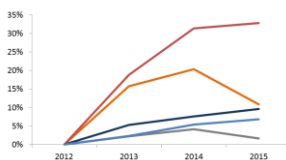


Newsletter January 2016

In our first newsletter of 2016, Egan Associates compares median CEO and CFO fixed remuneration adjustments over the past 4 years with movements in average weekly earnings, the Consumer Price Index and the relevant share price index. We also provide an overview of the current termination benefits regime and a summary of the key points from the Productivity Commission's final report on the workplace relations framework.

Concluding the Newsletter is 'The Agenda', which highlights current issues or matters that may be under review by Government or under consideration by Boards.

CEO & CFO Fixed Remuneration in Perspective



Egan Associates examines the variability in CEO and CFO median fixed remuneration and compares the data with average weekly earnings, the Consumer Price Index, and movements in the relevant share price index.



When is Shareholder Approval required for the Provision of a Termination Payment?

As the 2015 AGM season draws to a close and a new year begins, Boards may be reflecting on recent shareholder feedback and re-evaluating their termination policies. In light of this, we have provided an overview of the current terminations benefits regime.



Report on Workplace Relations Framework Released

The Productivity Commission released its final report on the workplace relations framework in late December 2015. The report marks the completion of the Commission's inquiry into the workplace relations framework.



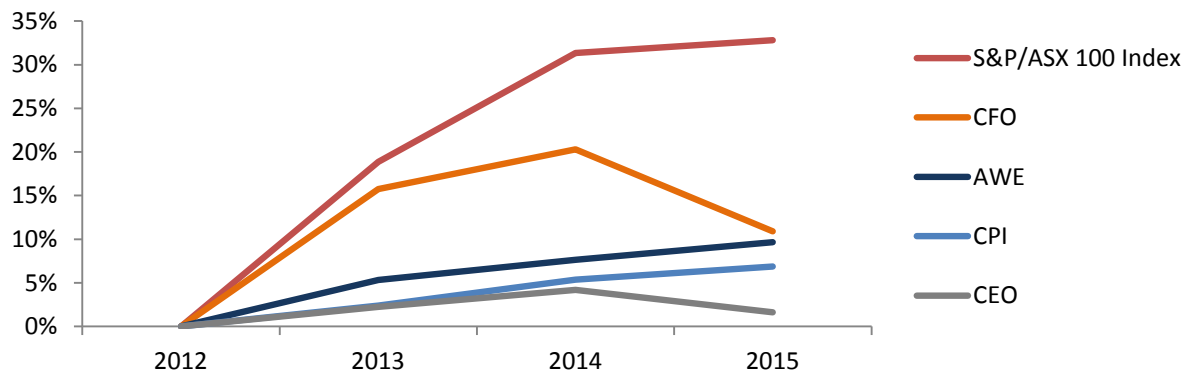
The Agenda

'The Agenda' highlights current issues or matters that may be under review by Government or under consideration by Boards of Directors, including those relating to superannuation, executive pay, the workforce and pay equity.

CEO & CFO Fixed Remuneration in Perspective

The graphs below highlight the variability in Chief Executive (CEO) and Chief Financial Officer (CFO) median fixed remuneration for the ASX top 300 companies (at 31 December 2015) using the median rate of increase. These statistics are compared with movements in average weekly earnings (AWE), the Consumer Price Index (CPI), and the relative share price indices addressing the top 100 companies, the top 200 companies and the top 300 companies.

