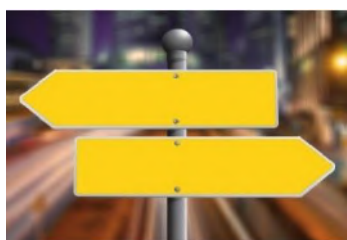


Newsletter April 2019



Board Remuneration Oversight

Initial concerns from the Hayne Royal Commission related to Director engagement in the determination of remuneration policy and, in particular, incentives. Where are shareholders focusing now?



Superannuation - Opportunity for Further Reform

There are significant savings opportunities available to government by providing working Australians and retirees with better incentives to be independent in retirement.



Director Capabilities

Boards need to be more transparent and provide more comprehensive information on their nominations process and Director capabilities.



Preparing for the World of Work

To what extent does tertiary training and education actually prepare graduates for the world of work?

Board Remuneration Oversight

Initial concerns from the Hayne Royal Commission related to Director engagement in the determination of remuneration policy and, in particular, incentives. Shareholder focus has since turned to Director's knowledge of performance outcomes leading to the distribution of incentive payments at all levels of the workforce.

Proxy advisers, industry funds and institutional investors have expressed concern about financial metrics and the weighting of those metrics, the use of qualitative performance criteria or, more broadly, non-financial criteria.

Investors appear to be seeking a more comprehensive explanation for incentive payments, particularly of above target payments in relation to the organisation's absolute and relative performance in the context of the industry sector and the organisation's plans and performance compared to the prior year.

While it does not appear there is universal agreement in respect of appropriate financial targets, there is general agreement that financial targets are critical. There is broad acceptance that KPIs which are aligned to an organisation's transformation and sustainability have increasing relevance, as do the implementation of strategies which support the above and foster growth for the benefit of incremental shareholder returns.



There does not appear to be a warm embrace of APRA's initial observations that 50% non-financial KPIs should represent the starting point in the design of incentive awards. There has also been increasing comment that Boards are not supportive of incentive plans being regulated or mandated in some fashion.

While there have been observations that total shareholder return is not always an ideal measure of a company's performance, earnings are generally accepted providing they represent year-on-year growth/improvement and an appropriate return on assets or invested funds.

There has been some push back on the integration of annual and long-term incentive plans which, while involving a partial deferment of an award, are often a derivative of a balanced scorecard assessment of performance. This does not currently enjoy wide support, as it almost universally leads to incentives always being paid.

Discussion has also arisen at recent conferences in relation to year-on-year financial improvement as a gateway before any incentive is paid and if financial returns and other quantitative measures are the most appropriate for the determination of an organisation's health, then other criteria which is qualitative should be embraced as either a gateway or a modifier.

There are clearly some KPIs which will impact variably between industries which are likely to be seen on the boundary of quantitative and qualitative. This is likely to include risk management and safety.

It is apparent that there is work to be done. The general consensus is that criteria applied under incentive plans need, in part, to be industry/organisation specific rather than representing a universe of expectation.

An ingredient which has emerged over the last 12 or more months is the level of engagement of Directors in the formulation of incentive strategy, the determination of targets and what constitutes stretch.

The Hayne Royal Commission also raised the question of rewarding revenue outcomes which are achieved in breach of policies or product guarantees or for services not provided.

Indeed, the past 12 months have heightened the expectation of shareholders in relation to Directors' engagement and understanding of how incentives operate in the organisations over which they have stewardship.

Move forward with confidence by calling Egan Associates now on 02-9225 3225. We have the experience and the know-how to help you ensure all your reward and governance frameworks align with your organisation's strategies and stakeholder expectations.

[Back to Title Page](#)

Superannuation - Opportunity for Further Reform

Australian workers earning \$450 gross or more per month are entitled to a superannuation contribution of 9.5% of their gross salary under the Superannuation Guarantee legislation, with contributions capped at \$25,000.

The single aged pension in Australia currently stands at \$926.20 per fortnight / \$24,080 per annum. For couples, the aged pension is \$698.10 each per fortnight or an aggregate of \$1,396.20 per fortnight / \$36,300 annually per couple. There are some variations to these arrangements for couples who become separated through illness.

