

# 01 Executive Remuneration – change, change and more change: So what is the current state of play?

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For anyone involved with executive remuneration, it is fair to say that the last 12 months has seen an unprecedented amount of uncertainty and change.

It seems everyone has a view on executive remuneration from the man or woman on the street, to unions and business leaders, to supervisory bodies, and Governments around the world.

Australian Government interventions in executive remuneration have taken the following form:

- the Productivity Commission inquiry into executive remuneration practices;
- the APRA Prudential Standard on Governance covering increased remuneration and governance requirements for regulated financial services entities;
- changes to the taxation treatment of employee share schemes; and
- proposed changes to the termination payment rules and when shareholders have a right to a vote on such payments.

Like any significant period of change, we will likely see a number of good and not so good initiatives / regulation – as to whether we end up with a better system than the one we have today – only time will tell.

## Key initiatives

- **Productivity Commission** released its draft report on Executive Remuneration on 30 September 2009, with submissions being sought by 6 November 2009. The final report is due by 19 December 2009.
- **APRA** released its second consultation package on Executive Remuneration in regulated financial services organisations on 7 September 2009, with APRA seeking submissions on this updated draft by 2 October 2009. It is expected that the final standard will be released in November 2009 and be effective from 1 April 2010 with transitional arrangements.
- The **Financial Stability Board** issued its implementation standards for its Principles for Sound Compensation Practices on 25 September 2009. The G20 has called on firms to implement these sound compensation practices immediately.
- New **Employee Share Scheme** tax rules are still in draft form, with final legislation due to be submitted to Parliament in the Spring sitting. The new laws are proposed to take effect from 1 July 2009.
- New **Termination Payments** laws on shareholder approval requirements for key management personnel have been passed by the House of Representatives, but are currently stalled in the Senate. Expected to become law late in 2009.

We have provided detailed commentary on the operation and impact of each of the above initiatives over the following pages.

## 02 Productivity Commission draft report on executive remuneration: A pragmatic approach to refining corporate governance and remuneration practices

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**Overall, businesses in Australia can collectively breathe a sigh of relief. Given the extent of reforms proposed in the US and UK, the Commission has chosen a less prescriptive approach and focused on fine-tuning the governance system. However, there may be some parties that are disappointed with this direction.**

- The Productivity Commission's draft report recommendations are largely pragmatic and acknowledge that the current system is fundamentally sound but could benefit from fine tuning from a corporate governance perspective.
- The report's recommendations acknowledge that remuneration practices are context specific and should therefore be structured according to a company's individual needs as opposed to a 'one size fits all' approach.
- The recommendations lie on a sliding scale from the very practical tax treatment of employee equity on termination of employment, to the far more challenging requirement that all directed proxies be cast.
- The Commission has taken a holistic view, by attempting to bring together the various regulations, principles and guidelines on executive remuneration.
- The proposed removal of employee termination as a taxing point for employee equity has been well thought through. There is still time to incorporate this change into the next draft of the employee share scheme tax legislation.
- Calls for simplifying remuneration disclosures provide an opportunity to create a valuable channel of communication between the company and its broad spectrum of stakeholders – rather than simply producing a compliance document. The challenges of moving to an alternate reporting regime will be defining the disclosure requirements and reconciling it with other information in the financial report.
- One of the more material draft recommendations is the "two strikes test". Where a company receives a "no" vote of 25% or higher on their remuneration report for two years running, the full Board is required to submit itself for re-election.
- The 15 draft recommendations aim to strengthen corporate governance – however many organisations have already adopted some of these practices voluntarily, therefore some of the proposed changes will not be a substantial additional burden for companies.

## 02 Productivity Commission draft report on executive remuneration (cont'd)

### Improved disclosure could help shareholders assess the independence and value of external advice to boards and their remuneration committees

The Productivity Commission has made 15 draft recommendations for further regulatory and governance reforms to strengthen and increase the integrity of pay setting by Boards.

