
IFSA GUIDANCE NOTE CIRCULAR



Investment & Financial Services Association Ltd

NON-BINDING SHAREHOLDER VOTE ON REMUNERATION REPORTS

September 2005

Background

The CLERP 9 reforms to the Corporations Act 2001 require Australian listed companies to put their remuneration reports to a non-binding shareholder vote at annual general meetings commencing this year. As this is a new measure, votes on these resolutions will form a major element in this season's proxy voting activity. Whilst in recent years there has been an increased attention on specific executive compensation proposals, the non-binding vote initiative will provide a new focus by requiring shareholders to deal with the remuneration report as a whole, rather than just specific components.

Purpose

IFSA's purpose in distributing this Note is to provide further guidance to members making decisions on how to vote on remuneration reports. When read in conjunction with IFSA's Blue Book – *Corporate Governance – A Guide for Fund Managers and Corporations*, the Note should assist companies to formulate remuneration policies and remuneration reports that are received positively by shareholders, both in Australia and offshore. Furthermore, IFSA believes this Note will assist in ensuring that the benefits from the non-binding vote are realised, including improved communication between shareholders and companies and improved construction and disclosure of remuneration practices, resulting in greater transparency in the Australian sharemarket.

What are the key considerations in voting on remuneration reports?

There are minimum standards that companies should meet in their remuneration reports to achieve shareholder approval. These are:

- shareholders should not approve a company's remuneration report if it lacks sufficient explanation and disclosure of remuneration policies and practices; and
- if a company's policies or practices are at variance with accepted guidelines (see over for details), IFSA members should expect a cogent explanation in the remuneration report as to why the variance is justified in the company's circumstances – ie why that variance is right for that company and its long-term investors.

It should be recognised that the remuneration of directors, senior executives and employees will be tailored to the circumstances and requirements of the company. This may cause some companies to develop remuneration policies and practices that are outside accepted guidelines, but which nevertheless are also sound. Shareholders need to consider their response on a case-by-case basis.

IFSA encourages its members to engage with companies regarding their remuneration reports by either:

- contacting the company to explain reasons why the shareholder voted 'Against'; or
- contacting the company where the shareholder voted 'For' or 'Abstain', but had some concerns on parts of the remuneration report.

Guidelines

Remuneration policies and practices

IFSA members expect that a listed company's remuneration policies and practices should:

-
- be designed to promote the long-term growth of shareholder value and to be both adequate and reasonable in comparison with industry and other benchmarks; and
 - address separately the remuneration of executive directors, non-executive directors, and key company personnel who are in a position to affect shareholder value.

The remuneration policies and practices should be clearly expressed and concise. They should include the following:

- the levels of base (guaranteed) pay and at risk/performance based (incentive) pay, the latter normally divided into appropriate short and long term elements, with reference to performance hurdles and outcomes;
- a percentage allocation to each element and why that allocation is appropriate in the company's circumstances; and
- important details of service contracts.

Remuneration disclosure

The remuneration report should provide public shareholders with meaningful explanation and disclosure of the company's remuneration policies and practices, of the relationship between those policies and practices and the company's performance, and of the board's control of the process. While the bulk of the report should detail company outcomes for the year under report in relation to remuneration policy, it should also incorporate *forward-looking* commentary in the key areas of directors' and senior executives' remuneration in particular, and employees' remuneration in general.

The remuneration report should disclose clearly and in sufficient detail the following:

- actual remuneration paid to the five most highly remunerated senior managers and all the directors of the company;
- if consolidated financial statements are required by a group of companies, the remuneration of the 5 top executives in the corporate group (potentially requiring the disclosure of the remuneration of up to ten senior managers);
- the principal elements of the service contract of any new CEO or other key executive, including remuneration details (such as any arrangements known in the market as golden hellos, golden handcuffs and golden goodbyes), contract period and any termination payments; and
- any payment or other compensation arrangement agreed by the board in connection with the departure of a director or key executive.

Incentive Pay (including equity based pay)

IFSA supports the implementation of properly designed Incentive Pay schemes that have robust performance hurdles. IFSA guidelines are not intended to restrict or diminish the flexibility of companies to attract, retain and motivate employees in the interest of improved company performance. The schemes must be fully disclosed and approved by shareholders, who can

appreciate that certain details of Incentive Pay may be competitively sensitive, but reasonably expect meaningful explanation and disclosure of the policy and structure.

IFSA has two Guidance Notes on equity based pay: the *Executive Share and Option Scheme Guidelines* (Note 12) and *Employee Share Scheme Guidelines* (Note 13). These Guidance Notes were developed in conjunction with the AICD, the ASA and the Australian Employee Shareownership Association. IFSA members expect all Australian listed companies to comply with these Guidance Notes.

Based upon the Guidance Notes, the Blue Book and general governance principles, IFSA members should expect Incentive Pay schemes to satisfy the following guidelines:

- Total remuneration must be reasonable and take into account the responsibilities and commitment of executives and employees.
- The level of reward should generally be consistent with comparable schemes operating in similar companies.
- Incentive schemes should be designed
 - to promote superior medium to long term company performance; and
 - around appropriate performance benchmarks that measure relative performance and provide rewards for materially improved company performance.
- Companies should clearly explain performance benchmarks to enable shareholders to evaluate whether they are appropriate.
- In relation to option schemes, the exercise price should not represent a discount to the share price prevailing on or around the day the options are granted. The methodology for determining the exercise price must also be fully disclosed.
- The number of shares and options issued under incentive schemes must be reasonable in relation to the existing capitalisation of the company. In established listed companies the aggregate number of shares and options issued under such schemes should not generally exceed 10% of the total number of shares on issue.
- The full cost of the incentive schemes, including the value of options when granted, should be disclosed to the shareholders.

Quantum

IFSA members expect that remuneration reports will contain details of the *value* (including target ranges) of incentive schemes granted to individual senior executives. There should also be an explanation of the maximum potential remuneration outcomes (in terms of the *value* of annual incentive pay granted), the key aspects of the valuation methodology and the details of performance benchmarks.

Non-executive director (NED) remuneration

IFSA members accept that a well-paid, alert and competent board, comprising a majority of independent directors, is integral to the long-term growth of shareholder value. Accordingly, the remuneration report should disclose clearly and in sufficient detail the following:

-
- the board's policy on payment of NEDs, including board fees to be paid to:
 - the chairman
 - any deputy chairman
 - other non-executive directorsand the same information for committees;
 - the shareholder approved fee cap and when it was last approved by shareholders;
 - the board's policy on:
 - share acquisition plans for NEDs
 - the board's policy and justification on:
 - any retirement benefits for NEDs (above statutory entitlements)
 - any incentive plans for NEDs.

Note:

IFSA would like to acknowledge Corporate Governance International Pty. Ltd., which was instrumental in initiating the need for this Guidance Note and provided significant input into the material contained herein.