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Executive Remuneration Inquiry
Productivity Commission
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National Australia Bank Submission on Draft Report into Executive & Director Remuneration

National Australia Bank Ltd (NAB) welcomes the opportunity to comment on the Productivity Commission's discussion draft report Executive Remuneration in Australia.

NAB is aware of community concerns over executive remuneration. Our Board and management continue to critically review our policies and payments to ensure that they are responsible and provide appropriate outcomes in line with superior and sustainable shareholder returns. NAB believes it has the balance right in setting hurdles which reward only superior performance, encourage long term horizons and discourage poor managerial behaviour. NAB's approach also ensures that if company performance is below expectations, variable pay will either be reduced or not earned at all.

NAB commends the Productivity Commission on what we believe is, overall, a well considered and effective report.

In framing its final recommendations, however, we would urge the Commission to take account of the fact that Australia has not seen the extremes in remuneration that have occurred elsewhere. The fact is that the great majority of Australian boards have discharged their responsibilities well. It would be regrettable if any new rules did not reflect that.

We would therefore urge the Productivity Commission to resist making changes to the laws governing all corporations because of isolated problems. We would also urge the Commission to ensure its recommendations are suitable to the boards and decision making of large complex corporations, as well as the long tail of smaller publicly listed companies.

We support the Productivity Commission's view that remuneration is ultimately an issue for shareholders, through their representatives on the Board. We are concerned, however, that a number of the Commission's recommendations reduce the freedom of shareholders or undermine the central role for the board and we are therefore opposed to those recommendations. Our reasons are set out in more detail below, along with our responses to the remaining recommendations.

Recommendation 1

The Corporations Act 2001 should specify that only a general meeting of shareholders can set the maximum number of directors who may hold office at any time (within the limits in a company's constitution).

NAB does not support this recommendation.

This recommendation fails to acknowledge the importance of maintaining the appropriate mix of skills and experience necessary for the boards of modern major corporations to oversee the complexities of their businesses. Directors take their responsibilities to maintain appropriately balanced boards very seriously and commonly use search consultants and robust selection processes to seek out and assess the best candidates, before putting them to shareholders for consideration. This recommendation seems to be based on an assumption that boards are 'closed shops' and that 'directors' clubs' determine who is able to join. That is simply not the case in the modern Australian corporation.

The recommendation also ignores the importance of good board working relationships. If enacted, the recommendation could lead to disruption on boards, to the detriment of the company.

For banks and other organisations regulated by APRA, directors have an additional responsibility to ensure that candidates are likely to be approved as 'Fit and Proper Persons' by the regulator. A provision that increased the likelihood of unsuitable candidates being elected would therefore be unacceptable.

NAB believes that the Productivity Commission should avoid making recommendations based on a perception of undesirable behaviour of a small minority of companies. The proposed change would make boards less effective and take away from directors the responsibilities they have (and have traditionally discharged properly) to act in the best interests of the company and its shareholders.

Recommendation 2

A new ASX listing rule should specify that all ASX300 companies have a remuneration committee of at least three members, all of whom are non-executive directors, with the chair and a majority of members being independent.

NAB agrees with this recommendation, and already complies.

Recommendation 3

The ASX Corporate Governance Council's current suggestion on the composition of remuneration committees should be elevated to a 'comply or explain' recommendation which specifies that remuneration committees:

- *have at least three members*
- *be comprised of a majority of independent directors*
- *be chaired by an independent director.*

NAB agrees with this recommendation, and already complies.

Recommendation 4

The Corporations Act 2001 should specify that company executives identified as key management personnel and all directors (and their associates) be prohibited from voting their shares on remuneration reports and any other remuneration-related resolutions.

NAB does not support this recommendation.

NAB believes that the existing protections under the Corporations Act are sufficient. Currently, directors and related parties are unable to exercise votes on resolutions where they have a pecuniary conflict of interest and directors have a legally binding fiduciary obligation to shareholders.

To prohibit all directors, including non-executive directors and their associates, from voting sets up a situation where substantial shareholders who have a board nominee are prevented from voting on a remuneration report. Removing the rights of major shareholders to vote on remuneration greatly increases the voting power of a minority of shareholders. When combined with Recommendation 15 (the 'two strikes' rule), this could also allow a very small percentage of the ownership of a company to use rejection of the remuneration report to force an entire board to stand for re-election.

Recommendation 5

The Corporations Act 2001 should prohibit all company executives from hedging unvested equity remuneration and vested equity remuneration that is subject to holding locks.

NAB agrees with this recommendation, which is consistent with NAB's existing Group Securities Trading Policy.

Recommendation 6

The Corporations Act 2001 and relevant ASX listing rules should be amended to prohibit company executives identified as key management personnel and all directors (and their associates) from voting undirected proxies on remuneration reports and any other remuneration-related resolutions.

NAB does not support this recommendation.

NAB permits the Chairman to vote, if expressly nominated as the proxy by shareholders. As the Chairman's voting intention is apparent, where shareholders have elected to appoint the Chairman as their proxy, their implicit voting wishes should be allowed.

Provided an organisation is clear on what the delegated party will do with the proxy, we do not support any change to the current practice.

Recommendation 7

The Corporations Act 2001 should be amended to require proxy holders to cast all of their directed proxies on remuneration reports and any other remuneration-related resolutions.

NAB supports this initiative in the interests of greater transparency and more effective shareholder voting processes.