A proportion of retired Australians, in particular those who have self-managed superannuation funds, do not qualify for the government aged pension and therefore do not place themselves as dependents upon the government for financial their needs in retirement.

These retirees are required to pay tax on their fund earnings, including dividends, at the rate of 15%

In the past, superannuation contributions made within the framework approved by government have been taxed concessionaly. Notwithstanding, the ultimate fund available for an individual at the time of retirement is reflective of investment returns and those earlier sacrifices made with a view to securing an independent retirement.

Clearly it is in the government's interest to provide working Australians with sufficient incentives to encourage and enable future retirees to live post-retirement without dependence upon the aged pension.

A particular strategy in this scenario would be for government to recognise the benefits to the nation by having a greater number of independent, self-funded retirees. Unfortunately, as a result of amendments to the Superannuation legislation in the 2016 budget, many current and future independent retirees are confronting unanticipated taxes and associated costs.

It is unwise for government to risk penalising independent retirees to a point where significant numbers of them find they must turn to the government for support.

A more pragmatic initiative from government would be to award independent retirees with the benefit of the deduction of a pension entitlement if they were calling upon the government for pension support. Where the earnings on their funds are taxable, in our opinion these individuals should be able to claim a deduction equivalent to a pension entitlement.

Assuming the earnings on an individual's accumulation fund were \$50,000 on which they would nominally pay tax of \$7,500 (15%), thus reducing their earnings to \$42,500. Under this



scenario, our proposal would be that the independent retiree should be entitled as an individual “pensioner” to deduct approximately \$24,080 from their earnings, leaving taxable income of \$25,920 where their new tax obligations on the balance of their earnings would be \$3,888 or a tax saving of \$3,612.

This tax saving is modest in relation to the aged pension though recognises the contribution of the pensioner to savings by government by their not drawing upon a pension of nominally, say, \$24,080, receiving a tax benefit of \$3,612 or 15% of the pension that they might otherwise be entitled to.

While this does not remove the tax obligation of \$3,888 which their fund would be required to pay, **it acknowledges the independent retiree’s contribution to the government through the saving of more than \$20,000 per annum in the aged pension.**

If the earnings on a couple’s accumulated funds from which they drew a retirement benefit was \$75,000 in a setting where they would have otherwise been entitled to a combined pension of approximately \$36,300, then that amount would be deductible from their earnings leaving a taxable amount of \$38,700 or a tax obligation of \$5,805, not the \$11,250, or indicatively an additional \$105 per week to meet their living costs.

Again, this is a net cost to the government of \$5,445 as compared with \$36,300 which would be the couple’s entitlement under the aged pension.

While this does not eliminate the change in the taxing regime on superannuation earnings for self-funded retirees, it does acknowledge the significant saving to the government through their independence.

It would also go towards encouraging those still engaged in the workforce to strive where possible towards self-funded retirement through more of a “carrot” than “stick” approach.

It is important for government to also be mindful of the very real sensitivities of the population to legislative changes when they are made retrospectively, particularly when such changes can have a dramatic and unanticipated impact on an individual’s livelihood and previously reasonable expectations.

These observations provide a supplement to the Coalition’s reduction in the marginal rate of tax being applied to wage earners on salaries of less than \$120,000 per year and supported by the Labor opposition. However, they propose an alternate construct for Australia’s retired and aging population who in parallel with younger members of society are likely to be incurring increased costs in relation to health, energy and general living.

In the Coalition government’s 2019/20 budget, a number of proposals were outlined. Many of these modifications, while positive to retirees or those preparing for retirement, require Parliamentary approval.

Among the amendments were the following:

- From 1 July 2020 Australians aged 65 and 66 will be able to make voluntary superannuation contributions, both concessional and non-concessional, without meeting the work test (a minimum of 40 hours over a 30-day period).
- From 1 July 2023 the Aged Pension will only be available to individuals who have reached 67 years of age by that date.

