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Review of the Financial Reporting Framework
Competition, Trade and Investment Branch
Ministry of Economic Development
PO Box 1473
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THE STATUTORY FRAMEWORK FOR FINANCIAL REPORTING – EXECUTIVE REMUNERATION DISCLOSURES

1 The Listed Companies Association Inc. executive (*LCA*) welcomes the opportunity to provide comment on the Ministry of Economic Development's discussion document entitled *The Statutory Framework for Financial Reporting* dated September 2009.

2 These submissions focus on part 9.2.4 of the discussion document, relating to remuneration disclosures of key management personnel.

Introduction

3 The LCA is an independent and voluntary non-profit organisation established in 1981. Its members are NZSX, NZAX and NZDX listed companies. Its main purposes are:

3.1 To help each listed company further the long-term interests of its shareholders by working for a fair, adequate and efficient regulatory system;

3.2 To assist those responsible for listed companies to maximise the benefits of listing and to make the requirements that come with that status appropriate and reasonable to comply with; and

3.3 To promote confidence in and growth of business and capital markets in New Zealand.

Submission on the remuneration threshold and band width

4 We support the proposal that the employee remuneration threshold and bands contained in section 211(1)(g) of the Companies Act 1993 (the *Act*) should be increased to more practical levels.

5 The current employee remuneration threshold has not been updated since it was first set when the Act was enacted in 1993. As such, it does not recognise the growth in management remuneration since this time. This has subsequently led to disclosure of remuneration of employees having few management accountability roles, contrary to the intent of section 211 of the Act.

6 Similarly, the band has remained at $10,000 since the Act was introduced. We agree with the point raised in paragraph 204 of the discussion document that this has reduced the quality of information disclosed to shareholders by disaggregating information to an unnecessary level of detail. We add that the current band is too narrow to adequately protect the anonymity of individual managers' remuneration within an organisation. This has the potential to create management issues, because employees are able to work out how well they are paid relative to their peers. We also note that working out in which band a particular individual lies on the basis of $10,000 bands can be an unnecessarily complicated, and time consuming, exercise for companies (the more bands there are, the more calculations need to be made to see on which side of a band a particular individual falls).

7 Accordingly, we suggest that the employee remuneration threshold should be raised to $200,000, to better ensure that it only captures a company's key management personnel. We also recommend broadening the band to $25,000, to improve the quality of information disclosed in the annual report by removing unnecessary detail and make preparation of the disclosure more straight forward.

8 We agree with the Ministry of Economic Development's view that these values should be reviewed periodically to ensure that they remain current. Accordingly, we submit that reviews should be undertaken within 10 years of the date from which they are changed, with a view to making appropriate changes to the values not later than every 10 years.

9 We add that companies are only required to report remuneration *received* by employees. This means that remuneration which accrues during a particular financial year, but which is only paid in the following financial year, is not disclosed in the financial year in which it accrues. As such, a company's annual report does not accurately reflect the remuneration that has been paid or becomes payable to executives in a particular financial year.

10 This issue can be addressed by requiring the disclosure of the aggregate of the amounts paid or payable in respect of the relevant financial year. In our view, this change to the reporting requirements would more accurately reflect the executive remuneration that relates to a particular financial year.

Submission on the "outcomes-based" approach

11 We have reservations about the proposal to adopt an "outcomes-based" approach to the disclosure of management remuneration, as currently exists in Australia under section 300A of the Corporations Act 2001 (Cth).

12 High standards of reporting and disclosure of executive remuneration are essential for ensuring accountability between a board and its shareholders, and for reassuring investors that executive remuneration arrangements are being negotiated at arm's length. However, in our view, an outcomes-based approach to remuneration disclosure will not improve accountability or transparency for the reasons outlined below.

Disclosure requirements are inappropriate for New Zealand companies

13 We consider that remuneration disclosures based on the Australian regime is inappropriate for the smaller New Zealand economy.

14 The increased disclosure requirements in Australia only apply to listed companies. It would be inappropriate to subject all New Zealand companies, including small and medium-sized enterprises, to such invasive and costly reporting requirements.