Recommendations	What this means
1. End of non-executive directors (NED) 'no vacancy' rule <ul style="list-style-type: none"> <li>- <i>Rule allows the Board to limit new nominations even if the maximum number of Board positions have not been filled.</i></li> </ul>	<ul style="list-style-type: none"> <li>• Could increase elections of shareholder nominees to Board positions.</li> <li>• Could also lead to Boards reaching their possible maximum size and put pressure on NED fee pools.</li> </ul>
2. Ensure Remuneration Committee independence – ASX 300 <ul style="list-style-type: none"> <li>- <i>All ASX 300 companies to have a Remuneration Committee of at least 3 members</i></li> <li>- <i>All members must be non-executive directors, with the chair and majority being independent directors.</i></li> </ul>	<ul style="list-style-type: none"> <li>• No major impact as the Corporate Governance Council already requires this and many companies already meet this requirement.</li> </ul>
3. Promote Remuneration Committee independence — 'comply or explain' <ul style="list-style-type: none"> <li>- <i>ASX Corporate Governance Council's guidelines on Remuneration Committee composition elevated to a "comply or explain" approach</i></li> <li>- <i>Mirrors recommendation 2.</i></li> </ul>	<ul style="list-style-type: none"> <li>• No major impact as many companies already meet this requirement.</li> </ul>
4. Prohibit key management personnel (KMP) (includes directors) voting on remuneration <ul style="list-style-type: none"> <li>- <i>Amend Corporations Act to prevent KMP from voting their shares on remuneration reports and any other remuneration-related resolutions.</i></li> </ul>	<ul style="list-style-type: none"> <li>• This may not cause issues for some companies as many Executive Directors currently voluntarily abstain on voting for their equity allocation.</li> <li>• NEDs must also abstain not only from election votes but also in relation to the NED fee pool.</li> <li>• More onerous requirements for KMP to abstain from voting on the remuneration report. This may be challenging for companies where the KMP have significant shareholdings.</li> </ul>

## 02 Productivity Commission draft report on executive remuneration (cont'd)

Recommendations	What this means
<p>5. Prohibit executives hedging equity</p> <ul style="list-style-type: none"> <li>- <i>Amend the Corporations Act to prohibit hedging of unvested equity and vested equity subject to holding locks.</i></li> </ul>	<ul style="list-style-type: none"> <li>• This should not be a major issue for most companies as many already prohibit the hedging of unvested equity.</li> <li>• Extension of requirement to equity held under a holding lock is not likely to be a major issue. However, we question whether this is appropriate as the vesting conditions for this equity will have been met, and in many instances the holding lock is merely a tax deferral tool rather than any means to align reward to company performance.</li> </ul>
<p>6. Prohibit KMP (including directors) voting undirected proxies on remuneration matters.</p>	<ul style="list-style-type: none"> <li>• Implementation will likely prove challenging; undirected proxies could represent a large number of potential votes on remuneration-related issues.</li> </ul>
<p>7. Oblige all directed proxies to be cast on remuneration matters.</p>	<ul style="list-style-type: none"> <li>• Implementation may prove challenging.</li> </ul>
<p>8. Improve information content and accessibility of remuneration reports to include:</p> <ul style="list-style-type: none"> <li>- <i>a plain English summary statement of companies' remuneration policies;</i></li> <li>- <i>actual levels of remuneration received by executives;</i></li> <li>- <i>total company shareholdings of individuals named in the report; and</i></li> <li>- <i>accounting value of equity disclosed in financial statements, with actual realised value of equity in remuneration report.</i></li> </ul>	<ul style="list-style-type: none"> <li>• Many companies already spend considerable time trying to make their remuneration reports as readable as possible. The challenges come from trying to comply with the Corporations Act and Accounting Standards mandated disclosures while attempting to present information shareholders would like to see.</li> <li>• Actual realised levels of reward will require careful definition to ensure disclosures have been made using similar principles. There are also real challenges in relation to valuation and the timing of a valuation – eg is it at the earliest vesting point, when the holding lock is released or when the shares are sold?</li> </ul>
<p>9. Remove superfluous disclosure — KMP only</p> <ul style="list-style-type: none"> <li>- <i>Remove requirement to disclose the top 5 executives by remuneration levels</i></li> <li>- <i>Suggestion to confine detailed disclosure to CEO and “top KMPs”, with remuneration of other KMPs reported collectively in bands.</i></li> </ul>	<ul style="list-style-type: none"> <li>• This is a step in the right direction - the anomaly between the Corporations Act and AASB 124 has been removed through the deletion of the 5 highest paid executives.</li> <li>• By aligning the Corporations Act with Australian Accounting Standards, we believe the recommendation to reduce the compliance burden is a good one.</li> <li>• However, the use of the term “top KMP” may create confusion. This could lead to more inconsistency in quality of reporting.</li> </ul>
<p>10. Require remuneration advisors to be independent of management — ASX 300</p> <ul style="list-style-type: none"> <li>- <i>Where a Board makes use of expert advisors, those advisors must be commissioned by and report to the Board, independent of management.</i></li> </ul>	<ul style="list-style-type: none"> <li>• This recommendation will be familiar to financial institutions as it is consistent with the draft APRA standard.</li> <li>• Management will still be able to engage an advisor. It is only in circumstances where the Remuneration Committee / Board use advisors that they will need to be commissioned by, and report to, the Remuneration Committee.</li> </ul>

