



# Guidance

## ON EXECUTIVE REMUNERATION

**E**xecutive remuneration has become an even bigger flashpoint issue for shareholders, our politicians, the media and the general public. It is also of vital concern to directors of listed companies. Negotiating and monitoring the compensation of the CEO is one of the core responsibilities of any board and controversy over the size of an executive's pay packet or termination payment can affect a company's reputation, its share price and its ability to raise funds in today's world.

The global financial crisis has highlighted the problems faced by listed company boards in setting the right remuneration structures and incentives for CEOs.

While most boards have got it right, in some cases, and in some companies, mistakes have been made. This has contributed to growing public concern about the size of executive salaries and termination payments and has fuelled calls for regulation and other restraints.

In the US and UK, government intervention to assist struggling financial institutions and other companies has been accompanied by the imposition of ceilings on senior executive salaries and bans on bonuses and other incentive payments.

While it is simply not correct to say we have seen the same excesses in Australia as on Wall Street, these concerns and pressures from some quarters for more regulation, are growing here too. For example, Prime Minister Kevin Rudd has signalled that the Federal Government will move to have executive remuneration in the financial sector linked to capital adequacy in an effort to rein in executive pay packages and discourage excessive risk-taking.

Opposition leader Malcolm Turnbull has called for binding votes by shareholders to approve executive remuneration. The Australian Greens, in a recent amendment in the Senate, pushed for a change to the *Corporations Act* so that any executive termination payments greater than \$1 million must have prior shareholder approval.

This year will inevitably see these pressures intensify. In this environment, there's a risk of what might be called "tabloid legislation" – knee-jerk, populist interventions by government.

The chances of more regulation, which would be counterproductive are very high.

AICD strongly believes that what is needed is improved self-regulation of executive remuneration, with our listed companies leading by example, not more government regulation.

In this new environment, it is vital that Australian boards adopt a best-practice approach to executive remuneration arrangements and that AICD, as the representative of directors, hammers home to government, the media and other stakeholders the message that more regulation is not the answer.

In light of this, AICD issued a new set of Guidelines last month to assist boards of publicly listed companies when designing, negotiating and monitoring CEO remuneration arrangements.

The publication, *Executive Remuneration: Guidelines for Listed Company Boards*, is aimed at assisting boards to adopt best practice, avoid bad practice and at encouraging a critical rethink of present arrangements where appropriate. It provides a series of Do's and Don'ts and highlights a range of issues boards should think about when determining executive pay.

The release of the Guidelines will be followed up with a series of directors briefings and other initiatives rolled out later in the year. AICD has a wide range of policy position papers and guidance for directors on issues of remuneration, in addition to the Guidelines, which can be reviewed on our website.

The huge response, both within AICD and among commentators, to the Guidelines shows there is a high level of interest in the topic of executive remuneration and highlights that there is a demand for guidance. The Guidelines – which were forwarded to key Federal politicians and regulators – are also a good example of the way AICD is leading the public debate on the issue and providing practical contributions to improve self-regulation and outcomes.

While the financial crisis has exposed problems of past executive remuneration arrangements, it also provides an opportunity for boards to critically reassess their approach. They must consider whether the current model of executive remuneration, with its heavy emphasis of short and long-term incentive components, is still the right one or whether new approaches would better serve their shareholders' interests.

By ensuring they have in place the right structures and processes as outlined in the Guidelines, they will also underline a fundamental principle in this debate: it is the board, not shareholders or government, that should continue to be responsible and accountable for executive remuneration setting and monitoring.

**John H C Colvin** FAICD  
CEO, Australian Institute  
of Company Directors

For more on AICD's initiatives on executive remuneration, see p52.