Discussion Draft – Executive Remuneration in Australia

ASX Submission to the Productivity Commission

9 November 2009

SUBMISSION TO THE PRODUCTIVITY COMMISSION: DISCUSSION DRAFT ON EXECUTIVE REMUNERATION IN AUSTRALIA

INTRODUCTION

ASX welcomes the opportunity to provide a submission to the Productivity Commission (the Commission) on its draft recommendations on executive remuneration prior to the preparation of a final report to Government by 19 December 2009.

The Commission's Discussion Draft provides a valuable and comprehensive analysis of the trends, complexities and drivers of executive remuneration in Australia and, importantly, in so doing provides the basis for a more informed public debate about the issues and the potential costs and benefits of particular proposals for regulatory reform.

Overall, ASX considers that the approach the Commission has taken in focussing on strengthening corporate governance arrangements aimed at enhancing transparency and board accountability and minimising conflicts of interest provides for an appropriate and proportionate approach to responding to the issues identified and improving executive remuneration practices in Australian listed companies.

ASX endorses the Commission's key finding that there has not been a systemic failure in remuneration setting for executives in Australia's listed companies and that, on this basis, the introduction of prescriptive regulatory measures such as salary caps cannot be justified. In order to avoid the potential adverse affects of intervention on the international competitiveness of Australia's executive labour market and Australian productivity more generally, it is important that a proportionate regulatory response is adopted by the Government. The response needs to recognise the diversity of Australian listed companies and preserve the central role of the board in determining executive remuneration.

ASX acknowledges the challenge of achieving the right level of shareholder involvement in executive remuneration to promote board accountability, without blurring the division of responsibility between directors and shareholders provided for in corporation law principles. At the same time, it is important that the recommended package of reforms is balanced such that the reforms do not have the effect of giving executive remuneration undue emphasis relative to other responsibilities of directors and, in so doing, provide perverse incentives for boards to allocate a disproportionate part of their time to considering executive remuneration.

IMPLEMENTATION RESPONSIBILITIES

There are three different bodies that would have decisions to make in relation to the Commission's final recommendations if they were to be along the lines of the draft recommendations:

- the Government – in relation to recommendations for legislative change;
- the ASX – in relation to proposals for amendment of ASX Listing Rules; and
- the 21 business, investment and shareholder groups that make up the ASX Corporate Governance Council (ASX being one of those members and providing the chair of the Council) – in relation to proposals for amendment to the Council's Principles and Recommendations.

In respect of the two proposals for listing rule amendments and the two proposals for adjustment to the Council's Principles and Recommendations, ASX acknowledges the benefit to ASX's decision-making processes (in its own right and as a member of the Council) from the Commission canvassing these four proposals in its Discussion Draft. ASX's intended course of action in respect of the two listing rule proposals is detailed below, along with ASX's comments on the proposals requiring implementation by the Parliament or by the Council.

ASX acknowledges the appropriateness of the delineation that appears to have driven the Commission's choice of implementation method, namely:

- legislation is necessary where the relevant obligations are to be imposed on individuals;[1]
- listing rules may be appropriate where the obligation is only appropriate for larger publicly-owned enterprises;[2] and
- The Council's Principles and Recommendations may be appropriate for the types of corporate governance issues where a striving for consensus by diverse groups within the Council has shown its value in producing balanced outcomes that can apply to a diverse range of publicly owned companies.

ASX's comments on specific draft recommendations are below.

IMPROVING BOARD CAPACITIES

Draft 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).

While ASX agrees with the Commission that board capability is central to ensuring robust executive remuneration governance, and ASX is supportive of promoting greater board diversity more generally, ASX does not believe that the proposal in draft recommendation 1 would have any bearing on improving board capabilities or necessarily engender greater diversity.

ASX notes that while boards are (appropriately) responsible for deciding the optimum size for a specific board at any time within the limits provided by the company's constitution, shareholders are currently empowered to put forward board nominees and resolutions.

ASX considers that the board is in the best position to take account of the wide range of factors that must be considered in assessing the required skills and the balance needed for the on-going operation of the board. The board is also best placed to be involved in determining transition paths for the purpose of board renewal. This adds up to a need for the board to decide the optimum size at any point in time within the range set by the company's constitution.