## 02 Productivity Commission draft report on executive remuneration (cont'd)

Recommendations	What this means
<p>11. Require remuneration advisors to be disclosed - 'comply or explain' – under ASX Corporate Governance Guidelines.</p>	<ul style="list-style-type: none"> <li>• This will be captured in the ASX Corporate Governance guidelines and is therefore less binding than if it was codified in the ASX listing rules as per the proposal in Recommendation 10.</li> <li>• In the event remuneration advisors are disclosed, companies need to be very clear about what the advisors were engaged to do, how the work was commissioned, and whether the board chose to follow that advice.</li> </ul>
<p>12. Institutional investors to disclose their voting on remuneration reports and other remuneration related issues.</p>	<ul style="list-style-type: none"> <li>• Good idea in theory - the issue is more around how practical it would be to implement this proposal.</li> <li>• The use of a Voluntary Code will result in different outcomes for different institutional investors.</li> <li>• Unlikely to be well received by institutions.</li> </ul>
<p>Finding 1: Remuneration “check list” for Boards</p> <ul style="list-style-type: none"> <li>• <i>Remuneration disclosure would be enhanced by ensuring certain key elements are being disclosed, ie:</i> <ul style="list-style-type: none"> <li>➤ <i>how the remuneration policy aligns with the company’s strategy, its risk profile and shareholder interests;</i></li> <li>➤ <i>how the mix of base pay and incentives relates to the remuneration policy;</i></li> <li>➤ <i>how comparator groups for benchmarking remuneration and setting performance hurdles / metrics were selected;</i></li> <li>➤ <i>how incentive pay arrangements were subjected to sensitivity analysis to determine impact of unexpected changes (eg in the share price);</i></li> <li>➤ <i>whether any incentive plan constraints or caps to guard against extreme outcomes applies;</i></li> <li>➤ <i>whether alternatives to incentives linked to complex hurdles have been considered (eg deferral of STI into equity);</i></li> <li>➤ <i>whether employment contracts have been designed (to the degree allowed by law) to inoculate against the possibility of having to “buy-out poorly performing executives”; and</i></li> <li>➤ <i>whether post-remuneration evaluations have been conducted to assess outcomes, and the relationship to the remuneration policy.</i></li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• This could be a useful checklist for Boards when assessing their remuneration practices. However, this will add further complexity and length to remuneration reports.</li> <li>• It is unclear whether this is a firm recommendation or simply a finding.</li> </ul>

## 02 Productivity Commission draft report on executive remuneration (cont'd)

Recommendations	What this means
<p>13. Remove termination of employment as a taxing point under the employee share scheme income tax rules.</p>	<ul style="list-style-type: none"> <li>• Agree taxation at termination was an impediment to deferral of incentives. We welcome this proposed change and hope that it can be built into the final employee share scheme tax legislation.</li> <li>• The scope to defer taxation of equity incentives beyond termination of employment could facilitate best practice principles around deferment of remuneration, thereby promoting better alignment between rewards and long-term company performance, as well as aligning with proposals put forward by APRA.</li> </ul>
<p>14. Confirm allowance of electronic voting.</p>	<ul style="list-style-type: none"> <li>• No material impact.</li> </ul>
<p>15. 25% or higher “no” vote on remuneration report two years running triggers Board re-election vote</p> <ul style="list-style-type: none"> <li>- <i>if receive a “no” vote of 25% or higher, the Board is required to report back to shareholders in the subsequent remuneration report, explaining how concerns were addressed, and if not, the reasons why</i></li> <li>- <i>if “no” vote is 25% or higher two years running, a Board re-election vote will be triggered.</i></li> </ul>	<ul style="list-style-type: none"> <li>• This is one of the more material proposals. However we believe the non-binding vote on remuneration reports is already working effectively.</li> <li>• Few ASX 100 companies have received a “no” vote greater than 25%. Nearly all companies with high no votes have addressed any issues the following year.</li> <li>• It could take three years before a full Board re-election occurs and by that time all NEDs would have been subject to re-election anyway (NED appointments are currently three year terms).</li> <li>• Practical issue is that companies do not always know what aspect of their remuneration practices are being voted down, and one shareholder’s reasons for a “no” vote may be completely different to another.</li> <li>• This proposal will require clear articulation of the treatment of voting abstentions and undirected proxies.</li> <li>• There is also the question of whether a 25% “no” vote is the right level to trigger a full Board re-election. This seems quite a low threshold to trigger such a major issue as a full Board re-election.</li> <li>• What happens if the whole Board is voted down? It may be difficult to quickly replace the Board and there could be a considerable loss of corporate knowledge.</li> </ul>