- The Government has proposed to extend access to the “bring forward” arrangements which presently allow those aged under 65 to those aged 65 and 66 to make 3 years’ worth of non-concessional contributions to their superannuation in a single year.
- Further, the age limit for receiving spouse contributions is to go up from 69 to 74. At the time of the 2020 budget those aged 70 and over cannot receive contributions made by another person on their behalf.
- The government also proposed a number of amendments which will streamline administrative requirements for the calculation of exempt current pension income. In this context, the government will allow a superannuation fund trustee with interests in both the accumulation of retirement phases during the income year to choose their preferred method of calculating exempt current pension income (ECPI).
- The government also announced changes to personal income tax extending out to the 2024/25 Financial Year.

Most of the government’s recommendations have been endorsed by the Labor opposition.

We further note that the government proposed that a retiree couple aged 65 or 66 who sell their family home will be able to make contributions to their superannuation up to \$1.2 million from the proceeds of the sale under new rules revealed in the budget.

While this proposal is clearly attractive, many commentators noted that the proceeds of such a sale could mean a reduction in aged pension entitlements and that retirees should also be aware that the family home is not counted in the assets test for the aged pension.

There were a number of other measures, all of which have been considered favourable or positive for those planning or in the early stages of their retirement.

One issue not acknowledged is that self-funded retirees’ pension arrangements were modified in the 2016 budget with earnings on investments outside the \$1.6 million exempt portfolio to be taxed at 15% while all pension receipts will be tax free.

It is our judgement that this is an area where further initiatives which are unlikely to cost the government a substantial amount of money can be introduced in recognition of the significant savings being made to the nation through the contribution of independent retirees.

Any comments? We’d love to hear from you if you have any feedback on this or any of our articles or posts. Call Egan Associates now on 02-9225 3225 and speak with one of our Consultants or email us at mail@eganrem.com.

[Back to Title Page](#)

Director Capabilities

Recent press comment and statements made in response to the Hayne Royal Commission have reinforced observations from investors, proxy advisers and others that Boards need to be more transparent and provide more comprehensive information on their nominations process and Director capability.

In our opinion, a proportion of both favourable and unfavourable comment in relation to the composition of Boards across all sectors arises from shortcomings in the corporate governance statement and annual reports of many organisations. These shortcomings relate to failing to appropriately outline the capabilities essential for effective Board stewardship and the skills and experience of each member of their Board and those who are presenting themselves for election.

As awareness of a Boards' obligations becomes more widely discussed and addressed, much of the controversial comment should be substantially reduced.

The Australian Institute of Company Directors (AICD) has regularly published articles which flag the criticality of these issues. In one such article ([see an edited extract from the book *Developing Your Director Career*](#)) by Elizabeth Jameson, the author reflects on the Components of a Balanced Board which come down to 4 main components:

- **SKILLS** – Boards asking what hard skills and qualifications do we need amongst our Directors
- **EXPERIENCE** – Boards asking what practical experience do we need amongst our Directors in terms of a track record in relevant fields
- **DEMOGRAPHICS** – Boards asking what sort of balance of age, geography, gender, ethnicity, culture, faith and other demographic attributes do we want in order to bring a sufficient diversity of views and styles of thinking
- **PERSONAL or BEHAVIOURAL ATTRIBUTES** – Boards asking themselves what type of behaviours (commitment, dedication, strategic thinking, integrity and team player ability) do we want amongst our Directors

These four components should be reflected in the Board's approved skills matrix or Board composition matrix reflecting the fact that what Boards seek is much more than hard skills and qualifications.

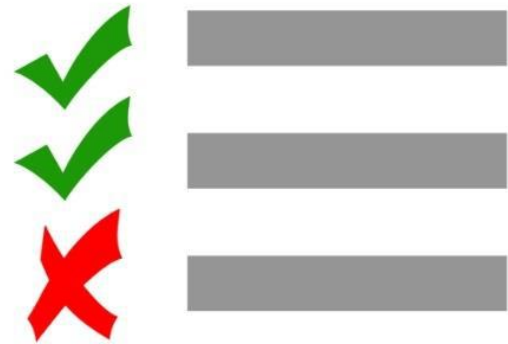
[In the extract](#), the author comments on the skills, experience, demographic, personal and behavioural attributes which are likely to have a relevance in this process. While the extract presents a comprehensive checklist, what one Board would regard as relevant skills in finance and accounting or information systems, data analysis and cyber security or legal skills, another may see as inadequate.

