

## CHAPTER 5: REMUNERATION OF DIRECTORS AND EXECUTIVES

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### Overview

405. Schedule 5 of the Bill contains amendments to:

- sections 300 and 300A of the Corporations Act regarding the disclosure of director and executive remuneration; and
- Division 2, Part 2D.2 governing the payment of termination benefits to directors.

406. These amendments are designed to strengthen the current provisions of the Corporations Act and address concerns about the lack of disclosure of payments made to directors and executives.

407. The Bill recognises that it is generally the function of members to approve the remuneration of directors and the function of directors to determine the remuneration of executives. In performing their function, boards need to be accountable for their decisions and shareholders need to be in a position to exercise their rights in an active and informed way. The provisions of the Bill are designed to achieve these objectives by promoting transparency and improving the accountability of those parties who determine remuneration.

408. The Bill builds on measures proposed in the Corporations Amendment Bill 2002 (CAB), which was released for consultation at the end of 2002. The CAB sought to clarify the current disclosure requirements in sections 300 and 300A of the Corporations Act. These provisions have been incorporated into the CLERP 9 Bill and are being advanced as part of the broader changes proposed by the Government to the disclosure requirements (see items 8 and 10).

409. The amendments in this Bill seek to enhance the existing regulatory framework by:

- extending the application of the disclosure requirements beyond the listed company to include the corporate group;
- enhancing the specific disclosures that must be made;

- giving shareholders greater capacity to hold directors accountable for their decisions regarding remuneration; and
- providing shareholders with greater say in relation to the quantum of termination payments.

410. As part of implementing the HIHRC recommendations, the Bill will rationalise definitions of 'officer' and 'executive officer'. A new definition will be inserted into the Corporations Act — 'senior manager' — which effectively covers paragraph (b) of the current section 9 definition of 'officer' (see Schedule 1, item 78 and Schedule 9). The term 'senior manager' will be applied to the section 300A disclosure requirements.

### **Remuneration information to be on a group basis**

411. Currently section 300A requires disclosure of the remuneration of directors and executives of a listed company. The disclosures required by section 300A are part of the broader financial reporting framework in Part 2M.3 of the Corporations Act. Other obligations in this Part require reporting on a consolidated basis. For example, subsection 299(2) requires listed companies to prepare their annual directors' report on a consolidated basis if they are required to prepare consolidated financial statements.

412. The Bill amends section 300A of the Corporations Act to require disclosure of the remuneration of directors and senior managers in relation to both the listed company and consolidated entity (items 10 and 11, proposed paragraphs 300A(1)(a) and 300A(1)(c)). The intent of these provisions is to provide a better picture of remuneration practices across the corporate group and to prevent corporate structures being used as a way of circumventing the reporting requirements.

413. The effect of the amendments will be to retain the current requirement for the disclosure of remuneration in relation to the five most highly remunerated senior managers and all the directors of the listed company. The provisions extend the disclosure requirements to the top five senior managers in the consolidated entity (item 11, proposed paragraph 300A(1)(c)).

414. In some circumstances the requirements may lead to the disclosure of the remuneration of up to 10 senior managers. In other circumstances it may be less, for example where one or more of the senior managers is within the top five in the listed company and also in the top five within the corporate group. In these circumstances the disclosure of that person's remuneration need only be made once (item 11, paragraph 300A(1)(c)). In determining this person's remuneration, all sources of their remuneration from within the group must be taken into account (item 13, proposed subsection 300A(4)).

415. Disclosure of the remuneration of all directors on a group wide basis will not be required as this could potentially place a large reporting burden on listed companies that have many related entities without providing any real benefit to users of financial reports.

### **Specific content of the remuneration section of the annual directors' report**

416. The Bill provides that the details of remuneration to be disclosed will be prescribed in regulations (item 11, proposed paragraph 300A(1)(c)), which will provide greater flexibility in tailoring the disclosure requirements.

417. In making disclosures about director and executive remuneration companies should approach their obligation from the starting point of providing shareholders with comprehensive disclosure. Shareholders should be placed in a position whereby they can understand the nature of the remuneration including any performance hurdles or contingencies on which the payment is based.

418. This will ensure shareholders are informed about the framework and main components of remuneration and understand the relationship between performance and remuneration. In addition the disclosure framework will limit the element of surprise in the event of a payment being made especially where that payment accrued over a number of years.