# 03 APRA Prudential Standard on Governance

## Key initiatives and background

- The Australian Prudential Regulation Authority (APRA) released its second consultation package on remuneration on 7 September 2009. It is seeking submissions on this updated draft standard by 2 October 2009.
- It is expected that the final standard will be released in November 2009 and be effective from 1 April 2010 with transitional arrangements. By 1 April 2010, regulated institutions are expected to have a Remuneration Committee and a remuneration policy in place.
- APRA is monitoring international developments and is satisfied that its approach is consistent with the Financial Stability Board's Principles which were endorsed by the G20 (outlined over the page).

## Application

- The APRA requirements apply to all authorised deposit-taking institutions and authorised non-operating holding companies (regulated institutions).
- The remuneration policy must cover:
  - responsible persons<sup>1</sup>;
  - persons whose primary role is risk management, compliance, internal audit or financial control (risk and financial control personnel); and
  - all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the institution.
- The Prudential Standard is intended to apply to the contractual arrangements that the institution has made with third party body corporates. It does not apply to the third party's remuneration arrangements with its own employees.

## Key points

- The APRA Prudential Standard on Governance as it applies to remuneration is broken down into two sections: Remuneration and Board Remuneration Committee.

### Remuneration

The key changes that are required in respect of remuneration policy is that the policy must:

- explicitly incorporate risk and encourage behaviour that supports the company's long-term financial soundness;
- take into account the cost of capital where appropriate. APRA is not expecting regulated institutions to create economic capital models solely for remuneration purposes. Instead, the intention is that institutions recognise that high risk activities warrant higher capital than low risk activities and that the cost of capital should be recognised in remuneration design;
- ensure the deferral period is aligned with the time that it takes to appropriately assess the business / individual's performance. This may differ across various business activities;
- provide the Board with discretion to adjust performance-pay downwards in light of significant unexpected or unintended consequences. This will require boards to have a qualitative overlay in determining bonuses rather than a straight formulaic design; and
- ensure that the remuneration structure of risk and financial control personnel does not compromise their independence. This may mean that these personnel can no longer participate in business unit profit pools and that they have a more conservative pay mix than revenue-generators.

### Board Remuneration Committee

- The Remuneration Committee's remit, accountabilities and responsibilities have increased under the APRA standard.
- Previously, Committees were primarily responsible for recommending to the Board the remuneration structure and levels of the company's most senior executives. Its remit has now been widened such that the Committee must also now consider the remuneration structure of risk and financial control personnel and those employees who have significant variable remuneration. The Board has discretion to determine what constitutes significant variable remuneration.
- Due to the extended remit of the Committee, we are likely to see changes in governance structures, such as the establishment of management-run remuneration oversight committees, to support the Committee in meeting their obligations.
- We are also likely to see more companies having separate remuneration advisors for the Board and management to ensure that no conflicts of interest arise.

1. Responsible persons refers to directors, executives and senior managers who make or participate in making decisions that affect the whole, or a substantial part, of the business of the regulated institution. It excludes responsible auditors and non-executive directors.

# 04 G20 and the FSB Principles for Sound Compensation Practices

## Key initiatives and background

- The Financial Stability Board (FSB) issued its implementation standards for its Principles for Sound Compensation Practices on 25 September 2009.
- The standards respond to a call by the G20 Finance Ministers and Governors for the FSB to set out for the Pittsburgh Summit detailed specific proposals on compensation governance, structure and disclosure to strengthen adherence to the FSB Principles, issued in April 2009.
- The G20 has called on firms to implement these sound compensation practices immediately. The FSB is to monitor implementation and, if required, propose additional measures by March 2010.

