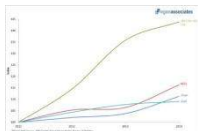


Newsletter July 2015

The time has come around again to release our annual KMP Report on Directors fees for Australia's Top 300 and New Zealand's Top 50 listed companies. The report has highlighted some interesting trends.

Given the focus on superannuation in recent months, we've also examined how much executives are contributing to their retirement, considering whether these contributions will be enough to sustain their independence from government support in retirement.

Completing the newsletter is another update on the proposed legislative amendments regarding superannuation Board independence and a report on global actions encouraging the clawback of executive remuneration.



KMP Report: Remuneration Trends for ASX 300 and NZX 50 Boards

Egan Associates has published its annual KMP report detailing remuneration trends for the top companies listed on the Australian and New Zealand stock exchanges.



Executives Should Plan Carefully for Retirement

Executives outside of the top tier of Australian companies may find it difficult to achieve independence from government support in retirement.



Clawback Gains Global Momentum

UK and US regulators have announced new clawback requirements, expanding uncertainty for executives on whether earned bonuses and long term incentives will remain theirs to keep.



Independence Plans Due in One Year for Super Boards

The government has released draft legislation that will require APRA-regulated superannuation Boards to be led by an independent Chairman and be comprised of a minimum of one third independent Directors.

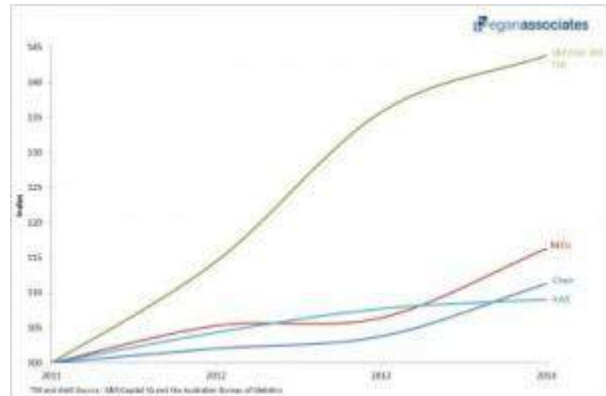
KMP Report: Remuneration Trends for ASX 300 and NZX 50 Boards

Egan Associates has published our annual KMP report detailing remuneration trends for the top companies listed on the Australian and New Zealand stock markets.

The report examines fee pools, aggregate Director fees, as well as retainer fees and committee fees.

Key findings include:

- Top companies in Australia have seen restrained growth in Director fees when compared to emerging organisations entering the ASX 300.
- Directors' fees in New Zealand in the last twelve months have reflected an uplift generally well above their counterpart organisations in Australia.
- The ratio of aggregate remuneration of a Chairman when compared to a Director is generally diminishing, reflecting workloads across organisations facing international complexity and disruption as well as fees paid for those serving on and chairing important committees of Boards.



For more of the findings, download the complete report from our website.

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Executives Should Plan Carefully for Retirement

It is an often-held view in the general public, and indeed by many executives themselves, that they will not be struggling in retirement to meet their needs.

However, the reality for many executives not in the top tier of Australian companies is that they may find it difficult to maintain their quality of lifestyle over an extended period of retirement.

Indeed, it appears many executives are not even contributing to the full extent of their available superannuation concessional contribution cap.

The median amount of superannuation paid on behalf the top five executives excluding the CEO for companies ranked 100 to 600 by market capitalisation (at 31 March 2015) in the 2014 financial year was approximately equal to that required for the maximum superannuation contributions base (circa \$18,000).



CEOs appeared less sanguine about their retirement. The median superannuation for CEOs was approximately \$25,000, which was the concessional contributions cap for the 2013-2014 year for those aged under 59. The \$25,000 contribution was reached by the 75th percentile of executives excluding the CEO.

Individuals over 59 at 30 June 2013 could contribute \$35,000 (the age reduced to 49 years on 30 June 2014). Only the 90th percentile of CEOs had this much superannuation recorded as part of their remuneration, with the 90th percentile of top 5 executives contributing approximately \$30,000.

The question arises, **is salary sacrificing to the concessional cap onerous for these executives?**

To answer this, we examine their accessible annual income for the 2014 year (fixed remuneration and bonus paid in cash rather than deferred in shares). The median CEO of a company ranked 100 to 600 received approximately \$670,000 at the median, while the other executives received approximately \$400,000. If only considering companies ranked 300 to 600, this reduces to \$540,000 and \$330,000 respectively.