15 With regards to listed companies, the continuous disclosure regime contributes to high standards of information disclosure in respect of executive remuneration. For instance, continuous disclosure obligations may be triggered where companies enter into employment agreements with key executives. Furthermore, listed companies are required to disclose details of directors' remuneration arrangements and the nature of any termination entitlements. In any case, listed companies seeking to attract international investment may voluntarily provide more detailed remuneration disclosures in their annual reports if they feel that it is necessary to do so in order to keep pace with international best practice.

16 If, contrary to our submission, an outcomes-based approach is considered appropriate for the listed company sector, a preferable means to implement a change would be for NZX to be required to include additional remuneration disclosure requirements in the Listing Rules (if necessary, through amendment to Part 2B of the Securities Markets Act), rather than through general company legislation, as that would be a more targeted approach and provide flexibility for future change (subject to the protection of Ministerial disallowance under the Securities Markets Act).

Shareholders are adequately protected

17 The current regulatory environment is sufficiently robust to protect the interests of shareholders:

17.1 Directors are subject to overriding legal obligations, by virtue of the Act and their fiduciary duties, to act in the best interests of the company (and, by extension, its shareholders) in setting and structuring remuneration contracts;

17.2 The Act imposes a number of obligations on the board to report to its shareholders in respect of the management of the company. The Board is, for example, required to:

(a) prepare annual reports for each financial year and make them available to shareholders;

(b) hold an annual meeting of shareholders; and

(c) hold a special meeting of shareholders if at least 5% of the voting shareholders request.

These measures ensure that shareholders are provided with sufficient information about the company's financial performance to assess its remuneration arrangements;

17.3 Shareholders are granted broad rights to question remuneration arrangements and take action against directors. For instance, shareholders:

(a) must be given a reasonable opportunity at meetings to question, discuss or comment on the management of the company;

(b) may pass resolutions at meetings relating to the management of the company; and

(c) may propose resolutions for the removal of directors; and

17.4 With respect to listed companies, the Listing Rules require shareholder approval in respect of director remuneration arrangements and payments to retiring directors.

Additional compliance costs

18 We understand that Australian companies incur significant costs in preparing remuneration reports. Management are spending a considerable amount of time and effort in drafting the reports, to the detriment of strategic and business risk issues. Furthermore, the engagement of external consultants to assist with this task and obtaining legal and audit compliance checks have proven to be costly exercises for Australian companies. It would be

particularly onerous to impose such costly reporting requirements on smaller listed companies.

Pressure on remuneration

19 The increased disclosure requirements in Australia have led to upward pressure on director and executive remuneration. This has arisen as a result of companies benchmarking remuneration levels and structures against executives' peers; information which has become publicly available as a result of the proposed outcomes-based approach. This, coupled with the practice of aiming to reward executives at the upper quartile of the peer group, has had an inflationary effect on the remuneration of executives.

Loss of competitive advantage

20 Under the proposed regime, the executive remuneration policy of companies will be revealed to competitors. The disclosure of such highly valuable information (such as how remuneration targets are set against performance) has the potential to undermine a company's competitive position and long-term performance.

Greater scrutiny of company directors

21 The actions and remuneration of company directors are scrutinised by shareholders and, in the case of larger and well-known companies, the media. This proposal is likely to introduce a new dimension of scrutiny by requiring directors to justify remuneration arrangements. This intrusion of privacy has the potential to discourage individuals from pursuing directorships.

Complexity of remuneration reports

22 The remuneration reports of Australian companies are particularly length and highly legalistic. Reports are routinely 20 pages in length, and some are over 50 pages long. This has been attributed to the complexity of remuneration arrangements and reporting requirements. As a result, remuneration reports are becoming increasingly difficult for shareholders to understand.

23 Furthermore, remuneration reports of Australian companies often do not provide meaningful information to shareholders. For instance, they have been criticised for providing superficial descriptions of the relationship between remuneration and performance and inadequately disclosing short-term performance hurdles and current ex ante valuations of equity-based pay.

Conclusion

24 For the reasons outlined above, we consider that an outcomes-based approach to remuneration disclosures of key management personnel is inappropriate. In our view, provided appropriate changes are made to the employee remuneration threshold and band contained in section 211(1)(g) of the Act, the existing framework adequately serves the needs of shareholders.

Further information

25 Please contact me if you would like to discuss any of the points raised in our submissions.

Yours faithfully,

Linda Cox
Chair