## Key points

<b>G20 response</b>	<ul style="list-style-type: none"> <li>• The G20 fully endorsed the FSB's implementation standards for their Principles of Sound Compensation Practices.</li> <li>• These principles aim to ensure effective governance of compensation, alignment of compensation with prudent risk-taking and effective supervisory oversight.</li> </ul>
<b>Remuneration Committee</b>	<ul style="list-style-type: none"> <li>• The Remuneration Committee is required to work closely with the Risk Committee.</li> <li>• It is also required to conduct an independent annual compensation review to assess compliance with applicable regulator standards – this is to be submitted to supervisors or disclosed publicly.</li> </ul>
<b>Deferral and claw-back</b>	<ul style="list-style-type: none"> <li>• For senior executives and other employees whose actions have a material impact on the risk exposure of the firm, 40-60% (or greater) of variable pay should be deferred for not less than three years (with potential claw-back) and at least 50% of variable pay should be awarded in shares or share-linked instruments.</li> <li>• Any unvested equity should be subject to claw-back in the event of negative contributions of the firm and / or the relevant line of business during the vesting period.</li> </ul>
<b>Risk and compliance personnel</b>	<ul style="list-style-type: none"> <li>• Remuneration for risk and compliance personnel should be determined independently of other business areas and be adequate to attract qualified and experienced staff.</li> <li>• Performance measures should be based principally on the achievement of the objectives of their function.</li> </ul>
<b>Disclosure</b>	<ul style="list-style-type: none"> <li>• There are increased disclosure requirements – not only for senior executives but also for employees whose actions have a material impact on the firm's risk exposure.</li> </ul>
<b>Supervisory oversight</b>	<ul style="list-style-type: none"> <li>• Supervisors may take steps, such as higher capital requirements, to those firms that fail to implement sound compensation policies and practices.</li> </ul>

# 05 Reform of the taxation of employee share schemes

## Key initiatives and background

- The Government released its Exposure Draft legislation on the taxation treatment of employee share schemes on 14 August 2009. The consultation period for this legislation closed on 31 August 2009.
- An Exposure Draft on the transitional rules was released on 15 September 2009. These transitional rules set out the proposed treatment of shares and / or rights acquired pre 1 July 2009 (ie under the old employee share scheme rules).
- The consultation period for the transitional rules legislation closed on 22 September 2009.
- The final legislation is due to go before Parliament in the Spring session, and this could be late October or November 2009.

## Application

- The new rules will apply to all shares and / or rights acquired under an employee share scheme on or after 1 July 2009.
- Under the new transitional rules, shares and / or rights acquired before 1 July 2009, but which have a taxing point which has been deferred beyond 1 July 2009, will also be brought within the new share scheme rules. However, the taxing point for these old shares and / or rights will continue to be determined by the old employee share scheme rules (ie as they existed prior to 1 July 2009).

## Key differences between the current and draft legislation

	Current law – shares / rights acquired pre-1 July 2009	Draft law – shares / rights acquired on or after 1 July 2009
<b>Is a tax deferral possible?</b>	<ul style="list-style-type: none"> <li>• Yes – provided shares / rights are qualifying and subject to either a risk of forfeiture <b>OR</b> a disposal restriction.</li> </ul>	<ul style="list-style-type: none"> <li>• Yes – provided shares / rights are qualifying and subject to a <b>real</b> risk of forfeiture.</li> <li>• Taxing point may be further deferred (ie beyond the date the risk of forfeiture ceases) where shares / rights are also subject to <b>genuine</b> disposal restrictions.</li> </ul>
<b>What is the maximum tax deferral period?</b>	<ul style="list-style-type: none"> <li>• 10 years.</li> </ul>	<ul style="list-style-type: none"> <li>• 7 years.</li> </ul>
<b>Can employees elect to be taxed at grant?</b>	<ul style="list-style-type: none"> <li>• Employees can choose / elect to be taxed at grant.</li> </ul>	<ul style="list-style-type: none"> <li>• Employees no longer have the choice to elect to be taxed at grant or defer tax.</li> <li>• The tax treatment will be solely driven by the structure of the employee share scheme.</li> </ul>
<b>How is the market value of shares / rights determined?</b>	<ul style="list-style-type: none"> <li>• Shares / rights which have a deferred taxing point beyond 1 July 2009 will be brought into the new rules.</li> <li>• Therefore the determination of market value and ultimately the assessable income will be determined under the new rules (see to the right).</li> <li>• Shares / rights which have a taxing point before 1 July 2009 will continue to be valued and taxed under the old rules.</li> </ul>	<ul style="list-style-type: none"> <li>• Shares (<i>unlisted and listed</i>) – valued according to ordinary market value concepts.</li> <li>• Rights (<i>unlisted and listed</i>) – can either be valued according to ordinary market value concepts <b>OR</b> can choose to use the old valuation rules (pending any final recommendations on a new valuation model from the Board of Taxation review).</li> </ul>

