Executive pay on-costs: The costs of remuneration advice in the S&P/ASX 200

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Key Takeaways

- Nearly a third of ASX200 companies disclosed fees paid to a remuneration consultant in FY12.
- Of these companies, 23 paid more than $100,000 for remuneration consulting advice and seven paid more than $200,000.
- In many cases companies appear to pay substantial fees for publicly available data.

BACKGROUND

In 2011 the Australian Parliament amended the Corporations Act to require listed companies to disclose the identity of any "consultant" who provided a "remuneration recommendation" for key management personnel (KMP) – the board and most senior executives whose remuneration is disclosed in the remuneration report.[1]

The requirements applied for the first time to financial reports for periods starting on or after 1 July 2011 so the 12 months ending 30 June 2012 was for most Australian S&P/ASX 200 companies the first time they had been required to disclose information relating to remuneration consultants. A handful of companies had disclosed the identity of their remuneration advisors voluntarily prior to 2012. Alongside these disclosure requirements came new requirements mandating restrictions on the involvement of executives in appointing and using consultants.

WHAT INVESTORS HAVE LEARNT

In the first reporting year of the changes the 183 Australian domiciled companies in the S&P/ASX 200 took a variety of approaches:[2]

- Just over 30 percent – 59 companies – disclosed the identity of their remuneration consultants but did not disclose any information on the fees paid to the consultant on the grounds no "remuneration recommendation" was provided.
- Another 75 companies disclosed the identity of remuneration consultants and the fees paid to these consultants.
- Of these 62 disclosed they had received a recommendation from their consultant and were required to disclose the fees paid to that consultant.[3]
- In another eight cases it was unclear whether a recommendation had been received but fees were nonetheless disclosed. This included three entities that were not subject to the new provisions.[4]
- There were five cases where no recommendation was provided but companies voluntarily disclosed fees paid to their remuneration consultants. This included Macquarie Group which was not subject to the Act's requirements until its annual report for the year ending 31 March 2013.

[1] Section 300A(1)(h). The changes relating to remuneration consultants were part of the changes introducing the so-called 'two strikes' regime for remuneration reports.

[2] The peer group includes five companies – Sigma Pharmaceuticals, Macquarie Group, Metcash, CSR and SP Ausnet – that were not required to comply with the new requirements in their 2012 annual reports due to the timing of their year ends. The 2012 year for these companies is included in the sample as several early adopted.

[3] This includes Spark Infrastructure which is a stapled trust and not subject to the remuneration reporting provisions of listed companies under the Corporations Act. Under its governance protocols Spark behaves as if it is subject to the Corporations Act provisions applying to companies.

[4] Dexus Property Group, which like Spark, consists only of trusts but behaves as if it is a listed company; Sydney Airport Group which at that time did not include a company and Metcash which reported fees to remuneration consultants for the year ended 30 April 2012 despite not being subject to the Act's provisions until its 2013 annual report.

SHOW ME THE MONEY

Of the 75 companies that disclosed how much they paid their remuneration consultants, the average fee disclosed for remuneration advice was $93,025.[5] There was however a large disparity in the fees paid, with 23 companies paying more than $100,000 in fees and eight paying less than $20,000.

Table 1: More than $200,000 spent with remuneration consultants

Company	Amount spent	Consultants	Advice received
BHP Billiton[6]	$556,285	Kepler Associates	Strategic review of KMP pay arrangements; valuation of incentives; advice on management proposals; pay benchmarking; attendance at committee meetings and review of executive pay trends.
Rio Tinto[7]	$473,437	Deloitte	Benchmarking data; advice on pay for non-KMP employees; recommendations on changes to LTI scheme; attendance at committee meetings and advice on management proposals.
Woodside Petroleum[8]	$364,784	PwC; Mercer	Review of executive incentive plan (PwC); CEO and NED pay benchmarking (Mercer).
Qantas Airways[9]	$306,625	PwC	Review and recommendations on annual bonus; provision of general advice, review of committee papers and attendance; information on market practice.
PanAust[10]	$233,955	Deloitte/Towers Watson	Structure of pay packages; benchmarking data; valuation of equity incentives; NED pay benchmarking and size of fee pool.
Aurizon Holdings[11]	$229,550	Egan Associates, KPMG, Towers Watson, Deloitte, Ernst & Young	Recommendations on pay levels & structure (Egan & KPMG); relative TSR calculations & peer group advice (Towers Watson); incentive plan valuations (Deloitte); recommendations on pay levels and KMP pay advice (EY).

[5] The Act requires companies only to disclose the fees paid for a recommendation and then other fees paid to that advisor. For some professional services firms this has resulted in very large fees for non-executive remuneration services such as audit, tax advice or super fund management being disclosed. These fees have been excluded.

[6] BHP Billiton Group, 2012 annual report, p. 136. Converted from GBP into AUD using the average exchange rate for the 12 months to 30 June 2012. In FY13 BHP Billiton spent GBP159,000, down from GBP362,000 in FY12 – see 2013 annual report, p. 159.