If superannuation contributions are limited to the value corresponding to the maximum contribution base, the CEO and top 5 executives retain most of their gross accessible income and after tax is paid they can spend it. Approximate amounts retained as a percentage are shown in the table below:

Rank	CEO	Top 5 Execs
100-600	97%	95%
300-600	97%	95%

This was reduced if executives elected to sacrifice salary up to the 2013-2014 concessional cap of \$25,000:

Rank	CEO	Top 5 Execs
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100-600	96%	94%
300-600	95%	92%

If sacrificing to the 2014-2015 salary cap of \$35,000, assuming executives are over 49, this reduces to:

Rank	CEO	Top 5 Execs
100-600	95%	91%
300-600	94%	89%

Contributing above the level of concessional contributions becomes more difficult, with a greater effect on accessible income. Given this is the same or less than the 9.5% current superannuation rate most Australians must contribute to superannuation, the question must be raised as to why a larger proportion of executives are not doing so.

If the executives contributed non-concessional contributions in addition to concessional, because the contributions are post tax, a larger amount of an executives' pay packet is sacrificed.

Assuming:

- The executive wanted to contribute a) \$50,000 b) \$100,000 or c) \$150,000 in non-concessional contributions (one third, two thirds or all of the 2013-2014 non concessional cap) in addition to a \$25,000 concessional contribution for 2013-2014, and
- The executive is paying tax at the rate of 47% (excluding the temporary debt levy but including the Medicare surcharge and disregarding any deductions)

the percent of gross accessible income retained would be:

a) For a \$50,000 non-concessional contribution:

Rank	CEO	Top 5 Execs
100-600	80%	66%
300-600	76%	60%

b) For a \$100,000 non-concessional contribution:

Rank	CEO	Top 5 Execs
100-600	65%	39%
300-600	56%	27%

c) For a \$150,000 non-concessional contribution:

Rank	CEO	Top 5 Execs
100-600	49%	12%
300-600	36%	Negative

If this were increased to 2015-2016 limits, assuming executives were over 49 and contribute to a concessional cap of \$35,000 and a non-concessional cap of \$180,000, the gross amount retained would be:

a) For a non-concessional contribution of \$60,000:

Rank	CEO	Top 5 Execs
100-600	76%	58%

300-600 70% 50%

b) For a non-concessional contribution of \$120,000:

Rank	CEO	Top 5 Execs
100-600	57%	26%
300-600	46%	11%

c) For a non-concessional contribution of \$180,000:

Rank	CEO	Top 5 Execs
100-600	38%	Negative
300-600	23%	Negative

As the above reveals, it is not easy or indeed possible for every one of these executives to contribute superannuation to the maximum amount they are entitled per year on a regular basis. The question then becomes, **do executives need to contribute at this amount to achieve a superannuation balance that will enable them to be comfortable in retirement?**

Let us investigate how much these CEOs and executives would have in their superannuation when they retired if they contributed at:

- The maximum contribution base.
- The limits of the concessional cap.
- The limits of the concessional cap and one third of the non-concessional cap.
- The limits of the concessional cap and two thirds of the non-concessional cap.
- The limits of the concessional cap and 100% of the non-concessional cap.

Assumptions:

- The CEOs/executives are 50 in the 2015-2016 year.
- They currently have \$500,000 in their super (as a conservative estimate considering the 90th percentile of annualised weekly wages for earners of that age is around \$128,000 according to Australian Bureau of Statistics data, and the 90th percentile of superannuation balances falls around the \$200,000 to \$299,000 range for that age according to the Association of Superannuation Funds of Australia statistics).
- The concessional contribution is taxed at 30% upon accumulation, even though executives who are close to the \$300,000 barrier and are carefully managing their tax affairs may utilise tax deductions to reduce their taxable income and may not be eligible for the additional tax.
- The maximum super contributions base increases by 4% a year (based on an average of the increases over the last ten years). The super guarantee rate increases as planned to 12% in increments over the period from 2021-2022 to 2025-2026.
- The concessional contributions cap is indexed at AWOTE rounded down to the nearest \$5,000 (the \$35,000 is a temporary cap limit, which will be superseded once the index contributions cap passes it). The CAGR for full time adult AWOTE over the last ten years has also been around 4%.
- The non-concessional cap is a multiple of the concessional contributions cap.