ASX considers that while the proposal is unlikely to produce the outcome sought in terms of greater board capability and diversity, it could make it more difficult for boards to implement orderly processes for board renewal. ASX notes that, if it were to be implemented, it would be important that the legislation was drafted such that it promotes practices consistent with orderly processes for board renewal. Board renewal, together with the composition and size of the board, is recognised by the Council's Principles and Recommendations as critical to the performance of the board[3]. An orderly process of renewal for a board may require that, for a period of time, the number of directors is increased to allow the new director(s) time on the board before immediately losing the skill set of a

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[1] Listing rules are a contract between ASX and listed companies. As such, they are not an appropriate instrument for imposing obligations on directors, as distinct from the listed companies of which they are directors. Legislation is also likely to be preferable to either listing rules or Council recommendations where there is a case for foreign incorporated/listed businesses with a significant presence in Australia to be subject to the same mandatory requirements as Australian-incorporated businesses. ASX's listing rules typically do not seek to impose Australian corporate governance values on foreign companies simply because they also have a dual listing on ASX.

[2] However, there needs to be strong support amongst the majority of the larger listed companies for the initiative in question. Otherwise the unpopular obligations may become an incentive to shift one's listing to another well-regulated market or to forego the benefits of listing altogether.

[3] Refer to Recommendation 2.4 commentary of the ASX Corporate Governance Council Principles and Recommendations.

retiring director(s). When the new director(s) has completed a period of serving on the board, it may then be appropriate for the size of the board to reduce.

REDUCING CONFLICTS OF INTEREST

Draft 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.

ASX agrees that remuneration committees are a useful and efficient mechanism to assist boards in exercising their responsibilities in relation to remuneration matters. ASX also agrees that remuneration committees can play a useful role in addressing actual and perceived conflicts of interest.

Whether it is a larger company which establishes a remuneration committee or a smaller listed company which deals with remuneration issues entirely at board level, it is imperative that conflicts of interest are managed.

Executive directors should not be involved in remuneration committee discussions and recommendations with respect to their own remuneration arrangements. However, there is a legitimate role for the involvement of the Chief Executive Officer and Managing Director (CEO and MD) in remuneration committee discussions with respect to the many other responsibilities of the remuneration committee.

Whilst the Commission's proposal is consistent with all of these objectives, it is problematic in three respects:

- it does not address the real conflict issue – whether a CEO is a member or merely attends the committee meetings is less important than ensuring that the CEO and any other executive director is not present when decisions are made about their own remuneration;

- the concept of 'independence of management', which is the relevant concept in relation to decisions on remuneration of the CEO, other executive directors and other executives is a less restrictive concept than is necessary in some other contexts, where independence from substantial shareholders may also be relevant. As a result, some complexities around crafting appropriate concepts of 'independence' would arise in a range of contexts if the Commission's laudable objectives were to be implemented by a listing rule that required the chair and a majority of members to simply be 'independent' (without clarification as to which concept of independence was intended); and

- a listing rule that indirectly mandates a minimum number of directors that do not have a substantial shareholding or association with a substantial shareholder (if 'independence' were defined so as to preclude association with substantial shareholders) is one that requires careful consideration, especially in relation to the small to medium sized companies that are around the ASX 300 mark.

It is important to avoid conceptually inconsistent approaches to ASX 300 companies versus companies just outside this arbitrary cut-off.

Balancing all of these considerations has lead ASX to conclude that an improvement on the Commission's formulation would involve ASX initiating slightly modified listing rule changes.

ASX intends to initiate listing rule changes which will be an amalgam of the Commission's Recommendation 2 (adopting a mandatory approach in relation to ASX 300 companies) and Recommendation 3 (applying the mandatory approach on the basis of the Council's views on appropriate composition as currently set out in the commentary on Recommendation 8.1 of the ASX CGC Principles and Recommendations). ASX envisages making listing rule amendments to require ASX 300 companies to have a remuneration committee. Such committees will be required to:

- have at lease three members;
- be comprised of a majority of independent directors; and
- be chaired by an independent director.

This approach would both provide for a high and consistent benchmark for all listed companies should the CGC adopt draft recommendation 3, and it would also allow the executive directors to be members of remuneration committees (but refrain from participation in decisions where they have a conflict of interest).