Accordingly, it is our view that rather than adopting a process which is the most common of a one to five-word statement in relation to skills or experience, it is important for the statement to be comprehensive in order that shareholders have a more thorough appreciation of the matters which the Board believe to be critical in fulfilling its role.

The AICD extract also highlights interesting observations in relation to demographics and personal and behavioural attributes. Among the latter we were interested to observe, among many, personal or behavioural attributes considered desirable. They included:

- Active listening
- Availability
- Courage
- Curiosity
- Emotional intelligence
- Integrity

In light of the Hayne Royal Commission where the primary focus was on those organisations in the financial services sector, many of the issues arising have a much wider relevance. Capability requirements, in this context, while having a number of universal attributes, will also have attributes which are specific to the organisation's scale, its internationalisation and the industry in which it both operates and competes.



Of increasing significance and questioning, following commentary over the past 12 months, is the criticality of the customer, the integrity of the relationship and how Boards maintain a familiarity with the organisation's policies and practices and embrace that understanding in their assessment of management's contribution to the organisation's sustainability and reputation.

While discussion in relation to these issues will continue, it is our opinion that of critical importance is a more transparent disclosure of Director capability and the relevance of that capability to the organisation's attributes.

Clearly, these disclosures and reviews should cascade down through the leadership team of the organisation with some reassurances given to provide shareholders with confidence.

This dialogue is also leading to market observations by regulators, investors and Directors on the criticality of measuring management's contribution to the organisation's performance and sustainability outside the more widely used financial metrics of shareholder return and earnings.

In reviewing corporate governance statements and annual reports over the past 12 months, we observed a high degree of commonality across industries among Australia's leading companies. This commonality relates to the attributes and capabilities which they seek in ensuring that their Board collectively have the right blend of knowledge and experience and personal attributes to ensure the effective stewardship of the organisations where they are representing significant shareholders.

In reviewing the capability requirements that are being increasingly reflected in a Board's engagement in both renewal and retention of Directors, we reviewed the statements of the nation's leading financial institutions, organisations involved in the health and the pharmaceutical sectors, the consumer sector, including consumer discretionary, the mining, energy and industrial sectors and media.

Excluding industry specific experience, the following list (ordered alphabetically) highlights the most common capabilities being sought at Board level:

- Capital projects / material transactions
- Executive / Board experience
- Financial acumen
- Governance
- Health and safety
- Information technology/ digital / cyber security
- International Experience
- Investment, M&A and entrepreneurship
- Judgement and Problem Solving
- Legal and regulatory
- Manufacturing / Supply Chain
- People, culture and conduct
- Public policy
- Remuneration and succession
- Risk management and compliance
- Sales, market and customer knowledge
- Science and technology
- Strategy
- Sustainability and environment

Egan Associates can assist with Board effectiveness reviews, the development of capability / skill matrices, and guidance on governance including details of Board and committee Charters. Call Egan Associates now on 02-9225 3225 and speak with one of our Consultants.

[Back to Title Page](#)

Preparing for the World of Work

To what extent does tertiary training and education actually prepare our youth for the world of work?

This question reflects an emerging challenge for government as many employers are questioning the work-readiness of Australian graduates with certificates, diplomas and degrees.

While most TAFE and University graduates receive a traditional and widely accepted credential to enable them to commence a career, it is believed that the majority of graduates have not been adequately prepared for work.

Attention is needed to address this deficiency at all levels of vocational training, TAFE and to supplement this with guidance from employers seeking to secure a stable, effective and balanced workforce.

