Mercer Consulting (Australia) Pty Ltd
ABN 32 005 315 917
Darling Park Tower 3
201 Sussex Street Sydney NSW 2000
GPO Box 9946 Sydney NSW 2001
+61 2 8864 6800
Fax +61 2 8915 1526
tim.nice@mercer.com
www.mercer.com.au

Mr David Woods
General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

15 March 2013

Subject: Corporations Amendments - Improving Disclosure Requirements

Dear Mr Woods

This submission by Mercer is in response to the public invitation to comment on the Exposure Draft of the Corporations Amendment (Remuneration Disclosures and Other Measures) Bill 2012.

Our objective is to comment specifically on the amendments outlined in the Explanatory Memorandum, relating to “Improving disclosure requirements in the remuneration report” (Chapter 2). In particular our submission focuses on the proposed requirements for listed entities to:

1. Include a general description of their remuneration governance framework in their remuneration report; and
2. Disclose for each Key Management Personnel (KMP)
    - the amount that was granted before the financial year and paid during the financial year (“past pay”)
    - the amount that was granted and paid during the financial year (“present pay”); and
    - the amount that was granted but not yet paid during the financial year.

In confining our commentary to these aspects of the Bill, we are not endorsing the other amendments. We have previously provided comments on aspects proposed, such as the clawback of remuneration, and we therefore believe our current contribution is most usefully directed to the sections where we have not previously articulated a view.

We appreciate the opportunity provided to present our views on the proposed amendments. Should you wish to discuss further any issues raised in our submission, please do not hesitate to contact me.

Yours sincerely,

Timothy Nice

Tim Nice, Principal

Summary of Mercer's comments on Exposure Draft – Corporations Amendment

The stated purpose of the Bill is to introduce a range of measures to enhance the disclosure of executive remuneration in Australia. The Bill implements many of the recommendations made by the Corporations and Markets Advisory Committee (CAMAC) in its 2011 inquiry into executive remuneration.

The discussion on why executives are paid what they are paid is critically important to enabling meaningful disclosure. We support the requirement of describing the process for determining the remuneration of KMP.

Meaningful disclosure of remuneration outcomes is also important. However, the Bill's requirement to disclose past, present and future pay could lead to greater complexity rather than clarity. It may also have unintended consequences if shareholders base their vote on the remuneration report on pay outcomes from past policies or decisions, rather than current policy intentions.

Chapter 2 – Requirement to include a general description of the remuneration governance framework

The exposure draft proposes listed companies include in their remuneration report a description of their remuneration governance framework (to the extent it is not otherwise disclosed in the annual report). This framework would effectively describe the process for determining the remuneration of KMP.

We support the objectives and intent of this change in the law. This recognises that while many companies already provide disclosure around their remuneration decision processes, there is still a wide variance on the degree of detail and transparency provided. The requirement should aid and assist shareholders in understanding how decisions are made and the factors that the Board considers in setting remuneration frameworks, designing remuneration plans and making decisions on remuneration outcomes.

The Explanatory Memorandum notes in section 2.12 that "CAMAC concluded in its report that it is not necessary to legislate specific details that would be required to be disclosed as part of the remuneration governance framework." We generally agree with this perspective and in addition concur the type of possible disclosures outlined in section 2.13 of the Explanatory Memorandum are useful guidance as to what should be included.

The guidance in the Explanatory Memorandum is not intended to be exhaustive although we suggest the following information would assist shareholders in understanding how decisions are made:

- How the Board ensures the remuneration strategy and policies are aligned with the company's business strategy
- How pay decisions for KMP are governed. For example, the Remuneration Committee makes recommendations on the CEO to the full Board for decision. Decisions on non CEO KMP are recommended by the Remuneration Committee, considering input from the CEO, to the full Board for decision
- Describing the comparator group or groups that the company uses to benchmark remuneration levels against, including the reason why this group or groups were selected
- Outline the cycle of planning and decision making for the Remuneration Committee.

We support the proposed amendment and our comments above are additive in their nature.

Chapter 2 – Requirement to disclose past, present and future pay

The aim of this requirement in the Bill is to have a consistent way for companies to report what pay is realised for KMP. As the Explanatory Memorandum highlights, there is currently no requirement on how remuneration to KMP should be disclosed other than the accounting requirements that appear in audited tables.

The overall intent that this disclosure will improve shareholder's understanding of remuneration for KMP underlies this proposed amendment. A consistent way to report remuneration for disclosure purposes can only assist in this intent.

However, more disclosure isn't always supportive of improving understanding. For example, long Product Disclosure Statements (PDS) often confused buyers in making decisions when purchasing retail financial products and hence we have seen a move towards the short-form PDS.

Similarly the reporting of executive pay in even more detail could potentially increase confusion, whereas simpler disclosure would increase clarity for shareholders, companies and the market.

Our comments on the disclosure of past, present and future remuneration are organised under the following headings:

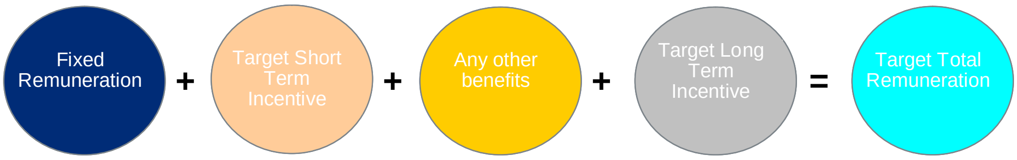
- Comparability of outcomes
- Linking remuneration outcomes to performance
- Informing the vote on the Remuneration Report.