While ASX can see merit in considering amendments to the Listing Rules to introduce such requirements for the top 300 listed companies on a cost-benefit basis, ASX would not consider it appropriate from a compliance cost perspective to extend these requirements to all listed companies. The smaller listed companies with smaller boards may not derive the same efficiency benefits from establishing a separate and formal remuneration committee structure and they may not be able to meet the composition requirements in relation to having an insufficient number of independent directors.

Draft 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; and*
- *be chaired by an independent director.*

ASX is supportive of the Commission's draft recommendation that the Council elevate the guidance on the composition of the remuneration committee to a recommendation in the Council's Principles and Recommendations. If the Council adopted this recommendation and ASX introduced a listing rule requirement consistent with the composition suggested in the Council's Principles and Recommendations for the top 300 listed companies, there would be a consistent benchmark as to the composition of remuneration committees across all listed companies.

Draft 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 remunerations reports and any other remuneration-related resolutions.

ASX supports the proposal to the extent that it involves all directors and executives identified as key management personnel being prohibited from voting their shares on remuneration matters where there is a direct conflict of interest. ASX considers that prohibiting directors and executives identified as key management personnel from voting on remuneration-related resolutions that relate to their own remuneration is appropriate to address conflicts of interest.

However, ASX is not supportive of the wide scope of the proposed prohibition in draft recommendation 4 such that directors (and their associates) are excluded from voting their shares on remuneration reports and remuneration-related resolutions where they will not directly obtain a benefit from the outcome of the resolution because there is no conflict of interest in these situations. ASX notes that where there is a direct conflict relating to remuneration-related resolutions involving the issue of securities to directors, including under an employee incentive scheme, an increase in the total amount of the directors' fee pool and certain termination benefits, directors are excluded from voting their shares under the Listing Rules (refer to Listing Rules 10.11-10.19 and 14.11).

The Commission notes in the Discussion Draft that a number of participants raised concerns about the dilution of voting power arising from equity grants to directors pursuant to Listing Rule 10.14 where the securities are acquired on market. The Commission also states that if draft recommendation 4 was

adopted, this concern would no longer arise. It is not clear how the proposal in draft recommendation 4 is relevant to the issues surrounding Listing Rule 10.14, given the purchase of securities on market does not involve a dilution of shareholders economic or voting interests and given such arrangements under a scheme do not require shareholder approval.

Consistent with the Chapter 7 Listing Rule requirement for shareholder approval for particular new issues of capital, the requirement for shareholder approval under Listing Rule 10.14 for the issuance of new securities to directors as part of an employee incentive scheme is primarily concerned with the dilution of shareholders' capital interests. Securities purchased on market do not involve shareholder dilution because the shares have already been issued and, as such, there is no difference between providing a director with remuneration in the form of cash and permitting the director to salary sacrifice in order to purchase securities on market that would justify the requirement for shareholder approval.

Draft 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.

ASX is supportive of hedging of unvested equity remuneration and vested equity remuneration subject to holding locks being prohibited on the basis that hedging would detract from the alignment of interests with shareholders that the remuneration arrangements were designed to achieve.[4] However, ASX notes that there will be significant challenges in drafting effective legislation such that it addresses the complexities around an innovative and evolving derivatives industry and, at the same time, does not have such wide scope to effectively prohibit all dealing by executives in derivative products relevant to the underlying securities.

Draft 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.

We recognise the force of the Commission's recommendations in relation to key management personnel and are supportive of that part of the recommendation. The case for extending the prohibition to non-executive directors is less clear.

ASX does not agree with the Commission's rationale that because non-executive directors should be prohibited from voting their own shares when there is a conflict of interest that it necessarily follows that shareholder votes in the form of undirected proxies given to non-executive directors should be nullified. Shareholders who intentionally make the choice to leave their proxies open for the chairman or other non-executive directors of the board to vote are quite likely to be signalling that they trust the chairman/directors to act, in accordance with their fiduciary responsibility, in the interest of the company.

ASX does not consider voiding such votes or removing shareholders rights to choose to defer their votes to the chairman/directors where they know that the resolutions will be voted in the affirmative is in the interests of shareholder democracy (subject to their being adequate disclosures). The notice to the meeting and proxy form that must be completed by the shareholder includes specific information to enable the shareholder to make an informed choice about how to lodge their vote and provides the necessary acknowledgement to demonstrate that choice.

