

Corporate Governance - Executive remuneration reforms June 2011

Senate passes reforms to executive remuneration and board composition with laws to take effect from 1 July 2011

The *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* was passed by the Senate on 20 June 2011, and will take effect from 1 July 2011. The passing of this bill brings significant changes to the laws regulating executive remuneration and board composition.

The following changes to the *Corporations Act 2001* will take effect as a result of the passing of these reforms:

- introducing a 'two strikes' rule in relation to shareholder approval of executive remuneration;
- requiring all directed proxies to be voted;
- requiring boards to disclose their use of external remuneration consultants and imposing restrictions on the ability of executive directors to engage remuneration consultants;
- preventing key management personnel from hedging their incentive remuneration; and
- abolishing the 'no vacancy' rule.

The 'two strikes' rule introduced

The importance of shareholders' votes on remuneration reports will increase significantly. A 'two strikes' test will be introduced and will apply to all resolutions on remuneration reports put to shareholders on or after 1 July 2011.

Under the 'two strikes' rule, the board risks being forced to stand down and face re-election if at least 25% of votes cast are voted against the remuneration report at consecutive meetings. The key rules are:

- If at least 25% of the votes cast at an AGM are voted against the remuneration report presented at that

AGM, the next remuneration report must provide details of how any concerns of members raised at the previous AGM were addressed or explain why such concerns were not addressed.

- If the remuneration report at the next AGM following a "no" vote of at least 25% also receives a "no" vote of at least 25% of the votes cast at that AGM, a 'spill resolution' must immediately be put to shareholders at the AGM to determine whether the entire board must stand for re-election.
- If the spill resolution is passed (by a normal majority of 50%), the board must vacate office and stand for re-election at another general meeting which must be convened within 90 days.

Key Management Personnel (**KMP**) and their closely related parties (such as a spouse, child, dependant or a company controlled by KMP) will not be allowed to vote on the remuneration report if it includes details of the remuneration of a KMP. This prohibition will apply to votes cast on or after 1 August 2011 regardless of whether the remuneration report relates to a financial year prior to, on, or after 1 August 2011.

All directed proxies must be voted

With effect from 1 August 2011, all holders of directed proxies must cast all of these directed proxies on all resolutions. Any directed proxies that are not voted by the proxyholder will be automatically defaulted to the Chair of the meeting, who must vote all directed proxies in accordance with the directions provided.

Engaging remuneration consultants

With effect from 1 July 2011, listed companies must comply with the following new rules:

- Remuneration consultants must be engaged by non-executive directors. The appointment of a remuneration consultant must be approved by the board or the remuneration committee.
- Company executives may not be provided with reports from remuneration consultants. Remuneration advice must only be given to the board or the remuneration committee. A report must not be provided to the company's executive directors unless the company has no non-executive directors.
- If a remuneration consultant provides a recommendation to the board, it must contain a declaration stating whether the recommendation has been made without any undue influence from the KMP to whom the recommendation relates.
- The company's remuneration report must contain a statement as to whether the board is satisfied that any remuneration recommendation was made free from undue influence by KMP to whom the recommendation related.

Hedging of incentive remuneration prohibited

From 1 July 2011, KMP and their closely related parties will be prohibited from hedging the KMP's incentive (or 'at risk') remuneration unless ASIC has declared otherwise in

writing. Previously, a company was required to disclose its policy in relation to hedging of remuneration for KMP. The hedging arrangements that are now prohibited include arrangements where a KMP would enter into a derivative or third party contract to reduce their personal exposure to the company's success or failure.

'No vacancy' rule abolished

From 1 July 2011, a board will no longer be able to declare the maximum number of directors to be less than the maximum number permitted by the company's constitution without member approval. Currently, boards can declare that there are no vacancies on the board when the company's constitution does not state a specific number of directors or allows the directors to specify the maximum number.

After the reforms take effect, public companies will be required to obtain shareholder approval at a general meeting if the board is to be permitted to declare that no further directors will be appointed to the board if the number of directors currently in office is less than the maximum number of directors permitted under the company's constitution.

Any limit approved by the shareholders will expire immediately before the next annual general meeting.

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