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General Manager
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Submission: Corporations Amendments – Improving disclosure requirements

CGI Glass Lewis appreciates the opportunity to comment on the Exposure Draft ("EP") issued by Treasury regarding the proposed legislation amendments to improve the disclosure of executive remuneration.

CGI Glass Lewis has been providing in-depth proxy research and analysis on ASX-listed companies from its Sydney headquarters since 1994, and is a subsidiary of Glass, Lewis & Co. ("Glass Lewis"), a leading independent governance services firm that provides proxy voting research and recommendations to a global client base of over 900 institutional investors that collectively manage more than US$15 trillion in assets.

Clients use Glass Lewis (and CGI Glass Lewis) research to assist them with their proxy voting decisions and to engage with companies before and after shareholder meetings. Glass Lewis' web-based vote management system, ViewPoint, provides clients with the ability to reconcile and vote ballots according to custom voting guidelines and to audit, report and disclose their proxy votes. Glass Lewis is an independent wholly-owned subsidiary of the Ontario Teachers' Pension Plan ("OTPP").

CGI Glass Lewis has always encouraged any efforts, legislative or otherwise, to make the disclosure and reporting of remuneration consistent, meaningful, readable and concise for all shareholders. In our view, shareholders should be able to make meaningful comparisons of remuneration between companies and make clear assessments as to the performance of the board in its oversight of remuneration. That requires remuneration to be reported in a singularly consistent manner across companies whereby shareholders can clearly assess each component of remuneration and their links to the company's performance and strategy, or otherwise.

The following sections address key amendments under the EP and possible alternatives to legislated standards. In each of these categories, CGI Glass Lewis' policies align with Glass Lewis' policies and the two entities can be identified interchangeably.

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Remuneration governance framework

CGI Glass Lewis is generally supportive of the insertion of paragraph 300A (1)(aa), whereby companies must provide a description of their remuneration governance framework for determining remuneration in relation to key management personnel ("KMP"). However, we have a strong preference that such disclosure should be in the remuneration report.

Lapsed options

CGI Glass Lewis is supportive of the substituted paragraph 300A(1)(e)(iv).

Clawback provisions

The proposed addition at the end of subsection 300A(1) will require listed companies who become aware of a material misstatement or omission to disclose whether any remuneration paid to KMP has been clawed back, and if not, to provide an explanation of why ("if not, why not").

However, given that the disclosure of material misstatements in Australia is rare, CGI Glass Lewis believes that the legislation will accomplish very little in practice. Further, the amendment may also mislead shareholders into believing that the clawback provisions will also apply to more common disclosures of material expenses, such as write downs and losses associated with disposal of assets, pursuant to AASB 101.

The proposed amendment would be more meaningful if it extended to material expenses under AASB 101.

AASB2 and past, present and future pay ("PPF") disclosure

Currently remuneration is required to be disclosed under AASB 2 and pursuant to 300A(1)(ca) of the EP, remuneration for each KMP will be required to be disclosed as follows:

i) the total amount of remuneration that was granted to the person before the start of the year and paid to the person during the year ("past pay"); and
ii) the total amount of remuneration that was granted, and paid, to the person during the year ("present pay"); and
iii) the total amount of remuneration that was granted to the person during the year (whether or not payment is dependent on satisfaction of a performance condition), but that is not to be paid to the person until after the end of the year ("future pay").

CGI Glass Lewis believes the intended purpose of CAMAC's recommendations and the government's proposed legislation has been to simplify disclosure and enhance transparency of remuneration practices and outcomes to facilitate investor comprehension, given that CAMAC identified that the current system was inadequate and "the application of accounting methodology to the remuneration report can confuse and mislead shareholders without providing useful information."

CGI Glass Lewis has always encouraged any efforts, legislative or otherwise, to make the disclosure and reporting of remuneration consistent, meaningful and understandable. On that basis we strongly support CAMAC's rationale for recommending the removal of requirements under AASB 2 from the remuneration report (Recommendation 4) and suggest that such disclosure be relocated to the notes of the financial statements.