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[4] It would be important that the Commission's recommendations do not experience "width creep" in the course of legislative development so as to also extend to other vested equity. Once equity has fully vested and is no longer "remuneration" but simply a privately owned asset, the relevant issue ceases to be one about achieving alignment. The commentary to the CGC Principles and Recommendations already deal adequately with the relevant issue – accuracy of company representations – by providing, in footnote 43 to the commentary on Recommendation 8.2, that "where a company makes any representations about the alignment of a senior executive's interests, the company should take into account the extent of that senior executive's alignment of interest based on any disclosure under the company trading policy."

ASX considers that the current disclosure-based approach under Listing Rule 14.2.3B appropriately addresses the issues surrounding the Chair's conflict with respect to his/her own shares without removing the right for shareholders to make an informed choice to lodge their vote in the form of an undirected proxy to the Chair. Listing Rule 14.2.3B provides that where a shareholder gives an undirected proxy to the Chair of the meeting, they must mark the box on the proxy form indicating that they acknowledge that the Chair may vote those shares notwithstanding that the Chair has an interest in the outcome of the resolution and that the votes cast by the Chair other than as a proxy holder will be disregarded because of that interest.

Consistent with the disclosure-based approach to this issue under the Listing Rules, consideration could be given to requiring additional disclosure in the meeting notice with respect to other directors that are excluded from voting their own shares on particular resolutions specifically for the purpose of informing the appointment of proxies.

Draft 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.

In-principle, ASX considers that proxy holders should endeavour to cast all their directed proxies on all resolutions in recognition of their role as a proxy holder. While proxy holders should not 'cherry-pick' and only vote the directed proxies that align with their own voting bias in the absence of a more fulsome discussion of the intended sanctions, it is not clear that a legislative requirement is the most appropriate approach to this issue. ASX considers that any such requirements, including the imposition of sanctions, would have to take into account circumstances where a proxy holder is unable to attend the meeting and vote on a poll or where a proxy holder is unknowingly appointed as a proxy. We certainly do not see any new initiative in this area being one that would appropriately be limited to proxies relating to decisions on remuneration issues.

A more productive set of responses to the legitimate concern raised by the Commission may be found in initiatives to encourage electronic or postal voting, so that the issues around proxy voting become less significant.

IMPROVING RELEVANT DISCLOSURE

Draft 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.

ASX acknowledges that remuneration reports, whilst invariably voluminous, are often not particularly illuminating as to the actual levels of remuneration received. We are not yet convinced that imposing an obligation to produce a plain English summary would achieve a significant reduction in impenetrability.

ASX considers that much of the impenetrability of remuneration reports stems from the legal risk associated with the complex disclosure obligations for remuneration reports under the *Corporations Act 2001* and the accounting standards and, as such, an effective solution is more likely to be found in addressing the source of the problem in the statutory obligations. Consideration could be given to the feasibility of setting out in the Corporations Regulations or other statutory instrument a model remuneration report which, to the extent that it was adopted, would render the relevant company compliant with its obligations. (A broadly similar approach has been adopted in relation to "replaceable rules" in the Corporations Act).

ASX agrees with the Commission that the introduction of a requirement for a short-form report in addition to the remuneration report would involve a significant compliance cost burden for companies, without necessarily achieving the objective of providing more accessible and informative material. On this basis, ASX would not support the introduction of a short-form requirement.

In relation to the proposal that actual levels of remuneration received by executives be disclosed, ASX notes the importance of carefully defining 'actual remuneration' so it does not provide for further confusion or misunderstanding. The main challenge in this regard is around the disclosure of both equity/options that vested in the current year, but which were granted in previous years and, as such, have no links to current year performance and the current year profit share that is granted, but deferred to future years. Notwithstanding this challenge, ASX is supportive of supplementary ex-post reporting of equity remuneration on a cash value basis at the time of vesting with respect to equity remuneration that is vested during the reporting period.

Draft Recommendation 9: *Section 300A of the Corporations Act 2001 should be amended to reflect that individual remuneration disclosures be confined to key management personnel. The additional requirement for the disclosure of the top five executives should be removed.*

ASX supports the Commission's draft recommendation that the *Corporations Act 2001* be amended and aligned with the accounting standards to require remuneration disclosure only in relation to 'key management personnel'. ASX considers that the definition of 'key management personnel' used under the accounting standards more effectively captures the most relevant individuals from a remuneration-disclosure perspective across a diverse range of companies. Aligning the disclosure requirement under the Act with the accounting standards will also be beneficial in terms of increasing clarity and consistency around the reporting requirements.

