

Senate Standing Committee on Finance and Public Administration

ANSWERS TO QUESTIONS ON NOTICE

Prime Minister and Cabinet Portfolio

Department of the Prime Minister and Cabinet

Additional Estimates 23-27 February 2009

Question: PM32a-g

Outcome 1, Output 1

Topic: Guidelines for addressing excessive executive salaries

Hansard Page: Written Question

Date set by the committee for the return of answer: 9 April

Senator Brown asked: In October 2008, the Prime Minister announced that the Government will develop draft guidelines for addressing excessive executive salaries, for discussion throughout 2009. The basic proposal is to link the structure of salary packages to capital holding requirements by APRA [Australian Prudential Regulatory Authority] regulated institutions.

- a) Why has the Prime Minister produced no such proposal?**
- b) Banks are already required to increase capital holdings if they take riskier decisions - so how would the link to executive salaries actually work in terms of encouraging greater risk management?**
- c) Under this proposal, is it still possible for companies to pay bonuses to CEOs even if they perform poorly? Will these guidelines allow for shareholder oversight of CEO salaries or bonuses?**
- d) Will these guidelines be voluntary or mandated?**
- e) Should the government need to assist a financial institution through its bank guarantee, is there anything in that guarantee which attaches conditions to the level of executive salaries or bonuses payable by the institutional receiving public funds?**
- f) The Prime Ministers proposal is dependent on definitions of 'excessive salaries' and 'excessive risk' and 'adequate capital requirements? What does the word 'excessive' mean? Is there an example in recent Australian corporate history of an excessive salary?**
- g) Why are President Obama's proposals on reining in executive greed, applied proportionately, not applicable in Australia?**

Answer:

32(a) In October 2008, the Prime Minister announced that the Government would be examining with the Australian Prudential Regulatory Authority what domestic policy actions on executive remuneration would be appropriate to avoid excessive risk-taking in Australia's financial institutions. In response to this request, and as outlined in its press release of 9 December 2008, APRA is developing a discussion paper on the necessary Australian prudential standards and prudential practice guide addressing sound compensation policies in APRA-regulated banks and insurance companies.

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APRA is scheduled to release the discussion paper in May 2009 to provide interested parties with the opportunity to submit their views. After considering submissions, APRA will issue a response paper along with draft prudential standards and guidance to be applied by the boards of APRA-regulated institutions. This response paper will provide interested parties with another opportunity for submissions before APRA finalises its approach, expected to be during the second half of 2009.

The Government has also requested the Productivity Commission to examine Australia's remuneration framework for company directors and executives. This inquiry will examine the existing regulatory arrangements that apply for companies, which are disclosing entities regulated under the *Corporations Act 2001*, including shareholder voting, disclosure and reporting practices. The inquiry will go beyond APRA-regulated financial entities. The Productivity Commission is expected to release an issues paper in early April 2009 and submit a final report to the Government by 18 December 2009.

The Government has also announced that it would amend the Corporations Act to significantly lower the threshold at which termination payments (also known as golden handshakes) must be approved by shareholders. Under the current legislation, termination payments can reach up to seven times a director's total annual remuneration package before shareholder approval is required. The Government has announced that it will reduce this threshold to one year's base salary and also expand the coverage of this requirement to all executives disclosed in the company's remuneration report.

32(b) Once finalised, the APRA prudential standards on sound executive remuneration arrangements will have statutory force. These standards will establish formal accountability of company boards. APRA will also issue a practice guide on sound and unsound remuneration practices. The practice guide will be a reference for company boards and other interested parties. The prudential standards and the practice guide will be the basis of amendments to APRA's supervisory methods to include an expanded and explicit focus on risk relating to unsound compensation incentive structures. APRA-regulated entities without sound remuneration practices will be subject to supervisory intervention, including, where appropriate, increased capital charges.

32(c) The Corporations Act requires companies that are disclosing entities to prepare an audited remuneration report, containing comprehensive details of remuneration packages, including a discussion of the relationship between executive remuneration and company performance. That is, companies are required to explain to shareholders the link between executive remuneration and performance.

The Corporations Act also provides shareholders with the opportunity to cast a non-binding vote on the company's remuneration report at the annual general

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meeting. The non-binding vote on remuneration provides shareholders with an effective mechanism to communicate their views to the company.

As noted above, the Government has moved to curb excessive termination payments and has referred the broader issue of executive remuneration to the Productivity Commission.

32(d) APRA intends to amend existing prudential standards on governance to mandate that boards must develop and maintain a prudential remuneration strategy. The prudential standards have statutory force. APRA also intends to issue a prudential practice guide on sound and unsound remuneration practices. This guide lacks statutory force, but assists boards (and APRA supervisors) in encouraging sound practice and avoiding poor practice. This approach is consistent with APRA's general approach to behavioural standards, which cover several areas including fit and proper responsible persons, risk management, and business continuity management.

32(e) There are no conditions relating to executive remuneration attached to the bank guarantee. As noted above, the Government has moved to curb excessive termination payments and has referred the broader issue of executive remuneration to the Productivity Commission.

32(f) The Productivity Commission will be conducting an inquiry into the broader issue of executive remuneration.

As noted above, a company's remuneration report contains comprehensive information on the remuneration arrangements of directors and executives, including base pay, incentive pay and termination payments. This information is included as part of a company's annual report and is publicly available.

32(g) Australia's financial system does not face the same problems as in the US. Unlike the US, no Australian financial institution has a capital shortfall requiring capital injections from the government. As a result, the Government has not needed to exercise the same control over Australian banks as has occurred in the US. US banks have required capital injections from the US Government to restore liquidity and stability in its financial system. As a result, the US Government has imposed conditions on executive pay in these banks.

As noted above, the Government has moved to curb excessive termination payments and has referred the broader issue of executive remuneration to the Productivity Commission.