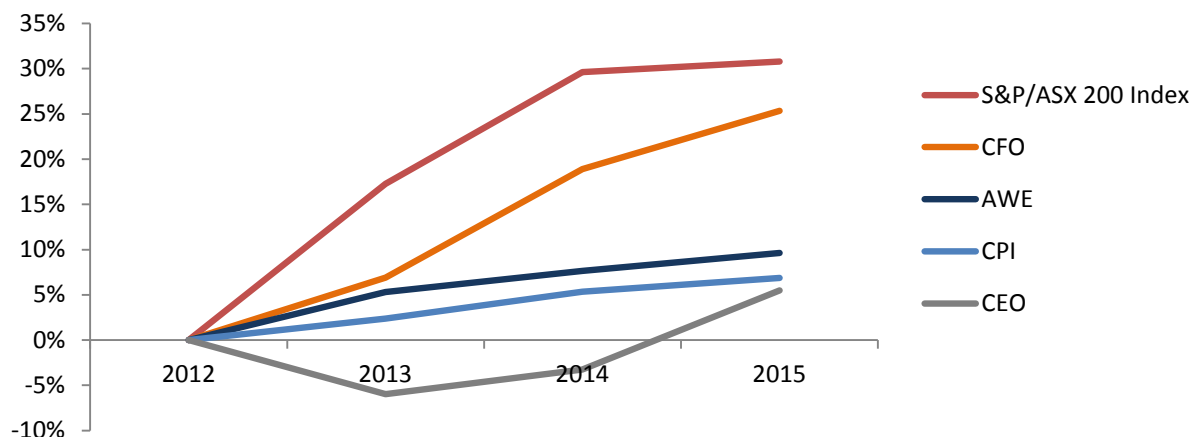
Top 100 – CEO & CFO Median Fixed Remuneration Adjustments



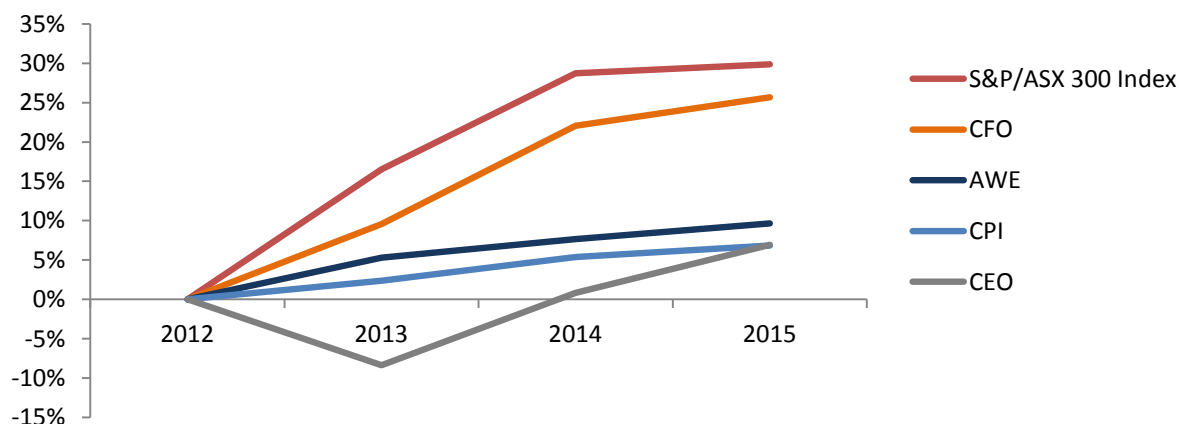
For the top 100 companies, the analysis reveals that CEO pay has increased at a rate below that of the CPI and average weekly earnings and well below movement in the share price index for the Top 100 companies.

CFO pay, on the other hand, has increased at a more rapid rate though the rate of increase has declined over the period from 2014 to 2015.

Top 200 - CEO & CFO Median Fixed Remuneration Adjustments



Top 300 - CEO & CFO Median Fixed Remuneration Adjustments



For the top 200 and top 300 companies the median increase in fixed remuneration for CEOs declined from 2012-13, despite an uplift in CFO fixed remuneration. The rate of increase for CEO pay was more in line with CFO pay for the 2014-2015 period.

Across all sectors, a proportion of up to 20% of CEOs have been replaced by new incumbents, where in the vast majority of instances fixed pay has been less than a long serving predecessor CEO or CFO. The significant uplift in CFO remuneration may also reflect the increased demands being placed on these positions relative to the CEO and what has traditionally been a significant gap in pay between the CEO and the top 3 executives in many of Australia's leading companies.