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However, under the EP the accounting methodology under AASB2 is to remain a requirement, along with the new PPF disclosure requirements. Beyond our opposition of the accounting methodology, the EP provides no guidance on how to reconcile these two separate reporting approaches i.e. AASB2 and PPF.

Further, given that "amount", "granted" and "paid" are not defined by the EP and it is unclear how equity should be disclosed, it is likely that companies will adopt different and varied methodologies in reporting remuneration.

In our view, the current EP would not achieve the government's intended purpose. We are concerned that it may instead lead to the very outcome the government has used as its rationale for not supporting CAMAC recommendations 4 and 6 i.e. "Allowing companies to decide on the valuation method may limit comparability between remuneration reports, given that there will be no requirement for numerical values to be calculated on the same basis. In addition, this recommendation could adversely affect the integrity of information provided in the remuneration report. "

In our view, three key questions under the PPF need to be addressed:

1) ***What does "paid" mean?*** Is it at the conclusion of the performance period and upon achievement of performance or otherwise (where hurdles are present) or at the conclusion of the vesting period (with or without hurdles present).
2) ***What is the value of the "amount"?*** In order to achieve "comparability", the definition and methodology needs to be consistent. Is "paid" the actual cost of the grant to the company's shareholders (i.e. grant value), the estimated accounting cost (i.e. amortised value) or the final value of incentives that an executive receives (i.e. vesting value)? These are fundamentally different things and any overlap is hugely misleading to shareholders.
3) ***Does PPF accurately describe pay to shareholders?*** When read literally, "Future" can imply guaranteed payment in a future period and "Past" can imply that payment has occurred in some other time than the previous financial year (which is already required to be disclosed).

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What does paid mean?

Under current AASB 2 requirements remuneration is effectively required to be disclosed as follows.

Current statutory disclosure – The cash expense for the period and the accounting expense for equity that vests during or after the current financial year, but which may have been granted prior to or during the current year. All equity components (i.e. deferred short-term incentives ("STI") and long-term incentives ("LTI") granted in different financial periods) are disclosed as a single figure under current statutory disclosure requirements (i.e. share based payments).

	PAST	PRESENT	FUTURE
Salary & Fees	-	A$800,000	-
Non-monetary benefits	-	A$100,000	-
Superannuation	-	A$75,000	-
STI cash	-	A$1,000,000	-
Deferred STI equity in current year (amortised)	-	A$500,000	-
Deferred STI equity from one year ago (amortised)	-	A$250,000	-
Equity granted during the year and vested during the year	-	A$50,000	-
LTI granted in prior years vested during the year (amortised)	-	A$1,000,000	-
LTI granted in prior years vesting after the year (amortised)	-	A$500,000	-
LTI granted during year vesting after the year (amortised)	-	A$500,000	-
Other	-	A$25,000	-
Total	**A$0**	**A$4,800,000**	**A$0**

Pursuant to PPF, the amount that is disclosed will be the amount that is paid to KMP, however, it is unclear if this means payment occurs at the conclusion of the performance period and upon the conclusion of the vesting period (with or without hurdles present) or the achievement of performance or otherwise (where hurdles or exercise prices are present). An illustration of these different approaches is below.

Vesting based PPF disclosure – The date an award is "paid" is at the conclusion of the vesting period, regardless of grant dates or performance hurdles/periods.

	PAST	PRESENT	FUTURE
Salary & Fees	-	A$800,000	-
Non-monetary benefits	-	A$100,000	-
Superannuation	-	A$75,000	-
STI cash	-	A$1,000,000	-
Deferred STI equity granted in current year and vesting after this year	-	-	A$500,000
Deferred STI equity granted in prior year and vested this year	A$250,000	-	-
Equity granted during the year and vested during this year	-	A$50,000	-
LTI granted in prior years and vested this year	A$1,000,000	-	-
LTI granted in prior years and vesting after this year	*Disclosed in previous financial year*		
LTI granted during year and vesting after this year	-	-	A$500,000
Other	-	A$25,000	-
Total	**A$1,250,000**	**A$2,050,000**	**A$1,000,000**

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Performance based PPF disclosure – The date an award is "paid" is when a performance hurdle is achieved or otherwise at the conclusion of the period, regardless of grant dates or vesting dates.

