

**NATIONAL OFFICE**

Level 2, 255 George Street  
Sydney NSW 2000 Australia  
TELEPHONE 02 8248 6600  
FACSIMILE 02 8248 6633  
media@companydirectors.com.au  
www.companydirectors.com.au

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## **AICD says termination payments legislation still flawed**

The Federal Government's moves to restrict executive termination payments go too far and will impact on the ability of Australian companies to recruit top quality executives, the Australian Institute of Company Directors (AICD) said today.

While welcoming some improvements made to the original draft legislation, it believes the *Corporations Amendment (Improving Accountability on Termination Payments) 2009* still has a number of practical difficulties and will have unintended consequences.

AICD welcomed the Government's decision not to proceed with the original proposal to force companies to wait until the next Annual General Meeting (AGM) following the departure of an executive to seek shareholder approval of a termination package.

The legislation brought into the Parliament today retains the existing provisions, which allow a shareholder vote to be held any time prior to the termination payment being paid to a director or executive.

This would permit companies to seek prior shareholder approval for the payment of termination benefits or call a special shareholders' meeting to approve termination payments, rather than waiting until the next AGM, which could be up to 12 months away.

However, AICD is disappointed that the Government has not addressed concerns about the impact of its imposition of a threshold of just one year's base salary before a termination payment requires shareholder approval.

There is no other comparable jurisdiction that has a legally prescribed shareholder approval threshold as low as one year's base pay. Termination payments for North American executives are typically about three times base salary plus bonus, whereas the European Corporate Governance Forum's guidelines state that up to two times annual remuneration is acceptable for director severance payments without shareholder approval. The United Kingdom has a 12-month threshold, but this is voluntary under an "if not, why not" disclosure regime.

The one-year base salary threshold contained in today's legislation unduly limits the flexibility of boards when negotiating senior executive remuneration packages and will impact on their ability to secure

executives. It will also stifle innovation in remuneration structures to enhance the alignment of executive reward with performance and improving shareholder value.

As virtually 100 per cent of recruitment searches for CEOs and their direct reports for ASX200 companies are global, it would put Australian companies at a competitive disadvantage in the market for executive talent relative to overseas companies, with flow-on consequences for business performance, jobs and the economy, said AICD chief executive, John Colvin.

“We remain of the view that the shareholder approval threshold should be changed from one year’s base salary to two year’s total remuneration,” he said.

“The Government should at least consider allowing a ‘stepping down’ of potential termination payments to give greater flexibility in this regard, with a threshold of two year’s total remuneration within the first two years of a contract, reducing to one year’s salary over time.”

AICD is also concerned that the definition of what constitutes base salary and what types of payments will be treated as a termination benefit, to be specified in regulations, is yet to be clarified. AICD will seek to actively participate in the targeted consultations the Government will conduct to finalise these definitions.

While AICD is still considering the detail of the legislation, it appears that it could produce some bizarre consequences. This includes the pro-rata reduction of the approval threshold where an executive has held office for less than one year, which significantly increases the uncertainty and risks for executives in accepting a new position and is likely to result in the inability to secure some candidates.

AICD called for the strict liability regime for directors contained in the legislation to be removed and said that the proposed increase in penalties should not proceed.

“A strict liability regime is inappropriate in relation to the payment of termination benefits, particularly where there remain so many uncertainties in connection with the current law and further uncertainties around the new definition of “base salary” and what should be included when determining whether shareholder approval is required,” Mr Colvin said.

“If strict liability is to be adopted for the failure to comply with a legislative requirement, the obligation must be unambiguous.”

“The changes – including the reduced approval threshold which could apply to all companies big or small, for-profit or not-for-profits and charities – should also clearly apply only to publicly listed companies, as this is the only area identified with any problems,” he said.

**Media Contacts:**

Steve Burrell, General Manager Communications and Public Affairs, (02) 8248 6627 or 0407 708 485

Juliet Chandler, Communications Advisor, (02) 8248 6624 or 0412 580 402

**Australian Institute of Company Directors (AICD)** provides education, information and advocacy for company directors Australia wide, with offices in each state to cater for over 24,500 members. AICD members work in diverse corporations such as small-to-medium enterprises, the ASX Top 200 corporations, public sector organisations, not-for-profit companies, large private companies and smaller private family concerns.