## 05 Reform of the taxation of employee share schemes (cont'd)

### Key differences between the current and new draft legislation (cont'd)

	Current law – shares / rights acquired pre-1 July 2009	Draft law – shares / rights acquired on or after 1 July 2009
<b>Application of new employer reporting requirements</b>	<ul style="list-style-type: none"> <li>• Yes – shares / rights which have a taxing point deferred beyond 1 July 2009 will also be subject to the new reporting regime.</li> </ul>	<ul style="list-style-type: none"> <li>• Yes – annual form to be submitted to employees by 14 July and the ATO by 14 August each year.</li> <li>• Form to be used to report shares / rights granted in the previous year and shares / rights which became taxable in the previous year.</li> </ul>
<b>Application of new employer withholding requirements</b>	<ul style="list-style-type: none"> <li>• Yes – but only where “No TFN / ABN” provided and shares / rights have a taxing point deferred beyond 1 July 2009.</li> </ul>	<ul style="list-style-type: none"> <li>• Yes – but only where “No TFN / ABN” provided.</li> </ul>
<b>Refund of tax on forfeited awards?</b>	<ul style="list-style-type: none"> <li>• Yes – however only applied to rights plans.</li> <li>• Only requirement was that the right was lost (regardless of the reason) without having been exercised.</li> </ul>	<ul style="list-style-type: none"> <li>• Yes – applies to both shares and rights.</li> <li>• However, if the forfeiture occurs due to a choice made by the taxpayer then no refund is available (eg an employee chooses to let the option lapse).</li> </ul>
<b>\$1,000 tax exemption</b>	<ul style="list-style-type: none"> <li>• Available provided the shares / rights are qualifying, the offer is non-discriminatory, there are no forfeiture conditions, and there is a disposal restriction at minimum until the earlier of 3 years or termination of employment.</li> <li>• No income test to determine eligibility for the concession.</li> </ul>	<ul style="list-style-type: none"> <li>• Same conditions as applied under the old tax rules.</li> <li>• New income threshold requirement provides that the adjusted taxable income of the employee must be not exceed \$180,000.</li> </ul>
<b>Salary sacrifice plans</b>	<ul style="list-style-type: none"> <li>• Plans typically used to sacrifice salary and / or bonuses on a pre-tax basis to acquire shares / rights.</li> <li>• Provided a disposal restriction applied, tax deferral was possible – ie no risk of forfeiture was needed to obtain a tax deferral.</li> <li>• No limits on amounts which could be invested under these plans.</li> </ul>	<ul style="list-style-type: none"> <li>• Same general requirements as under the old rules to qualify for tax deferral.</li> <li>• No need for forfeiture condition, just need a <b>genuine</b> disposal restriction to receive a tax deferral. However, the use of the word “genuine” suggests a higher standard test than that which applied under the old tax rules.</li> <li>• New concession only applies to share plans (ie rights / option grants do not qualify).</li> <li>• In order to qualify for the concession the total value of shares and rights acquired in the same income year, on which tax has been deferred, must not exceed \$5,000.</li> </ul>

# 06 Terminations payments regime

## Key initiatives and background

- The Corporations Amendment Regulations 2009 (Cth) were released in final form on 3 September 2009.
- The Regulations accompany the Corporations Amendment (Improving Accountability on Terminations Payments) Bill 2009 (Cth) which was first introduced into parliament on 24 June 2009.
- The Bill and the Regulations retain the key changes proposed in the exposure draft of the Bill and the draft Regulations released on 5 May 2009, but contain some important differences and address some of the issues raised in the consultation process.
- The Bill has been passed in the House of Representatives but has now stalled in the Senate. There is no indication to date as to whether the proposed amendments to the Bill and Regulations are acceptable to the Federal Government, but it is expected that they may become law late in 2009.