	PAST	**PRESENT**	**FUTURE**
Salary & Fees	-	A$800,000	-
Non-monetary benefits	-	A$100,000	-
Superannuation	-	A$75,000	-
STI cash	-	A$1,000,000	-
Deferred STI equity granted in current year and vesting after this year	-	A$500,000	-
Deferred STI equity granted in prior year and vested this year	*Disclosed in previous financial year*		
Equity granted during the year and performance this year	-	A$50,000	-
LTI granted in prior years and performance this year	A$1,000,000	-	-
LTI granted in prior years and performance after this year	*Disclosed in previous financial year*		
LTI granted during year and performance after this year	-	-	A$500,000
Other	-	A$25,000	-
Total	**A$1,000,000**	**A$2,550,000**	**A$500,000**

In CGI Glass Lewis' view the most desirable outcome is that "paid" defines the remuneration that is determined by performance at the end of the period. This allows shareholders to clearly assess the payment of remuneration components over a period as they directly relate to the company's performance.

What is the value of the "amount"?

Cash remuneration in any of the above approaches is straightforward; however, there are several ways to approach the valuation of equity based remuneration and in order for the government to achieve its desired goal of "comparability", an aim we support, we would like to see a singularly consistent approach.

As discussed earlier, CGI Glass Lewis agrees strongly with CAMAC's recommendation that "the application of accounting methodology to the remuneration report can confuse and mislead shareholders without providing useful information." Further, "comparability" cannot be achieved if the government insists on two sets of valuation requirements under AASB 2 and PPF.

We believe that equity should be valued at fair value based on the underlying market value of the security and excluding any consideration of performance requirements to ensure "comparability" across different companies.

Under PPF, the valuation of this equity can be taken at two key points in time, grant date and vesting date.

We believe that the most relevant amount is the fair value at grant date of equity. This reflects the incentive value that the board offers the executive and the underlying cost to the company's shareholders in acquiring that equity. When reporting on the value at the conclusion of the performance period, we believe that the percentage of the award vested should be the respective percentage of this grant date fair value.

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CGI Glass Lewis has already moved forward with this approach in our research coverage of the S&P/ASX 300 via our proprietary Pay for Performance model, where we use the grant date fair value of equity (currently calculated internally) to determine the cost of employment and easily compare ASX-listed companies on a consistent basis.

Some shareholders may also be interested in the underlying fair value of equity at the conclusion of the performance period or vesting date, but we do not believe that reflects what is "paid" by a company to an executive, as the grant of equity has already been determined by the board and taken place in a prior year. Nevertheless we would not be opposed to the reporting of this value elsewhere in the remuneration report, if only to indicate the value or otherwise that has been generated during the executive's tenure.

Example:

An executive is given a fair value grant of A$1,000,000 in company shares in FY2012 and three years later the shares have an underlying market fair value of A$2,000,000 in FY2015. The executive achieves 60% of the performance hurdles at the conclusion of FY2015 and so 60% of the equity is "paid" to the executive.

The disclosures of the equity under PPF over various years would look alternatively as follows:

FY2012

	PAST	**PRESENT**	**FUTURE**
LTI granted during year and performance after this year	-	-	A$1,000,000

FY2015

	PAST	**PRESENT**	**FUTURE**
LTI granted in prior years and performance this year (grant value)	A$600,000	-	-
LTI granted in prior years and performance this year (vesting value)	A$1,200,000	-	-

Does PPF accurately describe pay to shareholders?

CGI Glass Lewis has some concerns that the goal of better communicating pay to shareholders could be undermined by terminology that literally implies something else other than the intended meaning of the past, present and future components of pay.