[7] Rio Tinto Group, 2012 annual report, p. 94. Converted from USD to AUD using the average exchange rate for the 12 months to 31 December 2012.

[8] Woodside Petroleum Limited, 2012 annual report, p. 59. Fees of US$320,000 paid to PwC converted from USD to AUD using the average exchange rate for the 12 months to 31 December 2012.

[9] Qantas Airways Limited, 2012 annual report, p. 46. In 2013 Qantas did not disclose fees paid to consultants Ernst & Young and jws consulting as no recommendations were received – see 2013 annual report, p. 80.

[10] PanAust Limited, 2012 financial report, p. 18. Deloitte's Australian remuneration consulting practice merged with Towers Watson in April 2012.

[11] QR National Limited (now Aurizon), 2012 annual report, p. 27. In 2013, Aurizon paid jws consulting $45,034 for remuneration recommendations. The fees paid to jws, Egan Associates, Ernst & Young & Towers Watson for other non-recommendation advice were not disclosed. See 2013 annual report, p. 47.

Company	Amount spent	Consultants	Advice received
Dexus Property Group[12]	$211,841	Egan Associates, Ernst & Young, Clayton Utz	Remuneration advisory services (Egan & EY); executive contract advice (Clayton Utz).

When comparing companies' expenditure on remuneration consultants in 2012 the different disclosure approaches should be considered. Aurizon for example disclosed more information than required under the law as of the five named consultants who received fees only three provided remuneration recommendations and the law requires disclosure only of fees paid to consultants providing recommendations. Dexus, which as noted above is not required to disclose information on remuneration consultants as it is not subject to the Corporations Act provisions for listed companies, did not disclose whether any remuneration recommendations were received from the three consultants disclosed as receiving fees in the 2012 financial year.

It is also difficult in some cases to assess the type of advice provided from the disclosures provided by the company. The Act's disclosure requirements do not require companies to disclose the nature of the advice received; only whether or not it constituted a recommendation and the fees paid if a recommendation was received.[13] An extreme case is Transurban which in 2012 spent $26,000 on a remuneration recommendation from Ernst & Young but provides no disclosure on the nature of the advice provided.[14]

In a number of cases the fees paid appear substantial relative to the type of advice described – Aurizon for example paid Deloitte $22,850 for valuation of equity incentives allocated as deferred bonuses and long term incentives.[15] More striking was the case of Woodside where PricewaterhouseCoopers following a formal tender received US$320,000 to "undertake a review of the EIP in 2012 and to provide recommendations to the Committee in regard to the alignment of the plan with the Woodside values and strategies". The EIP or Executive Incentive Plan allocates both short and long term incentives at Woodside and the review resulted in Woodside granting shares rather than zero exercise price options (ZEPOs) as the deferred component of annual bonuses, extending the performance period for its long term incentive from three to four years, changing the peer group against which relative performance is assessed and changing the way ZEPOs were valued to decide how many to allocate to executives.[16]

From the information disclosed companies appear to pay relatively large amounts for 'benchmarking data' – information on the remuneration of executives and/or directors at comparator companies, many of which are publicly listed. For example, REA Group paid jws consulting $73,500 for recommendations on pay levels for non-executive directors and senior executives.[17] At Myer Holdings, Mercer received $36,000 for

[12] Dexus Property Group, 2012 annual report, p. 51. In FY13 Dexus paid Egan Associates $51,802 for recommendations and other advice. See 2013 annual report, p. 21.

[13] S. 300A(1)(h)(i)-(viii).

[14] Transurban Group, 2012 financial report, p. 15. In FY13 Transurban notes Ernst & Young provided it with "benchmark data only" and no recommendations were provided and so no fees were disclosed. See 2013 annual report, p. 34.

[15] See n. 11.

[16] See n. 8, p. 54.

[17] REA Group Limited, 2012 annual report, p. 26. In FY13 jws received $145,750 for providing data on executive and director remuneration levels for FY13 and FY14, including $105,317 for recommendations. See 2013 annual report, p. 25.

benchmarking the pay levels of non-executive directors and senior executives.[18] CSL, which in 2012 voluntarily disclosed the fees paid to its consultant Guerdon as no recommendations were provided, paid $151,000 for "market data analysis and remuneration review" for the CEO and other executives, a review of director fee levels and reviewing the 2012 remuneration report and the structure of the long term incentive plan.[19]

The high price of sourcing market data from external consultants which in many cases is publicly available, especially for directors and very senior executives, is a curious feature of the remuneration consultant market. Many companies seem unwilling to adopt the approach of Bendigo & Adelaide Bank, which prior to its 2011 AGM collected data using internal resources from published annual reports on comparative director fee levels as part of a review of non-executive director remuneration.[20]

FEE ODDITIES

The disclosures also revealed a number of companies where expenditure on remuneration advice was large in the context of the company or its circumstances.