Draft 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.

Having regard to the proposals being a response to conflict of interest issues, ASX is broadly supportive of the proposal, so long as the actual implementation is aligned with the objective.

ASX recognises that having the chairman of the remuneration committee undertake the responsibility for commissioning any expert advice that could impact on directors or key management personnel (and potentially a broader class of employees) is a good way of addressing real or perceived conflicts of interest).

ASX notes that the terms of Recommendation 10 – where a mandatory approach is proposed – are much narrower than the range of issues around expert advice upon which the Commission favoured an "if not, why not" approach under the CGC Principles and Recommendations (Recommendation 11) for all listed companies.

ASX considers that both sets of issues are more amenable to a non-prescriptive approach, given the definitional complexities inherent in aligning any rule with its underlying objective. ASX is supportive of the CGC giving further consideration to how the key issues identified in draft recommendations 10 and 11 could be addressed by an 'if not, why not' reporting obligation for all listed companies in the CGC Principles and Recommendations. ASX envisages monitoring the operation of any such recommendations put in place by the CGC before assessing whether there is a need to elevate such recommendations, or the narrower proposal included in draft recommendation 10, to a Listing Rule obligation with respect to larger listed companies.

Draft 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.

Consistent with the commentary included above on draft recommendation 10, ASX is supportive of the proposal in draft recommendation 11 that the Council should recommend disclosure with respect to whether expert advice had been sought, who appointed the expert advisers and who they reported to and the nature or other work undertaken by the advisers for the company. ASX considers that additional transparency in this area would likely be beneficial in addressing actual and perceived conflicts.

However, ASX is not convinced that there would be a net benefit in disclosing the identity of the expert advisers that have been used, especially given the issues that arise if a board chooses not to follow the advice of the remuneration consultant or uses multiple expert advisers. If, as it has been suggested, that disclosure of the expert advisers used would also require disclosure in relation to the extent that the advice was followed, it suggests a cost burden for which it is difficult to see commensurate benefits, particularly in the case where multiple expert advisers may have been used. Worse still, there is the potential for disclosure of this kind to create perverse incentives for boards to simply follow the advice provided by consultants, who, ultimately, have no fiduciary duty or accountability to shareholders.

Draft 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.

ASX supports the Commission's proposal that this issue is most appropriately dealt with by the institutions themselves and relevant industry bodies.

ASX notes that the IFSA Standard No.13 on Proxy Voting is a good example of an industry initiative that addresses the issues identified in the Commission's Discussion Draft around voting, and disclosure of voting, by institutional investors. Moreover, the scope of coverage of IFSA Standard No.13 addresses the issues around it not being applicable to require voting by certain types of funds such as index funds.

Furthermore, ASX agrees that institutional investors should not be subject to a legislative requirement to vote their shares on these issues because institutional shareholders, like all other shareholders, should retain the right to decide whether to vote based on an assessment as to whether it would be cost-effective or in the interests of their members.

ADDRESSING IMPEDIMENTS TO ALIGNMENT OF REMUNERATION STRUCTURES

Draft 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.

ASX strongly supports the Commission's draft recommendation that the taxing point of qualifying equity-based payments be moved from termination of employment to the time that the employee receives the full entitlement of the shares or rights.

ASX considers that termination of employment as a taxing trigger represents a significant impediment to boards seeking to structure remuneration in accordance with good governance practices to achieve a better alignment of interests. A taxing trigger that imposes tax liabilities on employees when they are unable to sell the relevant shares and where the value on which the employee is taxed is unlikely to reflect the value ultimately realised by the employee will act as a significant disincentive to remuneration arrangements that link executive rewards to appropriate long-term performance measures post-employment. ASX is of the view that a taxation policy that drives remuneration design and practices that are inconsistent with corporate governance policy is both inappropriate and counterproductive.

FACILITATING SHAREHOLDER ENGAGEMENT

Draft 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.

ASX is supportive of ASIC giving additional impetus to electronic voting without necessarily endorsing the proposition that it is ASIC's responsibility to opine on the particular issue identified in the Commission's recommendation.

