

Minority Report by Senator Xenophon

Introduction

- 1.1 The *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* amends the *Corporations Act 2001* to lower the threshold at which termination payments to company executives (including senior executives or key management personnel) must be approved by shareholders. It also specifies the types of benefits which are subject to shareholder approval, requires unauthorised termination benefits to be repaid immediately, provides that retiree shareholders cannot participate in a vote on their termination benefit (except as a proxy), and increases the penalties applicable to unauthorised termination benefits.
- 1.2 While I broadly support the intent of this Bill, a number of areas require further clarification. These areas include the conditions on which considerations of executive performance are made and the method by which payments are collected. This minority report addresses these and other areas requiring clarification.

Background

- 1.3 Submissions to the inquiry made it clear that the rate of corporate executive payments has grown at a significantly greater proportion than the average wage over the past twenty to thirty years. For instance, between 1971 and 2008, the growth in corporate salaries was around 470 percent, nearly nine times the 54 percent growth in real average weekly earnings over the same period.¹
- 1.4 Today, the average CEO of a top 100 company reportedly receives a termination payment of \$3.4 million, which is equivalent to twice their annual salary.²
- 1.5 The purpose of this Bill is to reduce the number and size of 'golden handshake' payouts made to corporate executives. Specifically, the Bill stipulates that the condition for shareholder approval of terminations payments be any payment that exceeds one year's base pay.
- 1.6 Under current Commonwealth legislation, corporate executives are eligible to receive up to seven year's total remuneration without need for shareholder approval. In its submission to the Committee, Treasury offered the following example:

"For example, a person with seven years service and an annual average salary over the last three years of \$10 million would be

¹ Professor David Peetz, *Submission 15*, pg 4

² *ibid*, pg 23

entitled to receive a termination payment of up to \$70 million without seeking shareholder approval".³

- 1.7 Treasury also referred to a November 2008 report by risk management and corporate governance analysts, RiskMetrics, which found that "out of a sample of 33 CEOs, only two (or approximately 6 percent) sought shareholder approval for termination payments".⁴

Consideration of executive performance and payouts

- 1.8 Submissions to the inquiry highlighted that Australia does not currently match international standards in reduction of thresholds for executive payments. Guerdon Associates (which specialises in board and executive remuneration matters) stated in its submission that "termination payments for North American executives are typically 2.99 times base salary plus bonus, while the Europeans... are content to set the level at twice base salary"⁵.
- 1.9 This Bill, by reducing the threshold from seven year's to one year's salary, will match or better the accountability standards for termination payments of many Australia's international competitors.
- 1.10 However, a number of submissions to the Committee expressed concern that reducing the threshold to one year's base salary was too low and would affect Australia's ability to attract executives of international standard.
- 1.11 There are also concerns that eliminating 'golden handshakes' will only result in 'golden hellos', whereby executives will access increased base salaries on commencement, increased bonuses in other forms, or other loopholes by which they will be able to maximise their income.
- 1.12 There is also an existing loophole whereby executives can have their termination payment pre-approved and included within their contract at the commencement of their employment.
- 1.13 In its submission, RiskMetrics argues that:
- "... 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."⁶

It goes on to explain:

"Without this requirement, based on RiskMetric's experience, boards may seek to maximise their discretion to pay termination benefits."⁷

³ Treasury, *Submission 22*, pg 4

⁴ *ibid*, pg 5

⁵ Guerdon Associates Pty Ltd, *Submission 1*, pg 3

⁶ RiskMetrics Australia, *Submission 11*, pg 2

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- 1.14 Further to this, shareholders should be able to re-approve this pre-determined payment at termination, where all the criteria for the pre-approved payment is not satisfied (for example, the executive only serves two years out of their three year contract) and where the value exceeds the threshold.
- 1.15 Similarly, the Bill should allow shareholders to vote on a specific amount at the time of termination, where the payment is greater than the threshold and where it was not pre-approved. This will prevent executives from receiving a vote in favour of a termination payment above the one year's base salary and the Board then determining how much greater it will be.
- 1.16 Importantly, companies should not be able to avoid shareholder rulings regarding executive payments and shareholder votes should be made binding. In the past year, shareholders have voted against 15 out of 300 companies' remuneration reports⁸, however the votes were considered 'simply advisory'.
- 1.17 This was clearly demonstrated in the case of ex-Telstra CEO, Sol Trujillo, in November 2007, when two-thirds of Telstra's shareholders voted against a pay increase for Mr Trujillo but this decision was not adhered to by the Board.⁹

Poor performance

- 1.18 While I support the proposed changes in this Bill in relation to shareholder approval of corporate executive payouts, I believe that the conditions upon which corporate executive performance is measured should be further clarified, especially where the reason for departure is due to poor performance.
- 1.19 In its submission to the Committee, Treasury referred to studies by Geof Stapledon which highlighted several instances of large termination payments being made following a period of very poor corporate performance.