The approximate superannuation balance at retirement given net returns on the portfolio of 3%, 6% and the APRA-provided five-year average annualised return of Australian super funds of 8% are:

Retirement age	Net Annual	a)	b)	c)	d)	e)
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	Return					
60	3%	\$870,000	\$950,000	\$1.7m	\$2.5m	\$3.3m
	6%	\$1.1m	\$1.2m	\$2.1m	\$3.0m	\$3.9m
	8%	\$1.3m	\$1.4m	\$2.4m	\$3.4m	\$4.3m
67	3%	\$1.3m	\$1.4m	\$3.1m	\$4.7m	\$6.4m
	6%	\$1.9m	\$2.1m	\$4.2m	\$6.3m	\$8.4m
	8%	\$2.5m	\$2.8m	\$5.2m	\$7.7m	\$10.2m

Where contributions are made at:

- The maximum contribution base.
- The limits of the concessional cap.
- The limits of the concessional cap and one third of the non-concessional cap.
- The limits of the concessional cap and two thirds of the non-concessional cap.
- The limits of the concessional cap and 100% of the non-concessional cap.

The analysis shows that these executives could have between \$870,000 and \$10m in their superannuation by the time they retire.

While the executives are likely to also own their home, the Productivity Commission noted in its recent *Superannuation Policy for Post Retirement* report that Australians do not usually tap the wealth in their home to provide income in retirement, instead using it as a safety net for potential costs later in life such as aged care.

According to the same report, a woman who is currently 65 can expect to live another 31 years in retirement and a man between two to three years less.

Research on safe withdrawal limits in retirement by Financial Services Institute of Australasia, a membership association for financial services professionals, shows that if individuals want their funds (invested 50% in growth assets and 50% in defensive assets) to last for thirty years with only a 10% chance of running out, the maximum annual withdrawal rate based on historical data is 3.62%.

Disregarding the minimum withdrawal rate for superannuation (as the executive could potentially withdraw at higher levels and reinvest outside the tax-exempt environment if required) and using a 3.62% withdrawal rate as an indication, executives would have initial income levels that were approximately:

Portfolio Amount	Approx Annual income
\$850,000	\$30,000
\$1m	\$36,000
\$2m	\$72,000
\$3m	\$107,000
\$5m	\$181,000
\$7.5m	\$272,000
\$10m	\$362,000

These would fluctuate up or down with time depending on market returns.

All of the annual income amounts are above the level of the full single pension and ASFA assessment of modest retirement lifestyle expenses for singles. A balance of approximately \$1.2 million or above is required to match the ASFA comfortable retirement lifestyle expenses for singles.

For those hoping to maintain their current lifestyle, a common yardstick is two thirds of current income, but amassing the necessary wealth in superannuation appears to be out of reach, for top

paid executives because that would require them to contribute beyond the bounds of their income, and for CEOs because they would breach contribution limits.

However, it is clear that those who do contribute additional amounts can maintain respectable incomes in retirement, even if international travel is taken into account.

What if the market is performing badly?

The 3.62% rate is based on the past performance of Australian investments, which may be misleading, as the Australian market has performed particularly strongly over the last century, a trend some experts believe unlikely to continue. Finsia examined 17 developed countries in its analysis, and found the maximum withdrawal rate was over 4% for four countries, between 2% and 4% for eight countries and under 2% for five countries.

If the executive wanted to be sure their portfolio would not fail, they could adjust withdrawal rates based on market returns, which could lead to commensurately lower income levels.

Conclusion

Executives should be aware of their expectations in retirement and the amounts they are contributing to superannuation. If the latter will not achieve the former, executives should consider increasing their contributions within the limits to which they can contribute under the current regime.

Given the amount of debate around superannuation concessions, the rules may not remain static over the next few years. There have been a number of submissions to the Federal Government's taxation whitepaper suggesting changes that will affect the ability of individuals to use the government's tax concessions to help save for retirement. Executives must keep the potential for changes in mind when making any decisions.

Some of the suggestions in submissions to the review include:

- Limiting tax exempt balances to \$2.5 million – as shown, this can affect executives who contribute above concessional caps.
- Reducing the threshold for 30% tax on super accumulation to those with incomes over \$180,000. It is currently set at \$300,000. This would affect executives who have structured their tax affairs to avoid the additional taxation.
- Implementing a flat tax of 12% for superannuation accumulation, earnings and withdrawals. This will affect assumptions around the tax-exempt status of super during the draw down phase.
- Increasing the age at which individuals can access superannuation to 65. This could affect the plans of those who are hoping to retire early.

Other possible scenarios for inclusion in superannuation scenario planning for the next 50 years could include:

- Limiting lump sum withdrawals from concessional superannuation fund accumulation to 10% of the fund balance at retirement age.
- Requiring high income earners to make mandatory contributions at concessional rates up to the superannuation guarantee percentage of their annual cash income, capped at \$100,000 per annum.
- Reducing the current mandatory aged-based superannuation withdrawal rates, with current rates to be considered as maximum withdrawal rates.