Egan Associates is increasingly observing that executives occupying the position of CFO, particularly among Australia's leading companies, have a broad base of experience where their career has not solely followed a path from graduate accountant through the specialist accounting functions to that of Financial Controller and onto Chief Financial Officer.

While the trend for CFO reward adjustment has remained consistent, in our judgement it primarily reflects replacement. In top 100 companies the tapering off of the rate of increase from the 2014 Financial Year through to date reflects fickle global bourses and challenging economic environments across a number of industries.

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When is Shareholder Approval required for the Provision of a Termination Payment?

Termination payments are widely utilised as a means of rewarding Executives when their service is terminated for sound commercial reasons. The contractual provision of termination payments in these circumstances will often be a key ingredient in attracting top talent, encouraging Executives to take more risks, and ensuring a measure of objectivity in negotiations for mergers and takeovers. However, the termination benefits regime, which increased in complexity due to amendments in 2009 (see Egan Associate's comment on the amendments [here](#)), can make it difficult for Boards to manage their obligations to shareholders when providing certain benefits to departing Executives.



As the 2015 AGM season draws to a close and a new year begins, Boards may be reflecting on recent shareholder feedback and re-evaluating their termination policies. In light of this, we have provided an overview of the current terminations benefits regime.

Summary of 2009 Amendments

The *Corporations Amendment (Accountability on Termination Payments) Act 2009* (Cth) commenced on 24 November 2009. As a result of these amendments:

- Termination benefits exceeding one year's base salary are subject to shareholder approval, whereas prior to the amendments termination benefits could reach up to seven times a recipient's total annual remuneration before approval was required
- The scope of the regulation was expanded from to include Senior Executives and Key Management Personnel in addition to Directors
- The definition of a termination benefit was clarified and expanded
- 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
- The penalty provisions were strengthened to 180 penalty units (previously 25 units) for a natural person and 900 penalty units (previously 150 units) for a body corporate

How are termination payments defined in the Corporations Act?

Termination payments are referred to as "benefits" in the termination provisions of the *Corporations Act*, and include the following:

- A payment or other valuable consideration;
- A payment in lieu of notice;
- Accelerated or automatic vesting of share-based payments or entitlements on termination;
- An amount paid as a voluntary out-of-court settlement in relation to termination of employment;
- An amount paid pursuant to a restraint of trade clause;
- Real or personal property, or any interest therein;
- A pension other than a pension paid from a superannuation fund or annuity; and
- Superannuation payments in excess of legislative entitlements, other than salary sacrifice

Excluded items and benefits exempt from shareholder approval

Not all payments provided to departing executives will be caught by Act and the following are specifically excluded:

- Deferred bonuses, including short and long term incentive awards, relating to performance up to the point of termination
- Genuine accrued benefits that are payable under law
- Payments required by law of a foreign country
- Payments from a prescribed superannuation fund due to death or incapacity
- Reasonable payments that are consistent with those made payable to all employees in the company purely based on the length of service and relating to genuine redundancy
- Payments from a defined benefits superannuation scheme that was in existence prior to 24 November 2009
- Genuine superannuation contributions paid by an employer or employee on or prior to 24 November 2009

For payments which do fall under the termination provisions, shareholder approval is not required under the Act if the benefit falls into one of the following categories and the amount does not exceed one year's average base salary:

- A benefit given in relation to past services, such as superannuation or an accumulated lump sum;
- A payment made as part of a restrictive covenant, restraint of trade clause or a non-compete clause;
- A benefit given as part consideration for the Executive taking up their position in office; and
- A genuine payment by way of damages for breach of contract.

However, it should be noted that ASX Listing Rule 10.19 provides that shareholder approval must be obtained for benefits provided to an officer that exceed 5% of the equity interests in the company.

Guidance on scope of termination provisions

Queensland Mining Corporation Ltd v Howard Victor Renshaw & Ors (Renshaw) is a useful recent (2014) case that provides guidance on the amended termination provisions including when it is necessary to seek shareholder approval.

