable for hiring a bank's CEO and that of senior executives. This includes the setting of remuneration arrangements. A board must exercise judgement in these responsibilities in the company's best interest, which may include making a termination payment in excess of what some commentators may believe is justified.

We regard the legislation as inconsistent with this principle. The legislation further limits a board's capacity to set remuneration according to its best judgement by requiring any proposed termination payments above one year's base pay to be explicitly approved by shareholders. This raises uncertainty over a board's capacity to make a payment it regards as appropriate.

International comparisons

The ABA's understanding is that this legislation, if passed, will be the most restrictive termination cap anywhere in the world. This simply means that the boards of Australian public companies will be relatively constrained in competing for executive talent.

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(Incorporated in New South Wales). Liability of members is limited.

To mitigate this impact, we suggest that an international agreement is reached on this element of executive remuneration. Already the G20 has announced principles for executive remuneration and these could easily be amended to include an international agreement regarding termination payments (defined as a multiple of base or total pay).

Incentive to increase base remuneration

The other problem we believe needs mitigation is the incentive the legislation creates to increase the base pay component of an executive's remuneration. Higher proportions of base pay means less variable or performance pay. This is clearly inconsistent with best-practice remuneration which aims to align shareholder and executive interests.

(The incentive to skew remuneration towards base pay is also being encouraged through the Government's employee share scheme legislation and APRA's proposed prudential standard on remuneration.)

One means of partially mitigating this is to restore the termination cap as a multiple of 'total salary' or 'total remuneration' rather than 'base salary'. This recommendation is consistent with international practice in those countries that have termination payment limits, except for the UK.

A further ABA recommendation is to increase the flexibility given to boards by increasing the potential limit that boards can pay terminating executives. We recommend this be agreed internationally, but in the absence of an international agreement, set with reference to a relevant benchmark, such as the United States (a key recruitment pool for Australian banks). The USA has a limit of three times base pay plus bonus.

Subsidiary Board Directors

Although the existing legislation already captures directors of subsidiary boards, the lowered threshold will require many of the larger banks to obtain shareholder approval by the listed parent of termination benefits for these employees. In these organisations, there may be several hundred employees on subsidiary boards at any one time, including large numbers overseas.

The employees on subsidiary boards range from more senior employees who would be captured by virtue as their role as a "managerial or executive office holder" to employees 2 to 3 levels down from this. We appreciate the intent of the legislation to capture "managerial or executive office holders" of the listed entity but it cannot be in the public interest or interests of shareholders to vote on the benefits that may be provided to lower level employees on termination, particularly where the employees have a significant length of service which has resulted in benefits in excess of one year's base pay on termination.

The additional administrative costs in complying with the legislation for this large number of employees will be significant.

Impact of the employee share plan legislation

The practical application of the termination benefits legislation is problematic because it is inconsistent with the tax treatment of shares and APRA's proposed guidelines.

The proposed tax treatment of employee equity awards forces early vesting at termination in order to fund the tax liability. However this accelerated vesting will now potentially require shareholder approval under the termination benefits legislation. This also conflicts with APRA's guidelines which recommend that performance periods should extend beyond termination of employment.

Although an employer could allow a portion of an award to vest in order that tax can be paid by the employees, this is contrary to the intent of performance hurdled equity awards, and could result in a windfall to employees. This windfall could arise if vesting is accelerated (i.e. to fund the tax) on securities that subsequently fail to meet the performance hurdle (in the normal course).

The employee could presumably claim a refund on tax paid, even though they were arguably never really entitled to this money (which has effectively been paid by shareholders). The partial vesting would also be caught for the purposes of determining an executive's position against the termination benefits cap.

Our preferred option is to remove termination as a taxing point for equity awards. An alternative (which we do not support because it conflicts with APRA's guidelines) is to exclude accelerated vesting of equity awards from the calculation of payments against the termination cap.

Deferred bonus exemption

The ABA supports the proposed exemption for deferred bonuses and proposes that "deferred bonus" be clearly defined in the legislation to avoid uncertainty and any unintended outcomes such as a move away from deferred remuneration and towards greater upfront remuneration. The definition should include bonuses in the form of equity or other property and bonuses which are subject to vesting or other conditions. There is increasing international recognition that a significant proportion of current year bonus should be retained over a vesting period and a significant proportion of that retained bonus should be delivered in equity.

The ABA also submits that a bonus which has been earned for past performance but is deferred for staff retention and alignment purposes should not be deemed to have lost its character as "deferred bonus" where it is released on typical "good leaver" provisions. Examples of this include provisions for the early release of deferred bonus in the case of death, disability or illness, redundancy or bona fide retirement. The retention and alignment objectives of bonus deferral are genuinely inapplicable in such circumstances, and imposition of continued deferral or forfeiture rules would be seen as unfair by staff and may erode the retention and alignment objectives of the relevant scheme.

Superannuation

The ABA does not support the continued treatment of superannuation as a termination benefit under the proposed broadened restrictions, subject to a limited exception for "statutory" contributions. This is inconsistent with the original objectives of the termination benefit restrictions and the public policy interest in encouraging employee retirement savings.

The current restrictions define 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 contrast, the vast majority of 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. Furthermore, the vast majority of superannuation schemes involve future delivery of remuneration which has been earned and accounted for in previous years, justifying a broad exemption consistent with the policy for deferred bonus.

For these reasons, the ABA would question whether there have been any instances of superannuation being abused for the sole purpose cited in the current restrictions, sufficient to justify the application of the proposed broadened restrictions to any superannuation in excess of the minimal "statutory" level in Australia.

Our preferred position is superannuation 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. On that basis, the ABA 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 proposed exemption for *Australian* statutory superannuation contributions should be amended to apply equally to superannuation amounts contributed under any *foreign* laws. The restrictions should also apply only to contributions made in the period in which a person holds the relevant office in company. Long serving employees should not be restricted from receiving superannuation from any period of employment which predates their appointment to the relevant office.

Transitional provisions

The ABA supports the provisions intended to avoid retrospectively applying the new restrictions to current employment contracts. However, 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".

The proposed treatment of any change in remuneration terms as a change to an essential term, would also cause the new restrictions to apply retrospectively too many current contracts, in circumstances where there is an increase in current remuneration or a change in the way current remuneration is delivered. In many cases such changes have no bearing on the employee's potential termination benefits.

The ABA's preferred outcome would be for the transitional relief to focus on changes to existing contracts which increase future retirement benefits. This is consistent with the broader objectives of the legislation and would avoid the inherent uncertainty of applying the moveable general contact law definition of "essential terms" to an area of law with significant criminal penalties. The ABA also submits that transitional provisions should enable companies to provide retirement benefits which have already been approved by shareholders under the current law.

If you need further information, please contact on (02) 8298 0401.

Yours sincerely,

David Bell

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