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Clawback Gains Global Momentum

The UK and US have announced new clawback requirements, expanding uncertainty for executives on whether earned bonuses and long term incentives will remain theirs to keep.

UK

Following a number of scandals that shook confidence in the financial sector, the UK's Prudential Regulation Authority and Financial Conduct Authority finalised new rules in June that require the implementation of long deferral and clawback periods.

Depending on the role, deferral of variable remuneration will extend to up to seven years after the end of the performance period, with clawback to apply until seven years after the award for material risk takers and another three after that for senior managers where a firm or regulatory authorities have commenced inquiries into material failures.

Organisations are required to "make all reasonable efforts" to recover some or all vested variable remuneration where:

- there is reasonable evidence of employee misbehaviour or material error, or
- the firm or relevant business unit suffers a material failure of risk management,

taking into consideration the proximity of the employee to the failure of risk-management in question and the employee's level of responsibility.

The new rules apply to banks, building societies, and certain investment firms for performance periods beginning on or after 1 January 2016.

US

The US Securities and Exchange Commission has proposed a law that would mandate listed companies to clawback remuneration from executives following an accounting restatement due to material error. No fault is required on the part of the executive for the remuneration to be reclaimed.

Incentive-based remuneration received by executives in the three financial years prior to the statement would be affected, with the portion to be reclaimed being the remuneration that would not have been received given the restatement. Incentive-based remuneration is defined as variable remuneration that is granted, earned or vested based wholly or in part on any financial reporting measure, including share price and total shareholder return measures.

Companies have discretion regarding the method of recovering remuneration. They must, however, disclose how much remuneration was subject to recovery, whether amounts remain outstanding and the names of executives the company decided not to clawback remuneration from and why it made that decision (they have discretion not to clawback remuneration when it would be impractical, for example when it would cost more than they would retrieve).

This proposed rule is now subject to comment.

Australia



It had appeared that the ASX Corporate Governance Council would make the introduction and disclosure of clawback policies and their implementation a recommendation in the most recent version of its Principles and Recommendations, but the recommendation was removed from the final document, leaving only the suggestion that companies disclose a summary of their policies around malus or clawback in the event of serious misconduct or financial misstatement. (While malus involves the company retaining bonuses that have not yet vested to the executive, clawback involves a return of bonuses that have already been paid to the executive.)

Despite the lack of a formal rule, many Australian companies have introduced malus or clawback policies.

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Independence Plans Due in One Year for Super Boards

Although existing superannuation organisations will have three years to transition to proposed changes to the *Superannuation Industry (Supervision) Act 1993 (The SIS Act)*, by 1 July 2016 they will need to formulate a transition plan **on an individual Director basis** to submit to the Australian Prudential Regulation Authority (APRA).

Treasury released draft legislation at the end of June that requires registrable superannuation entity (RSE) licensees to have Boards comprising one third independent Directors and an independent Chairman by the end of the next three years.

Independence has been defined in the legislation as:

A person is independent from an RSE licensee if the person:

(a) does not have, and is not directly associated with a person who has, a substantial holding (within the meaning of the Corporations Act 2001) in the RSE licensee, or in another entity that is a member of the same group as the RSE licensee; and

(b) does not have a material relationship with, and is not employed by an entity that has a material relationship with: (i) if the RSE licensee is a body corporate – the RSE licensee; or (ii) if the RSE licensee is a group of individual trustees – any of the trustees; and

(c) has not at any time in the last 3 years been an executive officer or director of a body corporate that has, or has at any time in the last 3 years, had a material relationship with: (i) if the RSE licensee is a body corporate – the RSE licensee; or (ii) if the RSE licensee is a group of individual trustees – any of the trustees.



Currently employer-sponsored superannuation fund trustee Boards are required to have an equal number of employer representative members and member representative directors, a requirement that will be repealed under the proposed legislation. Super organisations in existence before July 2016 have a three-year transition period where they will be allowed to breach both the equal representation requirements and independence obligations.

The legislation provides APRA with new powers and requirements. To meet its obligations under the legislation, APRA has announced its intention to:

1. Introduce a new Prudential Standard SPS 512 Governance Transition (SPS 512) to support super organisations' transition to the new framework and support this standard with further guidance.
2. Amend Prudential Standard SPS 510 Governance (SPS 510) to support the proposed legislation.
3. Review and extend Prudential Practice Guide SPG 510 (SPG 510) to align it with the new legislation and prudential standard.