In this case it was held that the payments made to Queensland Mining Corporation Limited (QMLC) Executive Mr Renshaw had not been approved by shareholders and did not fall into any of the categories of exempt benefits. Mr Renshaw was ordered to repay the entire amount he received (\$677,333).

In finding in favour of QMLC, the Court made the following observations:

- “Benefits” include amounts owing under contract
 - The *Corporations Act* expressly provides that a person is taken to have given a benefit even if the person is obliged to provide the benefit under a pre-existing contract.
- Payments were not a genuine superannuation contribution
 - It was proposed that one of the payments was intended to provide compensation for future superannuation entitlements that Mr Renshaw would have received under the service agreement and was therefore excluded.
 - The court held that the exemption does not apply to future entitlements to superannuation contributions that have not yet accrued.
- Payments of tax liabilities are not exempt
 - Amounts claimed to be for the purpose of withholding tax are not exempt as there are no exemptions in the Act or Regulations for payments intended to discharge such liabilities.
- Shareholder approval cannot be retrospective
 - Mr Renshaw could not rely on the proposition (for the purpose of estoppel) that QMLC would obtain shareholder approval once the Settlement Deed had been signed and the payments had been made, as shareholder approval must be obtained before the payments are made.

Conclusion

In summary, if the termination payment falls under the definition of a “benefit” (and/or exceeds 5% of the company’s value if the company is listed) it will be necessary to seek shareholder approval unless the payment qualifies for exclusion under one of the specified exemptions, clarified by *Renshaw*. When shareholder approval is required, it must be obtained prior to the payment or provision of the benefit.

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Report on Workplace Relations Framework Released

The Productivity Commission released its final report on the workplace relations framework in late December 2015. The report marks the completion of the Commission's inquiry into the workplace relations framework.

A summary of the key points, as finalised by the Commission, are as follows:

- The wage regulation function of the Fair Work Commission (FWC) should be separated from it. The existing FWC should concentrate on its tribunal and administrative functions and a new body, the Workplace Standards Commission (WSC) should determine minimum wages and award regulations.
- The Fair Work Act should be amended to minimise unnecessary compliance costs and poor outcomes as a result of the current unfair dismissal and enterprise bargaining provisions.
- Complementary policies that provide in-work benefits – such as wage subsidies or an earned income tax credit – might support higher incomes for lower paid employees.
- Minimum wages are justified; however, significant minimum wage increases pose a risk for employment.
- A new form of employment arrangement, the enterprise contract, should be introduced as a means to reduce complexities that smaller businesses face when making enterprise agreements.
- Sunday penalty rates for hospitality, entertainment, retailing, restaurants and cafes should be aligned with those on Saturday reflecting changing consumer preferences.



Business groups say that the cut to Sunday penalty rates will deliver more jobs and benefit consumers, while Unions and the Federal Opposition believe that it is an attack on the lowest paid workers of Australia.

Employment Minister Michaelia Cash said that it was up to the Fair Work Commission to make the final decision.

"The Government has no plans to change penalty rates" Ms Cash said.

"Penalty rates are set by the independent Fair Work Commission, just as interest rates are set by another independent body".

However, Labor's employment Spokesperson Brendan O'Connor has criticised the Government for failing to reject the proposal, stating that "If Malcolm Turnbull and this government does not want to support cutting penalty rates, then they can reject the recommendation of the Productivity Commission".

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The Agenda

John Egan quoted in Herald Sun

John Egan has been quoted in an article in the Herald Sun regarding the use of fair value accounting in long-term bonus schemes for Executives. The article comments on the pricing of share packages which often lack transparency and confuses shareholders.

You can read more [here](#).

Do Directors need skin in the game?

There is an ongoing debate as to whether Directors need to have “skin in the game”, or shares in the company they preside over, so that the Directors’ financial interests are more closely aligned with those of shareholders.

