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Subject: Fixing Executive Remuneration

Recently, I had a lively debate with some corporate remuneration experts about executive remuneration. This discussion was based on two articles published a few weeks ago in the Australian Financial Review: the first followed a speech by **Wayne Byers**, the Chairman of APRA, concerning the remuneration of bank executives; the second was a rebuttal by **Martin Lawrence** and **Dean Paatsch** of Ownership Matters.

Distilling the respective arguments into a concise summary could never satisfy the complexity of executive remuneration as we know it. However, it's clear that there are two opposing positions promoted by Mr Byers (APRA) and Lawrence & Paatch (OM):

APRA:
"Attempts to move away from the conventional model of executive remuneration have not been wholly welcomed. [Bank] boards have struggled to gain acceptance that new approaches are needed. … Work on executive remuneration [is needed] to better align potential rewards with a holistic view of performance – regulatory intervention, and a greater degree of prescription, will be required to shift [executive remuneration] practices. … there should be more than a single, share-price based metric … [so Total Shareholder Return] would go from the primary, if not sole, determinant of [long term incentives] to something less than 25%."

OM:
"It is demonstrably false [that] ... boards and executive teams are powerless ... to prioritise the pursuit of profit, dividends and share price growth. ... The chief frustration of institutional shareholders about banker pay is not the inclusion of non-financial performance metrics; but rather that executive rewards are insensitive to performance of any kind. ... TSR performance metrics ... mirror the shareholder experience over the long-term ..."

Our discussion of these conflicting positions raised several issues that are material to the administration of executive remuneration, including:

- The culture of executive management, which partly involves company directors being focussed on their executives' attraction and retention, rather than performance incentives;
- The directors' concern that if they don't remunerate their executives in line with the best opportunities written in their employment contracts, then they will walk away;
- The general perception that variable remuneration is only at risk if the circumstances are catastrophic;
- The discretion exercised by directors to adjust variable remuneration in favour of executives;
- The readily available and very detailed information on executive remuneration received by all key management personnel in listed companies;
- The time frames of performance objectives and the respective payments of cash bonuses based on annual targets, while senior executives are often expected to focus on multi-year strategies;
- The inclusion of deferred bonuses and equity vesting conditions that would better reflect the longer-term impact that most executives should have on business performance.

Of course, there are many other important aspects to consider. Nevertheless, is seems that banking, insurance and superannuation boards will need to make significant improvements to their administration of executive remuneration – otherwise, APRA may start wielding a blunt instrument. Other companies beyond Australia's finance sector should also take note.

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