At Alumina, a company which has as its major asset a 40 percent interest in the AWAC joint venture which is operated by partner Alcoa, Ernst & Young received fees of $125,000 for advice and recommendations on the remuneration report, general market trends and design and implementation of the remuneration framework and strategy. The company has three executives defined as key management personnel.[21]

At The Reject Shop consultant KPMG received $45,000 in fees for a review and recommendation of pay levels and pay structure for KMP at the company; this was equivalent to nearly 8 percent of all senior executive bonuses for 2012.[22] At Billabong Group, which was in worsening financial difficulties during 2012, consultant Ernst & Young received $15,460 for benchmarking data, "market commentary and professional guidance regarding Billabong's executive incentive plans".[23]

Developing rare earths producer Lynas Corporation also in its disclosures revealed the substantial fees paid to director search firms. In its 2012 annual report Lynas disclosed it had paid Egon Zehnder $126,000, after paying $220,000 in 2011, including for advice on director fee levels (see excerpt below).[24]

> **Base Fees**
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> NED fees are determined by the Committee and fall within the aggregate amount approved by shareholders. In 2011 the Committee engaged Egon Zender to provide advice on the appropriate levels for Non-Executive Directors' fees and Committee fees. Fees paid to Egon Zender during the year totalled $125,988 (2011: $219,991). As a result of this review the level of NED fees and Committee fees were increased effective February 1, 2011 (but did not exceed the NED aggregate pool).

Excerpt from 2012 Lynas Corporation annual report, p. 43

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[18] Myer Holdings Limited, 2012 annual report, pp. 45-46. In FY13 Myer appointed Ernst & Young to act as the board's remuneration adviser but received no remuneration recommendations and disclosed no fees. See 2013 annual report, p. 51.

[19] CSL Limited, 2012 annual report, p. 56. In FY13 CSL again voluntarily provided this information and disclosed total fees to Guerdon of $76,025 for review and analysis of market data for executive KMP pay.

[20] Bendigo & Adelaide Bank Limited, 2011 notice of annual general meeting, p. 9.

[21] Alumina Limited, 2012 annual report, pp. 26-27.

[22] The Reject Shop Limited, 2012 annual report, pp. 19-20. The 2013 annual report (p. 19) discloses no consultants were engaged in FY13

[23] Billabong International Limited, 2012 financial report, p. 18. The 2013 annual report (p. 24) discloses no remuneration recommendations were provided in that year.

[24] In addition, Lynas in 2012 paid Mercer $53,191 for advice on executive remuneration levels (2012 annual report, p. 41) and in 2013 paid Mercer $23,463 including $17,325 for a recommendation on the fee levels of the chairperson and deputy chairperson. See 2013 annual report, p. 43.

Lynas was the only firm to disclose Egon Zehnder as providing remuneration advice and the company did make two new non-executive director appointments during calendar 2011. Egon Zehnder has also been retained by Lynas to advise on new director appointments following recent retirements.[25]

HOW TO MAKE THE DISCLOSURE REGIME WORK BETTER

The rationale for requiring the disclosure of information about remuneration consultants is unclear. Directors are ultimately responsible for how to pay management, not consultants, and boards likely to 'outsource' remuneration decision-making to a consultant are unlikely to make good decisions even with tighter rules surrounding the disclosure and use of consultants. Remuneration consultants are not auditors, the other category of service providers whose fees are disclosed and where disclosure and independent advice requirements exist.[26]

Assuming that the existing regulatory regime for remuneration consultants is retained there would be some benefits to shareholders in improving the disclosure regime:

- Requiring companies to disclose any use of external advice in determining the remuneration for KMP, including advice related to remuneration such as tax planning. This would widen the current requirement which is limited only to remuneration recommendations. A description of the types of services provided would also be useful.
- Require disclosure of the fees paid for advice even when no remuneration recommendation was received. At present there is no requirement for companies to disclose the identity of advisors or fees if no remuneration recommendation is provided, although in the first year of operation a number of companies voluntarily disclosed additional information.

These changes would move the regulatory regime away from its present focus on conflict avoidance, which is unlikely to prevent poor behaviour and poor decisions by boards in overseeing executive pay, to disclosure about types of advice provided and the fees paid.

This would give investors more visibility over the actual cost of executive pay, including on-costs such as advice (including tax structuring). It is also more likely to create competitive tension among consultants given the level of fees companies presently pay for comparative information, often based on publicly available data. It would also shift the Australian regulatory regime closer to that which will take effect in the UK for annual reports for periods ending after 30 September 2013; the UK regime will now require disclosure of persons who provided services that "materially assisted" the board in consideration of remuneration matters, the nature of the services and the amount paid for the services.

[25] Ziggy Switkowski joined the Lynas board in February 2011 and Kathleen Conlon in November 2011. Lynas noted in the 20 August 2013 ASX announcement of the impending retirements of Switkowski and David Davidson that Egon Zehnder had been retained to "identify suitable candidates" to serve on the Lynas board.

[26] OM notes that when it comes to the audit of the remuneration report auditors appear to frequently miss breaches of the Corporations Act and accompanying regulations, most commonly the requirement under Regulation 2M.3.03(12) (f) to specify the proportion of annual bonuses for senior executives forfeited during a year due to performance conditions not being achieved.