

Chapter 1

Introduction

Background and conduct of the inquiry

1.1 The Government announced its intention to amend the *Corporations Act 2001* on 18 March 2009.¹ The principal change announced was to lower the threshold for shareholder approval for termination payments paid to company directors and certain other persons from the current seven years' *total remuneration* to one year's *base salary*.

1.2 On 5 May 2009, the Treasury released an exposure draft of the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 for public consultation. It also released an exposure draft of regulations to be made under the bill. This process led to a number of changes to the bill prior to introduction.²

1.3 The bill was introduced into the House of Representatives on 24 June 2009.

1.4 On 25 June 2009, the Senate referred the provisions of the bill to the Senate Economics Legislation Committee for inquiry and report by 7 August 2009. It was later agreed to extend the reporting date to 7 September 2009.

1.5 The committee invited written submissions by 19 July 2009. Details of the inquiry were placed on the committee's website and the committee also wrote to a number of organisations inviting written submissions. Submissions received by the committee are listed at Appendix 1.

1.6 A public hearing was held in Sydney on 25 August 2009. A list of witnesses appearing at the hearing is at Appendix 2.

1.7 The committee thanks those who participated in this inquiry.

Existing rules governing termination payments

1.8 Termination payments are governed by Division 2 of Part 2D.2 (Sections 200A to 200J) of the *Corporations Act 2001* ('the Act').

1 The Hon Wayne Swan MP, Treasurer, at Joint Press Conference with Senator the Hon Nick Sherry, Minister for Financial Services, 18 March 2009, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=transcripts/2009/041.htm&pageID=004&min=wms&Year=&DocType=2>, viewed 8 July 2009.

2 Treasury website, <http://www.treasury.gov.au/contentitem.asp?NavId=066&ContentID=1584>, viewed 22 July 2009.

1.9 Sections 200B and 200C of the Act prevent the payment of a benefit to a person in connection with their retirement from a 'board or managerial office' without the approval of members of the company (i.e. shareholders in the case of a listed company).

1.10 Under section 200D of the Act, receipt of a benefit in contravention of sections 200B or 200C is an offence. Section 200E sets out the rules for obtaining member approval.

1.11 Sections 200F and 200G provide exemptions to the requirement to obtain member approval. The most relevant to this inquiry is that member approval is not required for retirement benefits which are less than seven years' total remuneration.

1.12 Section 200H provides that benefits do not require approval if failure to give the benefit would 'constitute a contravention of a law in force in Australia or elsewhere'. Section 200J provides that benefits paid in contravention of section 200B are taken to be held in trust by the person for the company.

1.13 Additional guidance on termination payments is provided by the ASX Corporate Governance Guidelines, which state in relation to termination payments:

Termination payments, if any, for chief executive officers should be agreed in advance, including detailed provisions in case of early termination. There should be no payment for removal for misconduct. Agreements should clearly articulate performance expectations. Companies should consider the consequences of an appointment not working out, and the costs and other impacts of early termination.³

Other inquiries currently underway

1.14 On 18 March 2009, the Government also announced a Productivity Commission inquiry into executive remuneration more generally. The Commission is due to release its draft report in September and its final report by 19 December 2009.⁴

1.15 On 24 May 2009, the Australian Prudential Regulatory Authority (APRA) released a discussion paper on remuneration for authorised deposit-taking institutions. Subject to consultation, it is expected that the final prudential standards and associated prudential practice guide will be released in September 2009 and effective from 1 January 2010.

3 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (2nd Edition), 2007, p. 36.

4 Productivity Commission website, <http://www.pc.gov.au/projects/inquiry/executive-remuneration>, viewed 21 July 2009.

Previous parliamentary consideration

1.16 In June 2004, the Parliamentary Joint Committee on Corporations and Financial Services noted concern about the current thresholds:

...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.⁵

1.17 The committee unanimously recommended that 'all payments made to directors be subject to shareholder resolution including payments such as the maximum annual cash payment and any retirement benefit or termination payout.'⁶

1.18 Australian Labor Party members of the committee called for the Act to be amended so that shareholder approval is required for termination payments which exceed one year's salary (excluding statutory super).⁷

1.19 Treasury cited the work of the Parliamentary Joint Committee as evidence that 'there has been concern for a number of years about the need for reform to these arrangements'.⁸

Provisions of the bill

1.20 In summary, the bill:

- lowers the amount that a termination payment may be before shareholder approval is required. The threshold will go from seven years' total remuneration to one year's base salary. The term 'base salary' will be defined in regulations;
- extends the Act to cover termination payments for all 'key management personnel' (i.e. not just the CEO and directors but other senior people). In the

5 Parliamentary Joint Committee on Corporations and Financial Services, 'CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters,' June 2004, p. 95.

6 Parliamentary Joint Committee on Corporations and Financial Services, 'CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters,' June 2004, Recommendation 16.

7 Parliamentary Joint Committee on Corporations and Financial Services, 'CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters,' June 2004, p. 259.

8 Mr Geoffrey Miller, General Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 73.

case of reporting entities, this consists of all key individuals that are disclosed in the company's remuneration report;

- prevents directors and executives from voting in relation to their own benefit (except in relation to proxies);
- requires that any payments made without required approval must be repaid; and
- increases penalties for payments made without approval.

1.21 These provisions will commence the day after Royal Assent, but will only apply in relation to contracts which are made, renewed or varied after commencement.

1.22 The bill establishes four new regulation-making powers:

- The definition of 'base salary' (under section 9 of the Act);
- A list of things to be specified as benefits (under section 200AB(1));
- A list of circumstances in which a benefit can be given in connection with retirement (under section 200A(1A)); and
- Cases where the restriction on voting by retirees or associates on their own termination payment does not apply (under section 200E(2C)).

1.23 The committee understands that Treasury is currently engaged in further targeted consultations on the content of the regulations.