419. The Bill requires the remuneration disclosures to be made in a clearly dedicated section of the annual directors' report (item 9, proposed subsection 300A(1)).

### **Specific disclosures**

420. The Act will retain the current requirements in paragraphs 300A(1)(a) and 300A(1)(b) relating to the discussion of board policy and the relationship between remuneration and company performance. The language of paragraph 300A(1)(a) has, however, been modified to reflect amendments originally proposed in the CAB and to extend the application of the provision to corporate groups.

421. Disclosures under proposed paragraph 300A(1)(a) and paragraph 300A(1)(b) should explain the qualitative aspects of remuneration, the basis on which remuneration packages are structured and how this relates to corporate performance. To assist in meeting this obligation, the regulations will require disclosure of information such as performance hurdles to which the payment of options or long term incentives of directors and executives are

subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met.

422. The Regulations will outline the disclosures that are to be made under proposed paragraph 300A(1)(c). This section primarily relates to the quantitative elements of remuneration. The regulations will require disclosure of the nature and amount of each element of the remuneration of the persons named in proposed paragraph 300A(1)(c) (item 11).

423. It is intended that the information to be disclosed will be the same as that proposed to be disclosed under the accounting standards (see AASB ED 106 *Director, Executive and Related Party Disclosures*). The intention is that a company that meets the requirements in the accounting standards will also be in compliance with the requirements in the regulations. This approach takes into account recommendation 1 of the HIHRC, which indicated that remuneration disclosure requirements should achieve clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form.

424. In the absence of an accounting standard, as a minimum, the following information will need to be disclosed:

- primary benefits including cash and other incentive and base remuneration;
- post-employment benefits, including retirement benefits and contributions by, or changes in the liability of, the entity to pension or superannuation plans and other arrangements to benefit employees following cessation of employment;
- equity compensation; and
- other compensation benefits not disclosed under the above categories.

425. Details of the elements falling under each category are contained in AASB ED 106 *Director, Executive and Related Party Disclosures*.

426. Prior to the commencement of the Bill, the progress of ED 106 will be monitored to determine how the actual regulations will be framed. The AASB's work program indicates that the standard is intended to be finalised in the fourth quarter of 2003.

## **Discussion of remuneration disclosures at company AGMs**

427. The Bill also sets up a framework that gives shareholders an opportunity to collectively express their opinion on the remuneration paid to

directors and senior managers and the board's policy on remuneration. This will facilitate more active involvement by shareholders and improve the accountability of directors for decisions regarding remuneration.

428. The Bill requires the chair of the AGM to allow reasonable opportunity for discussion by shareholders of the remuneration section of the directors' report at the AGM (item 6, proposed section 250SA). In addition, the directors must put, and allow shareholders to vote on, a non-binding resolution as to whether the members adopt the remuneration report (item 7, proposed subsection 250R(2)). The notice of meeting must inform members that the resolution on the remuneration report will be voted upon (item 5, proposed subsection 249L(2)).

429. While the resolution will not be binding, the process provides an avenue for shareholders to actively express any views they may have regarding decisions taken in relation to remuneration.

### **Shareholder approval of termination payments**

430. Part 2D.2, Division 2, of the Corporations Act governs the circumstances in which shareholder approval is required before a benefit may be given to a person in connection with their retirement from 'board or managerial office'. 'Board or managerial office' effectively applies the provisions to company directors regardless of whether they act in different capacities within the company.

431. Subsection 200B(1) prevents a payment being made in connection with retirement from board or managerial office unless shareholder approval is first obtained. Sections 200F, 200G and 200H provide exceptions to this rule. The Bill will modify the operation of two exemptions contained in section 200F.

432. Currently subparagraphs 200F(a)(ii) and (iii) allow a termination benefit to be paid to a director or former director without shareholder approval where that payment is:

- a genuine payment by way of damages for breach of contract; or
- given to that person under an agreement made before the person became a holder of that office as a part of the consideration for that person agreeing to hold the office.

433. The Bill will retain these exemptions but will limit the scope of their operation (item 4, proposed subsection 200F(2)). Where a payment is made pursuant to one of these exemptions, shareholder approval will be required where the payment exceeds an amount calculated in accordance with

subsection 200G(3). Payments not exceeding the amount so calculated will not require shareholder approval.

434. The use of the formula in subsection 200G(3) will ensure that payments made to directors upon their retirement from office are subject to shareholder scrutiny.