To address the discrepancy between qualification and work-readiness, it may be expedient to require tertiary institutions to achieve mandatory targets linked to work-related competencies in order for those institutions to receive ongoing funding.



Although not all training colleges and universities have staff equipped to provide this form of training, there are sectors in the education and training environment which could collaborate with tertiary institutions to better prepare graduates. This would not only benefit graduates but would also provide better capacity and potential for graduates to repay HECS debts.

New digital technologies are [changing the way Australians live and work](#). Emerging technologies such as the internet of things, artificial intelligence, automation and robotics will affect the nature and type of jobs available and the skills and capabilities required to perform both existing and new jobs. While it is difficult to anticipate precisely the scale and impact of these changes, we can be reasonably confident that [the jobs of tomorrow will require new skills, while some existing skills will become obsolete](#).

However, it is generally accepted that the **pace of change is accelerating**. [Predictions vary](#), but the [Organisation for Economic Co-operation and Development \(OECD\)](#) estimates that in coming decades approximately 14 per cent of current jobs are at high risk of automation, while another 32 per cent are likely to be affected by significant modifications, changing how jobs are carried out. Non-routine, cognitive jobs, involving an emphasis on non-technical skills, are likely to be [the most resilient in the face of automation](#). The [World Economic Forum](#) has highlighted the **importance of non-technical skills such as creative thinking, originality, initiative, analytical thinking, innovation and complex problem solving** in Australia's future skills needs.

For decades, vocational education and training (VET) has been one of the key pillars of Australia's economic success story. Generations of tradespeople and skilled workers have successfully developed their skills and knowledge in a practical work-based learning environment.

Vocational education today remains an effective and efficient way of **imparting the skills needed for employment**. If anything, it's likely that work-based learning models will be more important in the future as technology-driven changes to the 'way we do things' need to be quickly transmitted across industries and around workplaces. Our fast-moving world will need flexible and applied ways of learning, so people can lay strong foundations for their careers and then build further skills and knowledge in order to participate in new and changing industries.

The current Commonwealth government has recognised the need to equip new and existing workforces to meet these changes and have just released a review by The Hon. Stephen Joyce of the current Vocational Education system in Australia.

With **under-employment and unemployment** arising from organisations pursuing their manufacturing and customer support activities in overseas economies where labour costs are lower, employers looking for talent will increasingly be facing **the intersection of young graduates and more mature unemployed or under-employed individuals in their 40s and 50s**.

With the latter group having acquired many of the skills essential to contribute positively in the world of work and accepting that employment between \$60,000 and \$100,000 per year is far more attractive than unemployment benefits, domestic **competition for administrative and technical work is arising from unexpected quarters**.

Many of **those who have been in the world of work for 20 or more years** have developed both soft skills and have technical know-how across many industries and in many employment settings which make them valuable and **potentially more stable, humble and less ambitious and upwardly mobile than young graduates**.

It is likely that work-based learning models will be more important in the future as technology-driven changes to the 'way we do things' need to be quickly transmitted across industries and around workplaces. [Our fast-moving world will need flexible and applied ways of learning](#), so people can lay strong foundations for their careers and then build further skills and knowledge in order to participate in new and changing industries.

Any comments? We'd love to hear from you if you have any feedback on this or any of our articles or posts. Call Egan Associates now on 02-9225 3225 and speak with one of our Consultants or email us at mail@eganrem.com.

[Back to Title Page](#)

About Egan Associates



For 30 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.
- **ealQ:** *Define and evaluate positions and analyse pay the easy way!* Our new cloud-based software captures more than 30 years' knowledge, learning and experience in organisation analysis and remuneration in a suite of products which operate either as powerful, stand-alone modules or as an integrated combination. Access more than 1,000 role templates and over 13,000 accountability statements or easily create your own PDs from scratch. Organisation charts are generated automatically. Powerful analytics give you pay and workforce insights in one click. And our intuitive, user-friendly job evaluation module is designed to bring your JE process into the 21st century. And because *Workforce is* designed and hosted in Australia by Egan Associates, you know you're in great hands!



Egan Associates

Phone 02-9225 3225

