



RiskMetrics Group

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The Secretary
Senate Economics Legislation Committee
Parliament House

Attention: Mr John Hawkins

By email: economics.sen@aph.gov.au

Dear Mr Hawkins

Thank you for the opportunity to comment on the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009. RiskMetrics (formerly Institutional Shareholder Services) is the world's largest governance advisory firm, providing governance research to more than 1700 institutional investors in Australia and around the world.

As a general comment, RiskMetrics strongly supports the proposals in the Bill to:

- introduce a significantly lower threshold for the approval of termination benefits by shareholders; and
- extend the application of the termination benefit provisions beyond directors to executives at the sub-board level who fall within the new definition of persons holding a "managerial or executive office".

RiskMetrics also strongly supports the introduction of a regulation-making power to declare specific arrangements to be, or not to be, termination benefits, as well as the introduction of a provision precluding the retiring executive (and their associates) from voting on proposals relating to termination benefits.

Comments on provisions of the Bill

RiskMetrics considers that there are a small number of areas in which the provisions of the Bill could be further enhanced or clarified:

- **Scope of definition of holder of "managerial or executive office":** The Bill (s. 200(1) and (2)) in the case of a listed entity states that a person holding "managerial or executive office" is one whose remuneration is required to be disclosed in the remuneration report. RiskMetrics notes that one of the objections to the Bill that has been raised publicly by industry groups relates to the possibility that the scope of this definition, together with s. 200E(1B)(b), could mean that listed groups would need to seek shareholder approval for termination payments to persons holding executive office in relatively small subsidiaries of listed groups. RiskMetrics notes that any uncertainty as to the application of this definition to listed entities could be resolved by specifying that in a listed entity, those holding managerial and executive office are *only* those persons whose remuneration details must be disclosed in the remuneration report.



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- **Base salary:** RiskMetrics strongly supports the reduced thresholds for shareholder approval but recognises the potential for these approval mechanisms to be manipulated through enlargements of what constitutes a “base salary”. One way of addressing this would be, in place of the definition included in Schedule 1 of the Bill, to introduce a more detailed definition. This, however, has the disadvantage of introducing additional complexity into the Bill. RiskMetrics suggests a simpler alternative, in keeping with the underlying rationale for the Bill: the amendment to s 200F(2)(b) in the Bill could be altered to read “the lower of [a stipulated figure such as] \$500,000.00 and the amount worked out under whichever of subsections (3) and (4) is applicable”. An equivalent alteration would also be made to the amendment in the Bill to s 200G(1)(c).
- **Timing of approval:** RiskMetrics also notes that the Bill differs from the Exposure Draft in that it removes the requirement for approval of an ‘excessive’ termination payment to be sought after termination has occurred. This allows a company to seek approval shortly after the contractual termination payments are agreed but as presently drafted would allow the board to seek approval for payments in excess of the 12 month base salary limit without specifying the extent to which the payments would be in excess of 12 months base salary.
- To ensure that shareholders are informed in advance of the maximum amount that may be paid, the Bill should be amended to require any advance approval of a termination payment to specify a maximum dollar cap that may be paid under the authority sought from shareholders. Without this requirement, based on RiskMetrics’ experience, boards may seek to maximise their discretion to pay termination benefits. With the ability to seek approval up-front, the Bill’s purpose would be undermined by reducing shareholders’ ability to control substantial termination payments to failed executives. It is also possible that the Bill as presently drafted would create the perverse outcome whereby the ability to make termination payments in excess of the present overly-generous limits would be increased by allowing up-front approval with minimal disclosure.

Comments on the Regulations

RiskMetrics wishes to draw the attention of the Committee to the following issues in relation to the draft Regulations released by the Treasury. As the Committee is aware, the draft Regulations are instrumental in establishing the scope of the two key terms of “base salary” and “benefit”:

- **Status of personal contributions to superannuation:** RiskMetrics notes that the Bill appears to capture as a benefit requiring shareholder approval on termination (above the threshold) any contributions to superannuation over and above statutory requirements (draft reg. 2D.2.01(b)). This raises the possibility of an executive requiring shareholder approval to receive contributions made by way of salary sacrifice or out of post tax income on departure. RiskMetrics considers this would be undesirable and the Bill or the Regulations should be amended to ensure that personal contributions to superannuation do not require shareholder approval on departure (subject to necessary measures designed to prevent abuse).



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- **Exceptions to benefit:** There is also potential for the exceptions to “benefit” introduced by the draft Regulations to be manipulated in relation to the proposed exception of “deferred bonus” in draft reg. 2D.2.01(2)(a). Presumably, the intention is to exclude bonus entitlements that have accrued prior to, but have not been paid at the time of, the commencement of the provisions set out in the Bill. If that is the case, this should be made explicit and the exception should be “grand-fathered” in line with the exception for payments from defined benefits schemes in proposed reg. 2D.2.01(2)(b). (The latter could also be clarified by making it explicit that the exception applies only to defined benefit entitlements that have accrued up to the time of the commencement of the Bill.)

RiskMetrics also notes that the Bill may potentially encourage companies to seek to avoid shareholder approval by categorising amounts paid on cessation of employment as bonuses for services prior to departure (it is common at present for an executive to be entitled on termination to an amount based on their bonus entitlement for the year in which termination occurs based on performance regardless of the proportion of the financial year served). The Bill should be amended to ensure that any such payments are caught within the definition of a benefit in connection with cessation of employment along with accelerated vesting of options (and other equity incentives) presently caught under the draft Regulations (see reg. 2D.2.02).

Please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail. Thank you once again for the opportunity to comment on the issues raised in the Bill.

Yours sincerely

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