Drafts of the standards are to be released later in 2015, with the final standards to take effect on 1 July 2016.

Regarding the new prudential standard SPS 512, APRA has proposed that:

- Organisations create and implement a transition plan to ensure effective functioning of the Board and timely adoption of the new requirements. The plan (which is to be submitted to APRA) must be prepared and approved by the Board in time for the 1 July 2016 commencement date of the legislation. The plan will include:
 - a list of current Directors and whether they would be independent under the new legislation
 - The Board's plan for each individual Director throughout the transition period including whether they will be replaced, when this is likely to occur and when each Director's term expires.
 - The Board's target number of Directors and independent Directors.
 - Key milestones throughout the transition period.
- Boards assess, monitor and review transition risks during the three-year period, identifying and managing impediments to compliance.
- Boards meet governance requirements in SPS 510 at all times during the transition period, including maintaining an appropriate range of Board skills.

Regarding the amendment of SPS 510, APRA has proposed that:

- Examples of "material relationships" include material professional advisors, consultants or suppliers. They are also likely to include relationships between the RSE licensee and employer sponsors, parent companies and bodies with the right to nominate potential directors.
- Independence requirements for committees be altered, requiring that the chairman and the majority of the members on the audit and remuneration committees be independent.
- The Chairman of the Board may be the chairman of the remuneration committee.
- The Chairman of the Board not be able to chair the audit committee.
- Regular assessments of the independence of individual Directors be conducted.
- APRA rarely use its power under proposed legislation to determine whether an individual Director is or is not independent.
- The requirement that Boards have formal policies on Board renewal be extended to encompass other aspects of Director appointment and removal, including provisions for the nomination of candidate Directors and the framework used to assess the suitability of the candidates.
- Although c) in the independence definition above prohibits Directors who have been an executive or Director of a body with a material relationship with the licensee from being classed as independent, some independent Directors of the conglomerate group would meet the legislative and SPS 510 requirements and could serve as independent Directors on the Board of the RSE licensee.

Regarding SPG 510, APRA intends to review and extend guidance as to:

- Board size
- Renewal and appointment processes
- Tenure limits
- Management of conflicts of interest (particularly for multiple directorships)
- The role of Board committees.

Parties wishing to comment on APRA's intentions should provide submissions to the regulator by 31 July 2015.

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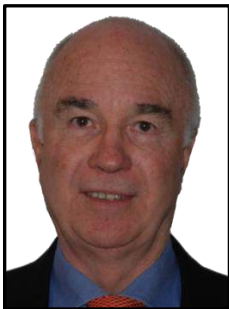
About us

For more than 25 years, Egan Associates has advised leading organisations and emerging enterprises in Australia and New Zealand on the remuneration of Board Directors, executives and key staff members, as well as performance management, corporate governance and Board effectiveness.

Our Services include:

- **Remuneration reviews and benchmarking:** for CEOs, executives, senior management and professional positions, including specialist roles
- **Annual incentive plan structures:** advice on performance criteria, target and maximum payment levels as well as deferral and clawback provisions
- **Long term incentive plan structures:** advice on participation, performance hurdles, equity instruments, valuation and allocation, as well as provision of performance monitoring services
- **Corporate transactions / IPOs:** assistance transitioning pre-IPO reward arrangements into the listed company environment (or any other corporate transformation) considering issues including escrow provisions
- **Government pay reviews:** assistance at federal, state and local level in administrative, policy and corporatised environments on reward for senior executives, professional and administrative staff, and governing Boards
- **Board fee reviews:** benchmarking Board fee levels, including Chairman and Director retainer fees, Committee Chairman and member fees and fees for adhoc engagements.
- **Board effectiveness:** assistance with Board reviews, Board skills matrices, scenario planning and Board documentation.

John Egan



John's early career was with Cullen Egan Dell (now Mercer Human Capital), which he chaired from 1983 to 1989, when he formed Egan Associates. John has been an advisor to Boards and senior executives on organisation, governance and reward issues over many years. He has assisted a significant majority of Australia's top 200 companies as well as a myriad of entrepreneurial organisations and government entities across a wide range of industries.

John has been actively involved with Universities, chairing Sydney University's Board of Advice for its Faculty of Economics & Business (2001 – 2010). John is an Honorary Fellow of the University and an Adjunct Professor in the School of Business.

His personal interests are in cool climate gardens – www.thebraesgarden.com – and he served as a Trustee of the Sydney Royal Botanic Gardens & Domain Trust from May 2010 to June 2014.