Comparability of outcomes

The definitions of past, present and future pay are simple enough in the draft Bill. However, definitional issues may still arise as companies make judgements on how they should report remuneration under the three pay categories. For example, do vested but not exercised options count as "paid"? Clarity through regulations will be required to avoid potential confusion.

If this is not provided then a shareholder will need to not only understand the basis on which a company has prepared its disclosure, but could also be hampered in their ability to make relative comparisons between KMP of two or more companies.

Our view is that target total remuneration is the best basis on which to compare or benchmark remuneration of KMP between two or more companies (see illustration below). It is also, in our view, the best way to communicate the intent of the company's remuneration strategy and programmes. What is described as future pay in the Bill correlates to this definition.



Linking remuneration outcomes to performance

The disclosure of past, present and future pay does nothing on its own to improve shareholders understanding of the link between pay outcomes and performance.

A number of companies provided a table (illustrative example in Appendix 1) in their 2012 Remuneration Report that outlined a version of past and present pay. These moves were admirable attempts to improve disclosure by representing cash paid in 2012, STI outcome as a percentage of target and prior year equity awards that vested during 2012. Despite this level of detail and in effect almost conforming to the present Bill, a shareholder is not able to clearly understand even with careful reading of the table, why these pay outcomes occurred. For example, there is no explanation of what portion of the previous LTI grant vested, or the performance conditions for the LTI award and the extent to which these were met.

Any disclosure representing pay that has resulted from previous grants or decisions needs to be accompanied by an explanation of what impacted the remuneration. A simple framework might be as follows:

- Target Remuneration (as defined above): this would clearly state what was the intent of the remuneration programs

- Remuneration outcomes: the results as represented by (1) STI actually paid and (2) LTI grants that vested
- Performance discussion: this would explain the performance measures for the STI and LTI and the extent to which these were met
- Shareholder impact: describing the benefit to shareholders over the corresponding time period.

Remuneration reports have become increasingly lengthy as companies try to provide more information and respond to the legislative and stakeholder requirements for greater detail. If the objective is transparency, this may be achieved but at the expense of the ability to understand the data that is presented. More detail does not necessarily equate to more clarity. We question whether three definitions of pay improve the ability of investors/shareholders (sophisticated or not) to understand why KMP are paid what they are paid.

The current Bill does not address the issue of clearly outlining the link of pay outcomes to performance in a way to improve meaningful disclosure, nor does it meet an objective of simplicity.

Informing the vote on the remuneration report

With the introduction of the "two strikes" rule the importance of voting on the Remuneration Report has become of great consequence to listed companies.

Again while supporting the objective of greater transparency and clearer, meaningful disclosure, disclosure of past, present and future pay may not assist in better governance. An unintended consequence could arise from greater disclosure where shareholders could be displeased with pay outcomes (past pay) that were the result of:

i. Subsequently changed or discontinued remuneration programmes;
ii. performance hurdles and consequent performance results set under different business conditions;
iii. decisions made under a different composition of the Board; or
iv. a combination of all of these.

Based on their dissatisfaction, shareholders could then cast a negative vote on the basis of pay outcomes reflecting past conditions or practices. This is the intent of the vote on the remuneration report.

Conclusion

In relation to the current Bill, Mercer's comments in summary are:

- We are supportive of initiatives that provide greater transparency and meaningful disclosure. The requirement to provide an overview of a company's remuneration governance framework will assist in this objective
- We believe it is important for shareholders to understand how performance and pay outcomes are related. The disclosure of past, present and future pay does not necessarily assist in this objective. Additional narrative is required by companies to ensure that the policies, performance targets and business conditions that impact remuneration outcomes are understood
- We are concerned about unintended consequences of the disclosure. Shareholders may vote against a remuneration report based on information disclosed under past, present and future pay, which reflects past decisions and business conditions rather than current policy intentions.

We are supportive of a regime that simplifies the way executive remuneration is reported and provides clearer justification for how remuneration is established; and gives both companies and shareholders the opportunity to have a more productive conversation around pay.

About Mercer

Mercer is a global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people.

Our services include consulting to corporations, boards of directors and board remuneration committees concerning the pay of directors and executives. In Australia, and globally, we have extensive experience in designing and implementing executive and board remuneration programmes. As a result, we understand how boards and remuneration committees function and we have assisted countless companies improve their executive remuneration disclosure and related governance processes under their respective reporting requirements, locally and around the globe.

Mercer Consulting (Australia) Pty Ltd is a wholly owned subsidiary of Marsh & McLennan Companies Incorporated. The views expressed in this submission are the views of Mercer Consulting (Australia) Pty Ltd and do not necessarily represent the views of Marsh & McLennan Companies, its affiliated companies or clients.

Appendix 1

Illustrative Example of Remuneration Outcomes for the CEO and Senior Executives as seen in some 2012 Remuneration Reports

	Fixed Remuneration	2012 Short Term Incentive Payment	Percentage of STI awarded	Other short term benefits	2012 Total Cash payments	Prior Year Equity Awards vested in 2012	Prior Year Equity Awards forfeited in 2012
CEO	$ 1,500,000.00	$ 1,250,000.00	83%	$ 36,333.00	$ 2,786,333.00	$ 1,896,000.00	$ -
CFO	$ 750,000.00	$ 600,000.00	80%	$ -	$ 1,350,000.00	$ 452,000.00	$ 345,678.00