This is the scenario typically preferred by proxy advisors and institutional investors; The Australian Council of Superannuation Investors (ACSI) recently revealed that nearly 11% of ASX 100 Non-Executive Board seats are held by Directors with no shares in the company, which it believes is a “poor result”.

Indeed, Director ownership was a key focus for the 2015 AGM season, and several companies, including Super Retail Group and Cardno, have since introduced “minimum securities holdings” requirements.

However, the Australian Institute of Company Directors (AICD) cautions that it is a matter of balance.

AICD Managing Director John Brodgen stated that, although there is an argument that everyone should have “skin in the game”, Boards also need independent Directors who only take a fee so that they make decisions independent of their own interests.

SEC to complete final rules for compensation disclosures

The Securities and Exchange Commission (SEC) is due to complete the disclosures mandated by the Dodd-Frank Act in the next year. The SEC has so far adopted final rules for 7 mandatory provisions related to Executive compensation, with 5 more proposed. Some of the key rules yet to be adopted include:

Recovery of Executive Compensation

This rule is designed to improve the quality of financial reporting and enhance accountability to investors by requiring Executive officers to pay back incentive based compensation that they were awarded erroneously. Companies would be required to develop and enforce recovery policies that, in the event of an accounting restatement, “claw back” from current and former Executive officers incentive based compensation they would not have received based on the restatement.

Hedging Disclosure

The hedging disclosure requirements would require companies to disclose whether they permit any employees, officers or directors, or any of their “designees,” to purchase financial instruments or otherwise engage in transactions that are designed to have the effect of hedging or offsetting any decrease in the market value of company equity securities: granted as part of compensation; or held by them, “directly or indirectly.”

Pay v Performance Disclosure

Under this Rule, companies would be required to disclose:

- The relationship between the compensation actually paid and the company’s total shareholder return
- The relationship between the company’s TSR and the TSR of its peer group.

British CEOs highest paid in Europe

A study among top companies on Executive pay in Europe, undertaken by the **Vlerick Business School**, has revealed that Britain’s CEOs are paid an average of €5.65 (\$AUD 8.76) million each year, ahead of €4.26 (\$AUD 6.6) million in Germany, €3.15 (\$AUD 4.88) million France, and €2.91 (\$AUD 4.51) million the Netherlands.

The UK has the highest variable component of remuneration, with the average CEO receiving 74% of his or her remuneration from short and long term incentives (bonuses and shares). The next highest is Germany, with an average of 61%, followed by the Netherlands with 50%. CEOs in France and Belgium have the lowest variable components; they receive the majority of their pay from fixed remuneration (65 and 64% respectively).

However, the study also revealed that the share based component of remuneration has declined in recent years. The number of European companies granting share based remuneration decreased from 45% in 2007 to 23% in 2014, while in the UK over 86% of firms issued shares as pay in 2013 which dropped to 75% in 2014.

You can read more [here](#).

AGM process under scrutiny

The **Australian Institute of Company Directors (AICD)** has revealed that a third of Directors believe the AGM process is dysfunctional and outdated.

“The old company AGM no longer meets its purposes. We’re getting fewer and fewer people attending, and many of the decisions are made well and truly before the AGM is opened” said AICD CEO John Brogden.

“The concept that through democratic capitalism shareholders come along to an AGM where they vote and decisions are made is long gone.”

Mr Brogden said that shareholders have plenty of options to be heard which do not necessarily involve showing up in person. He suggests interactive web casts, which would make it easier for shareholders to become more involved.

However, the Australian Shareholders Association (ASA) Board member Don Hyatt said that technology could not replace the face-to-face experience of an AGM.

“I think this is the one time of year that the Directors and Chief Executives actually have to face the shareholders and ultimately it’s a great opportunity to actually look the Directors in the eye and interact with them” he said.

You can read more [here](#).

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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 with transitioning pre-IPO reward arrangements into the listed company environment, or a trade sale or any other corporate transformation
- **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 – he served as a Trustee of the Sydney Royal Botanic Gardens & Domain Trust from May 2010 to June 2014.