

June 2011



## **New director and executive remuneration legislation passed by Parliament**

On Monday 20 June, 2011, the Senate passed the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011*.

The new legislation significantly strengthens the annual vote on the remuneration report through a new 'two-strikes' rule (whereby Directors will face a spill vote if the Remuneration Report receives no votes of 25% or more in two consecutive years), whilst bringing into force several other governance and disclosure requirements.

Each of the provisions in the legislation has an effective date of either 1 July 2011 or 1 August 2011.

Companies should review their approach to executive remuneration. We summarise what the changes mean for companies in this document.

Note: the Government recently undertook a short submission process (which closed on 9 June 2011) regarding the Corporations Amendment Regulations 2011 that will accompany the Bill. The Regulations will provide more detail regarding what does and does not constitute a remuneration recommendation for the purposes of the remuneration consultant requirements, and more detail regarding what is and is not a 'hedge' for the prohibition of hedging requirement. The final Regulations are yet to be released.

## Summary of the legislation

The legislation implements the following changes to the Corporations Act:

- ▶ **The 'two-strikes' rule** - If a company receives a 'no' vote of 25% or greater of the votes cast on its remuneration report the company's next Remuneration Report must explain the board's proposed action in response to the 'no' vote, which may include engaging a remuneration consultant, or explain why no action has been taken. If, at the subsequent AGM, the company receives another 'no' vote on its Remuneration Report of 25% or more of the votes cast shareholders will vote at the same AGM to determine whether the directors will need to stand for re-election. If this 'spill resolution' vote is 50% or greater, a separate re-election meeting must be held within 90 days. The first potential strike under the two-strikes rule will be for remuneration report resolutions held after 1 July 2011.
- ▶ **Use of remuneration consultants** - The legislation introduces rules governing the engagement and disclosure of remuneration consultants who provide recommendations to the company on the quantum and elements of Key Management Personnel ("KMP") remuneration. The definition of a remuneration consultant is narrower than the scope of remuneration services that a company may require. Such consultants (as defined) must be approved by, and recommendations provided directly to, non-executive directors. The consultant must provide a declaration that the recommendation is free from undue influence from the KMP to which the recommendation relates. The requirements apply to contracts with remuneration consultants executed on or after 1 July 2011.
- ▶ **Amendment to persons required to be named in the Remuneration Report** - The Bill removes the requirement to disclose remuneration for the five highest paid executives and limits disclosure only to KMPs as defined in AASB 124 *Related Parties*. Further, remuneration disclosures are only required for the KMP of the consolidated entity rather than currently for the KMPs of the company and consolidated entity, if different. This requirement applies to Remuneration Reports for financial years commencing on or after 1 July 2011.
- ▶ **Hedging of incentive remuneration** - From 1 July 2011, a KMP of a company that is a disclosing entity and the KMP's closely related parties must not enter into arrangements that hedge or limit the KMP's exposure to risk relating to incentive remuneration (e.g., unvested awards and awards that remain subject to a holding lock).
- ▶ **Prohibiting KMP from voting on remuneration matters** - KMP will be prohibited from voting on the Remuneration Report and the spill resolution. This prohibition includes their shares, shares of their closely related parties and undirected proxies (unless the Chair has been expressly authorised by the shareholder to vote the undirected proxy). This rule will be effective for resolutions held after 1 August 2011.
- ▶ **Cherry picking** - For all resolutions held after 1 August 2011, a vote will be required for all directed proxies. To the extent a nominated proxy does not vote, the proxy will default to the chairman, who is required to vote on all directed proxies.
- ▶ **No vacancy rule** - Shareholder approval will be required for a public company to declare 'no vacancy' if the number of directors is less than the maximum specified in the company's constitution. This rule applies in relation to the setting of board limits on or after 1 July 2011.

To discuss how we can support you, please contact your Ernst & Young advisor or one of the contacts below:

**Mike Hogan**  
+61 2 8295 6853

**Bruno Cecchini**  
+61 3 9288 8423

**Chris Galway**  
+61 2 8295 6476

## What the changes mean for companies

We suggest that companies review their approach to executive remuneration, which may include consideration of the following:

- ▶ **Develop and implement a structured and comprehensive shareholder engagement strategy** - The legislation puts further pressure on the Remuneration Report vote via the implementation of the two-strikes rule. As such, we suggest you:
  - ▶ Revisit your shareholder engagement strategy to ensure shareholders understand the remuneration structures and the business rationale underpinning the remuneration design. You should engage early with both shareholder advisory groups and major shareholders,
  - ▶ Revisit the content and structure of the Remuneration Report to ensure that it complies with the requirements of s300A of the Act, and
  - ▶ Minimise shareholder confusion or concern by ensuring the Remuneration Report is clear, concise and easy for shareholders to read and understand.
- ▶ **Review the role of the board and management as it relates to executive remuneration** - There will be an increased focus on the role of the board, particularly in the governance of remuneration arrangements. Assess the role of your organisation's remuneration committee, including reviewing the remuneration committee charter and delegated management authorities, to ensure they appropriately delineate between the role of the committee and management. Revise your governance framework as required to reflect the legislation.
- ▶ **Review your approach to appointing and working with remuneration advisors** - Companies should review and revise (where needed) their approach to engaging and working with remuneration advisors, including the role of the board and management, and the required processes. For most companies, we anticipate that the changes will be an evolution of your current approach to using advisors rather than a significant change.
- ▶ **Review the implications of the changes to voting rules** - Consider the implications of the two-strikes rule, no vacancy rule, the cherry picking rule and the prohibition of KMP voting. Where one-strike has occurred after 1 July 2011 subsequent Notices of AGM's must allow for the possibility of a spill resolution being held at that meeting. The restriction on KMPs voting undirected proxies may impact voting outcomes for some companies. Companies may also wish to revisit their constitution and considering AGM procedures. Due to the legislation's transitional provisions, KMP may vote their own or undirected proxies on the Remuneration Report at an AGM held before 1 August 2011.
- ▶ **Prepare for the prohibition of 'hedging' by KMP** - To the extent that your policy does not already cover this topic, establish a procedure for all KMP to declare that they and their closely related parties have not entered into a hedging arrangement for unvested equity or equity subject to a holding lock.

Ernst & Young

Assurance | Tax | Transactions | Advisory

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com)

© 2011 Ernst & Young, Australia.  
SCORE NO. AU00001081

This communication provides general information which is current as at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk.

Liability limited by a scheme approved under Professional Standards Legislation.