In particular, some shareholders may consider the term "future" to imply guaranteed payments in a future period. Similarly, "past" is a confusing term as it implies a payment that has occurred in the previous financial year, when it has actually been determined and realised during the current financial year (performance based or vested). In our experience shareholders most commonly want to know what an executive's "take home pay" is for a particular year and the division of "past" and "present" actively prevents that.

To address these two issues, we would propose more literal terminology that can be immediately understood by all parties and, separately, the combination of "past" and "present" into a single

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component of pay (given past remuneration is literally the previous financial year's remuneration which is already required to be disclosed in remuneration report). This would also simplify the reconciliation of pay across multiple financial years under the EP.

As such we would suggest that 300A(1)(ca) of the EP be simplified, with remuneration for each KMP required to be disclosed as follows:

i) ***the total amount of remuneration that was granted during or prior to the start of the year and paid to the person during the year ("actual pay"); and***
ii) ***the total amount of remuneration that was granted to the person during the year but that is not to be paid to the person until after the end of the year ("potential future pay").***

Actual pay and potential future pay disclosure – The date when the award is "paid" is the date that a performance hurdle is achieved or otherwise at the conclusion of the period, regardless of grant dates or vesting dates.

	ACTUAL	**POTENTIAL FUTURE**
Salary & Fees	A$800,000	-
Non-monetary benefits	A$100,000	-
Superannuation	A$75,000	-
STI cash	A$1,000,000	-
Deferred STI equity granted in current year and vesting after this year	A$500,000	-
Deferred STI equity granted in prior year and vested this year	*Disclosed in previous financial year*	
Equity granted during the year and performance this year	A$50,000	-
LTI granted in prior years and performance this year	A$1,000,000	-
LTI granted in prior years and performance after this year	*Disclosed in previous financial year*	
LTI granted during year and performance after this year	-	A$500,000
Other	A$25,000	-
Total	**A$3,550,000**	**A$500,000**

Example remuneration report disclosure:

The above explanatory table for "actual pay" and "potential future pay" disclosure would then allow for additional simplification in practice, appearing in the remuneration report as follows:

	ACTUAL	**POTENTIAL FUTURE**
Salary & Fees	A$800,000	-
Non-monetary benefits	A$100,000	-
Superannuation	A$75,000	-
Short-term incentive (cash)	A$1,000,000	-
Short-term incentive (deferred)	A$500,000	-
Other equity	A$50,000	-
Long-term incentive	A$1,000,000	-
Long-term incentive	-	A$500,000
Other	A$25,000	-
Total	**A$3,550,000**	**A$500,000**

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CGI Glass Lewis' proposed disclosure

CGI Glass Lewis will always encourage any efforts to make the disclosure and reporting of remuneration consistent, meaningful, intuitive and concise for all shareholders. While we are supportive of the government's intentions to simplify remuneration disclosures and to provide comparable figures across the market, we are concerned that the current EP will not achieve those aims. The lack of guidance on how to report remuneration pursuant to PPF will likely lead to many different approaches being adopted for reporting, preventing comparability between companies and threatening the integrity of information provided. Further, requiring four different components of remuneration disclosure for each KMP subject to two different methodologies under AASB 2 and PPF will complicate (rather than simplify) remuneration disclosures, defeating the intended purpose of the EP and creating unnecessary additional regulatory burdens on companies

In summary, we make the following recommendations to Treasury:

- Clawback provisions would be more meaningful if extended to material expenses under AASB 101.
- The requirements under AASB 2 should be removed from the remuneration report and be relocated to the notes of the financial statements.
- The EP should define "paid" as remuneration that is determined by performance or otherwise at the end of the period.
- Equity should be consistently valued at the grant date fair value, based on the underlying market value of the security and excluding any consideration of performance requirements to ensure "comparability" across different companies.
- 300A(1)(ca) of the EP should be simplified to require disclosure of two pay categories "actual pay" and "potential future pay" as opposed to "past", "present" and "future" pay.

Please do not hesitate to contact us if you would like to discuss any aspect of our submission further.

Respectfully submitted,

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