"In 2002, five senior executives of AMP departed with close to \$12 million, despite the fact that they had been in office while AMP lost more than \$13 billion of its market value."¹⁰

and,

"In 2003, Southcorp's CEO, Keith Lambert, departed with a termination payment of \$4.4 million, even though during his 19 months at the helm, Southcorp's shares lost 40 percent of their value."¹¹

⁷ *ibid*, pg 2

⁸ Parliamentary Library, Bills Digest – Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, 05 August 2009, pg 4

⁹ Emma Alberici, ABC The World Today, *Telstra shareholders reject directors' pay rise*, 07 November 2007 <http://www.abc.net.au/worldtoday/content/2007/s2084383.htm>

¹⁰ Treasury, *Submission 22*, pg 2

¹¹ *ibid*, pg 2

- 1.20 Professor David Peetz, Professor of Employment Relations, Griffith University, stated in his submission:

"It is clear that a number of large payouts were made to CEOs who underperformed, or whose poor performance was the reason for their departure."¹²

Professor Peetz also referred to a study by RiskMetrics, which found that "one-third of the nation's top 100 companies in the past three years paid their chief executives a combined \$112 million to 'go away'."¹³

- 1.21 Shareholders, by the very nature of their holdings, should be granted greater powers when it comes to approving and evaluating the performance of their executives. Unless all performance criteria are met, executives should not be entitled to receive payments above the termination payment threshold – in the same way as the average worker does not receive payment for poor work outcomes.
- 1.22 However it is apparent that companies are not detailing in full the reasons for departure. The Australian Council of Super Investors states in it's submission:

"We remain concerned that companies should be more transparent with their shareholders with respect to whether executives have in fact resigned, retired or been terminated. There appears to often be an inconsistency arising where CEO's departures are not described as terminations, however later disclosures reveal that termination payments were still made."¹⁴

- 1.23 The definition of 'poor performance' should be more clearly defined, particularly in relation to whether it is determined by profit and share price in comparison to competitors, and the executive's performance against these measures should be presented to shareholders for their vote.

Methods by which payouts are accessed

- 1.24 Tax concessions were created to encourage employee share ownership but have become increasingly popular for CEOs themselves. According to analyst, Dean Paatsch from Riskmetrics Australia:

"... tax need only be paid on a maximum of 20 percent of the value of the share component of CEO pay. Once the shares are safely ensconced in the hands of the executive, the capital gains tax regime kicks in to ensure that future gains after one year are taxed at 22.5 percent."¹⁵

¹² Professor David Peetz, *Submission 15*, pg 23

¹³ *ibid*, pg 23

¹⁴ Australian Council of Super Investors, *Submission 13*, pg 2

¹⁵ Dean Paatsch, *The Age*, *Tackling tax breaks is vital as CEO salaries soar*, 03 May 2008
<http://business.theage.com.au/business/tackling-tax-breaks-is-vital-as-ceo-salaries-soar-20080502-2aeo.html?page=-1>

Mr Paatsch goes on to state:

"It's no wonder that there's been an explosion in share payments to CEOs – the average share payment to Australia's top 300 executives is now valued at about \$600,000 a year (double five years ago). If the research about the routine undervaluation of options is right, that \$600,000 ends up being worth about \$2.1 million to the executive. And the tax on this largesse? Well, it seems many executives get to choose their own rate - and you can bet your life it's not the 46.5 percent top PAYG rate or, in many cases, even the 31.5 percent rate that the bulk of taxpayers cop."¹⁶

1.25 Corporate executives receiving significant termination payments should be prevented from using non-taxable bonuses, low-tax bonuses or 'salary sacrificing' of their payments to effectively maximise a termination payment above that approved by shareholders.

1.26 One way to address this would be to introduce a new high tax rate. Professor Peetz advocates the creation of a "new, higher marginal tax rate that cuts in at a substantially higher income range than at present (for instance, \$400,000 per annum) but into which CEOs would typically fall"¹⁷.

He also suggests wealth taxation on very high income individuals "for example, those with over \$20 million in accumulated wealth"¹⁸ as a means to address this concern.

1.27 A review of how executives are able to collect these payments should be carried out to close any loopholes executives may be maximising to their benefit.

Conclusion

1.28 While I support the premise of this Bill, I believe it requires amendment if it is to successfully match its intent.

1.29 The Productivity Commission is due to release its findings into executive remuneration in December 2009 and the Australian Prudential Regulatory Authority is also preparing a discussion paper on remuneration, to be published in September 2009. The findings from these reports should be considered to make further amendments regarding termination payments, and the legislation should include a sunset clause which would trigger a review based on the findings of these reports.

¹⁶ *ibid*

¹⁷ Professor David Peetz, *Submission 15*, pg 27

¹⁸ *ibid*, pg 27

Recommendation 1

That the Bill not be passed in its current form.

Recommendation 2

That the Bill be amended so that shareholders are able to vote on the exact amount of termination payment, not just in favour of "an amount greater than the threshold".

Recommendation 3

That the Bill be amended such that corporate Boards are required to specify whether an executive has resigned, retired or been terminated, and that the reason for resignation is stated.

Recommendation 4

That the Bill be amended for shareholders to be required to re-approve termination payments where the amount has been pre-approved at the time of employment, is greater than one year's base salary, and where performance by the executive has not been satisfactory.

Recommendation 5

That the Bill be amended so that that shareholder votes for termination payments are binding.

Recommendation 6

That the Bill be amended such that executives are prevented from using taxation and other loopholes to maximise termination payments, such as non-taxable bonuses or share schemes.

Recommendation 7

That the Bill includes a sunset clause of two years from the date of release of the Productivity Commission's final report into executive remuneration in order to trigger a review of this legislation, taking into account the report findings.



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