## Key differences between the new and current legislation

	New law	Current law
<b>Coverage</b>	<ul style="list-style-type: none"> <li>• Directors (including directors of subsidiary companies who also perform management functions for a holding company), key management personnel and the five most highly remunerated group and company executives.</li> <li>• Only applies to new contracts, or contracts that have been renewed, extended, materially varied, or where a condition in the contract occurs, after the commencement of the new regime. It will not apply to termination benefits made under existing (and unchanged) contracts.</li> <li>• Changes which effect an essential contract term (including any term relating to remuneration) will be considered a material variation of a contract or variation of a "condition", but minor changes to an existing contract will not.</li> </ul>	<ul style="list-style-type: none"> <li>• Directors only.</li> </ul>
<b>Terminations payment threshold (above which shareholder approval is required)</b>	<ul style="list-style-type: none"> <li>• Termination benefits to directors and executives covered by this regime which exceed one year's base salary will require shareholder approval.</li> <li>• Base salary is defined as having the meaning specified in the Regulations. This is essentially comprised of fixed remuneration, being:               <ul style="list-style-type: none"> <li>– one year's base pay;</li> <li>– short-term employee benefits, share based payments and / or superannuation contributions, which are not dependent on the satisfaction of performance hurdles;</li> <li>– fees or short-term compensated absences;</li> <li>– non-monetary benefits (including motor vehicles and other salary sacrifice arrangements); and</li> <li>– any fringe benefits tax payable.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Up to seven times a recipient's total annual remuneration.</li> </ul>
<b>Treatment of unauthorised termination benefits</b>	<ul style="list-style-type: none"> <li>• Benefits must be held by the executive on trust for the company and must be repaid by the executive immediately.</li> <li>• Provisions introduced to facilitate the recovery of unauthorised benefits.</li> </ul>	<ul style="list-style-type: none"> <li>• There is no express requirement on an individual to repay an unauthorised termination benefit.</li> </ul>

## 06 Terminations payments regime (cont'd)

### Key differences between the new and current legislation (cont'd)

	New law	Current law
<b>Definition of termination benefit</b>	<ul style="list-style-type: none"> <li>▪ A “benefit” includes a payment or other valuable consideration and any kind of real or personal property. The Bill specifically provides that what is considered a “benefit” will be broadly interpreted, and the economic and commercial substance of conduct will take precedence over its legal form.</li> <li>▪ The Regulations provide that “benefits” include:               <ul style="list-style-type: none"> <li>– any kind of pension<sup>2</sup> or superannuation payments which are not considered “genuine”</li> <li>– payments in lieu of notice;</li> <li>– amounts paid as a voluntary out of court settlement;</li> <li>– payments made as part of a restrictive covenant, restraint of trade or non-compete clause (where the value of the payment and other payments received exceeds the termination payment threshold); and</li> <li>– the accelerated or automatic vesting of share based payments on, or as a result of, the executive’s retirement from office.</li> </ul> </li> <li>▪ The Regulations provide that “benefits” do <b>not</b> include:               <ul style="list-style-type: none"> <li>– payment of accrued annual leave and long service leave;</li> <li>– reasonable and genuine redundancy payments;</li> <li>– payments required by a law of a foreign country;</li> <li>– deferred bonuses previously earned, accrued or allocated prior the executive’s termination but which were not released at that time and for which payment is due (unless they are subject to automatic or accelerated vesting and exceed the termination payment threshold);</li> <li>– payments from an existing defined benefits superannuation scheme;</li> <li>– genuine superannuation contributions made by the executive or employer; and</li> <li>– payments from a superannuation fund on an executive’s death or incapacity.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• There is currently some legal ambiguity as to whether certain types of payment meet the definition of a termination benefit and as a result require shareholder approval.</li> </ul>
<b>Timing of the shareholder vote</b>	<ul style="list-style-type: none"> <li>▪ Essentially retains the current law.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Can be held at any point in time before the benefit is paid.</li> <li>▪ Details of the benefit must be set out in, or accompany, the applicable notice of general meeting.</li> </ul>
<b>Shareholders eligible to participate in a shareholder vote</b>	<ul style="list-style-type: none"> <li>▪ Retirees that hold shares in the company can no longer participate in a shareholder vote on their termination benefit except when acting as a proxy.</li> </ul>	<ul style="list-style-type: none"> <li>▪ All shareholders are able to participate in a vote on termination benefits.</li> </ul>

2. Other than a pension paid from an Australian or overseas superannuation fund or superannuation annuity.

## How PwC can help

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