Draft 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.*

ASX considers that there is scope for a modified version of the Commission's proposal to achieve the underlying objectives without significant adverse consequences. ASX is supportive of facilitating increased shareholder engagement and board accountability on remuneration. ASX does not support that aspect of the current proposal which involves a minority 'no vote' operating as the trigger point at any stage. This would not, in our view, provide for an appropriate balance between the benefits of providing for greater accountability and the potential costs and serious implications for board stability and succession planning that could result from a voting process that could be used by some shareholders to send a signal to the board on issues unrelated to remuneration.

ASX does not consider that the problems identified in the Commission's Discussion Draft warrant a minority voting threshold akin to that for special resolutions. Moreover, there does not appear to be a strong case to justify why remuneration should be treated so differently to other significant corporate decisions around how the company's assets are to be deployed. Setting such a threshold would imply, inappropriately, that such decisions were even more significant than decisions around issuance of new shares involving dilution of existing holdings and major acquisitions and disposals (where a majority vote is the relevant threshold).

Given the costs and potential disruptions to companies of requiring the board to stand for re-election, ASX does not find the fact that very few remuneration reports receive less than 50 per cent support as a justification for a minority 'no vote' threshold of 25 per cent. Such a threshold gives a minority of shareholders undue influence.

ASX suggests that the Commission recommend in the final report to Government that a majority 'no vote' of greater than 50 per cent for both votes as the relevant thresholds under the proposed 'two strikes' rule on the basis that it would provide for greater shareholder engagement on remuneration, whilst balancing the costs and benefits of doing so.

Adoption of a "two-strikes" approach based on a majority vote of greater than 50 per cent being required on each occasion would represent a powerful accountability mechanism. We recognise that, in the event of the requirement (that all board members submit for re-election) being triggered, some directors who have served the company well may not be prepared to continue. There may be other unfortunate consequences.

One problem with the 2 strikes proposal (even with a majority vote threshold) may be that at the second meeting there will be an increased reticence to vote against the remuneration recommendation, as to do so could create a period of destabilisation and cost for the company. One amendment to the proposed policy which would avoid this would be to require at the second meeting the company to include a resolution (only to be noted on in the event that the remuneration resolution fails at that meeting) which allows shareholders to resolve that the spill of the board which would then ensue need not occur.

In relation to the Commission's invitation for comment on when board members should be required to submit for re-election following a second significant 'no vote', ASX considers that the timing of the election and whether it should be held at the next annual general meeting or at an extraordinary meeting should be at the discretion of the board. The board will be in the best position to make a judgement on what is the most appropriate option in terms of minimising disruption for the company, board instability, and cost.

It has been suggested that the proposal be modified to only require that board members comprising the remuneration committee be up for re-election should a remuneration report receive two consecutive significant 'no votes'. ASX is not supportive of this suggestion because it would not only operate as a significant disincentive for directors taking on a role on the remuneration committee. Furthermore, it ignores the fact that while the remuneration committee provides recommendations and advice to the board, it is the board that is ultimately responsible for the remuneration report.

CONCLUSION

Whilst ASX largely agrees with the approach and the draft proposals put forward by the Productivity Commission in the Discussion Draft, there are a number of opportunities for the Commission to enhance the recommendations in the context of the final report to Government. ASX considers that the design of the proposed 'two strikes' rule is the most significant issue worthy of further consideration by the Commission on the basis of the potential costs and significant disruptions for companies, which would, ultimately, not be in the interests of shareholders.

In relation to recommendations 2 and 3, ASX would have no difficulty with larger listed companies becoming subject to an obligation, created via listing rule amendment, to have a remuneration committee with the same composition features as are currently suggested in the CGC Principles and Recommendations. ASX would also support any CGC initiative to elevate what is currently suggested on the composition of the remuneration committee to an "if not, why not" recommendation for all listed companies.

In relation to the key issues identified in recommendations 10 and 11, ASX would support adoption by the CGC of an "if not, why not" approach which applies to all listed companies, and is focussed on the potential conflicts associated with commissioning of expert advice by executive management, but does not involve recommended restrictions that extend to situations where no such conflict exists. ASX envisages monitoring the operation of any such recommendations put in place by the CGC before assessing whether there is a need to elevate such recommendations to an obligation, via listing rule amendment, in respect of larger listed companies.