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## **Productivity Commission is right to reject salary caps, says AICD**

The Australian Institute of Company Directors (AICD) has welcomed the Productivity Commission's recognition that salary caps and other prescriptive regulation are not the answer to tackling concerns about executive remuneration.

Responding to the Commission's draft report into regulation of executive remuneration released today, AICD supported a number of the recommendations, particularly removing the current taxation impediment to the deferral of incentive pay for senior executives, noting that it has already advocated many of the proposed changes itself.

However, it expressed concern about the unintended consequences of the proposed "two strikes, you're out" policy forcing boards to face re-election if a minority of shareholders vote against company remuneration reports in two successive years.

It also noted that comments made in the report raised doubts about the appropriateness of including a one year's base pay threshold for shareholder approval of a payout in the Federal Government's termination payments legislation.

AICD welcomed the thoroughness of the Productivity Commission's report, the consideration it has given to a range of views on the issue and its intention to "stress test" its proposals through further consultation with business.

"We commend particularly the Commission's recognition of the central role of the board in setting executive remuneration and its acknowledgement that the way forward is not to by-pass the board through prescriptive regulatory measures such as pay caps," said AICD Chief Executive John Colvin.

"The Commission recognises that these would give rise to severe practical problems and have undesirable consequences for Australian companies and shareholders, as well as serving to weaken the important alignment between shareholders' interests, company performance and executive pay."

AICD also welcomed the Commission's view that a binding vote on the remuneration report would be unworkable in practice and would fundamentally compromise the capacity and authority of boards to negotiate with executives.

However, AICD has concerns about the practical problems that may flow from the draft recommendation for a "two strikes, you're out" policy. This would force all non-executive board members to face re-election if there were two consecutive remuneration reports receiving 'no' votes above 25 per cent in the first year and an unspecified vote threshold, possibly also 25 per cent, in the second year.

"Such a 'Say on Pay' policy, while perhaps superficially attractive from a shareholder engagement perspective, could open a Pandora's box of unintended consequences for both boards and shareholders," Mr Colvin said.

"The current non-binding vote on the remuneration report has worked well. Boards take them very seriously and have generally responded to the shareholder concerns expressed in those votes."

"Requiring them to formally explain and respond to shareholders after a 25 per cent 'no' vote – the 'first strike' – is merely codifying something many companies would already do."

“However, the ‘two strikes’ approach would make a second vote against the remuneration report effectively a vote against the entire board – and, crucially, it could give that power to a minority of shareholders.”

“It would disenfranchise the majority, up to 75 per cent depending on the threshold decided, who vote in favour and could see the remuneration report become a battleground for a wide range of issues and interests that may have nothing to do with remuneration.”

“The remuneration report could become a stalking horse for any issue, of which a relatively small minority of shareholders could take advantage, with consequences for board stability and business continuity.”

“For this reason it creates some of the same problems thrown up by a binding vote on remuneration, which the Commission explicitly rejects.”

AICD supported a number of the Productivity Commission’s recommendations relating to avoiding conflicts of interest in setting remuneration, noting that it had already advocated a number of the proposed changes in its own policies and guidelines for boards.

In particular, it backed strengthening requirements for the independence of remuneration committees, including having a majority of independent directors and an independent chairman, although it questioned whether this should extend as far as a listing requirement for all ASX 300 companies as recommended by the Commission. AICD welcomed the proposal to promote remuneration committee independence in other listed companies on a “comply or explain” basis but questioned whether a separate listing requirement was needed in any case.

It backed the proposal to prohibit executives from voting their shares on the remuneration report, as well as requiring remuneration consultants to be independent of management, reporting directly to the board or remuneration committee, and for disclosure in remuneration reports of the use of remuneration consultants on a “comply or explain” basis.

It strongly supported a prohibition on executives hedging unvested shares and options, which undermines the incentives provided by “at risk” pay. This is already AICD policy.

“Plain English” presentation of remuneration reports and reporting of total realised pay for executives would also improve investor understanding of executive pay and would be a valuable reform, Mr Colvin said.

AICD strongly supported the Commission’s recommendation to remove the taxation impediment to deferred equity incentive pay currently in the tax system.

“The current arrangements which deem equity or rights to vest, and become subject to taxation, at the point an executive leaves a company runs completely counter to calls by shareholder groups, proxy advisors and APRA, as part of its new remuneration guidelines, to allow deferral of equity incentives beyond the point of departure,” Mr Colvin said.

“Removing this barrier to deferred remuneration would encourage longer term alignment of shareholder and executive interests and reduce incentives for excessive risk-taking.”

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**Australian Institute of Company Directors (AICD)** provides education, information and advocacy for company directors Australia wide, with offices in each state to cater for 25,000 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.