Recommendation 8

Section 300A of the Corporations Act 2001 should be amended to specify that remuneration reports should additionally include:

- *a plain English summary statement of companies' remuneration policies*
- *actual levels of remuneration received by executives*
- *total company shareholdings of the individuals named in the report.*

Corporations should be permitted to only disclose fair valuation methodologies of equity rights for executives in the financial statements, while continuing to disclose the actual fair value for each executive in the remuneration report.

NAB supports the principle of simplification of remuneration reporting. S300A of the Corporations Act should not be amended to specify that remuneration reports should additionally include a plain English summary. We recommend that any short-form or plain English reports be non-statutory.

NAB has made considerable efforts to ensure our reports are more accessible to shareholders and are in plain English, with actual levels of remuneration and company shareholdings provided.

NAB would most likely continue to report both the fair value and actual levels in the remuneration report so it is easier to reconcile with the amounts reported in the financial accounts.

Recommendation 9

Section 300A of the Corporations Act 2001 should be amended to reflect that individual remuneration disclosures be confined to the key management personnel. The additional requirement for the disclosure of the top five executives should be removed.

NAB supports this recommendation. The amendment will simplify reporting and reduce duplication.

Recommendation 10

The ASX listing rules should require that, where an ASX300 company's remuneration committee (or board) makes use of expert advisers, those advisers be commissioned by, and their advice provided directly to, the remuneration committee or board, independent of management.

NAB agrees with the intent of this recommendation and recommends that the ASX Corporate Governance Council provide further guidance on the information that should be provided to shareholders.

NAB's Remuneration Committee Charter currently allows the Board to appoint remuneration consultants independently and for that advice to be provided directly to the Committee.

It needs to be acknowledged that it is appropriate for management to also engage with remuneration advisors. It is important for shareholders to have confidence that where a Board or Remuneration Committee appoints an advisor to provide advice on executive remuneration that the advisor reports independently to the Board.

Recommendation 11

The ASX Corporate Governance Council should make a recommendation that companies disclose the expert advisers they have used in relation to remuneration matters, who appointed them, who they reported to and the nature of other work undertaken for the company by those advisers.

NAB agrees that transparency is important, however, we do not support this recommendation as we are concerned with any moves that would limit the services that external advisers or consultancies can provide to a company. In Australia, there is a limited pool of qualified and reliable companies that offer the kinds of services NAB requires. This recommendation will also be complicated to implement as expert advisers provide a range of services that have varying impacts on a board's final decision. In light of Recommendation 10, we do not believe this recommendation is necessary.

Recommendation 12

Institutional investors should disclose, at least on an annual basis, how they have voted on remuneration reports and any other remuneration-related issues. How this requirement is met should be at the discretion of institutions.

NAB supports a mandatory code of practice for disclosing how institutional investors have voted on all resolutions considered at an AGM, including the Remuneration Report.

Well conceived remuneration policies - Draft Finding: "The Commission's checklist"

NAB agrees with this finding and already has these practices in place, although has not specifically reported on them in the past. However, we would caution on balancing the need to report on these aspects with the need to simplify reporting and information provided to shareholders.

Recommendation 13

The cessation of employment trigger for taxation for equity-based payments should be removed, with the taxing point for equity or rights that qualify for deferral being at the earliest of: where ownership of, and free title to, the shares or rights is transferred to the employee, or seven years after the employee acquires the shares.

NAB supports this recommendation. It will bring taxation arrangements into line with APRA's intention to defer equity-based payments.

Recommendation 14

The Australian Securities and Investments Commission should issue a public confirmation to companies that electronic voting is legally permissible without the need for constitutional amendments – as recommended in 2008 by the Parliamentary Joint Committee on Corporations and Financial Services.

NAB supports this recommendation and has amended our Constitution to enable electronic voting.

Recommendation 15

The Corporations Act 2001 should be amended to require that where a company's remuneration report receives a 'no' vote of 25 per cent or higher, the board be required to report back to shareholders in the subsequent remuneration report explaining how shareholder concerns were addressed and, if they have not been addressed, the reasons why.

If the company's subsequent remuneration report receives a 'no' vote above a prescribed threshold, all elected board members be required to submit for re-election (a 'two strikes' test) at either:

- *an extraordinary general meeting or*
- *the next annual general meeting.*

NAB opposes this recommendation.

The proposal runs a significant risk of causing unintended consequences unrelated to remuneration. Such a rule would open the way for abuse by factions and/or minority shareholders.

It goes against all traditional governance principles to have a situation where a minority (eg, 25% if that were the threshold in the second year) is able to remove a board against the wishes of the majority.

Even if the threshold was set at 50% of votes cast it would be open to abuse. For example, a significant minority shareholder (say, holding 20-30 percent) could attend the meeting and, without warning, vote their shares against the remuneration report and win more than 50% of the votes cast on the day.

As noted above, the effect of Recommendation 4 in potentially excluding major shareholders from voting further reduces the effective threshold that would allow a minority of shareholders to remove a board.

If there were to be such a rule, the only reasonable threshold for the second instance would be 50% of the issued shares in the company.

NAB appreciates the opportunity to respond to the Productivity Commission's draft report. As noted above, we believe the report overall is well considered. There are a number of recommendations however that would seem to impose new burdens on the majority of companies to fix problems that either do not exist, or only exist at the margins. NAB therefore opposes those submissions.

If you require any further information, or have any queries in relation to the above, please don't hesitate to contact us.

Yours sincerely

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