

Incentive Structures & Risk Appetite – The Value of Governance

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Introduction

This paper will provide an overview of a PhD research project entitled “Testing for a relationship between incentive structures and risk appetite in corporate decisions”. In more detail the value of governance and regulation will be discussed in the light of recent investigations and reports including the Productivity Commission’s and the Corporations and Markets Advisory Committee’s reports on executive remuneration.

The trends in governance and regulation will be addressed in conjunction with recent financial events that have brought about these changes. The discussion is not limited to financial decisions but, in the view of the author, must also consider the implications that incentive structures may pose to both safety and reputational risk faced by the organisation.

Particular attention is given to the new two-strikes rule that took effect on the 1st of July this year. Early trends in the voting behaviour of shareholders, in regard to the remuneration report, is discussed as are the changes made by companies that experienced a no vote in the prior year and the effect of any action taken in addressing the concerns of shareholders.

Section 1 – Testing for a Relationship Between Incentives and Executive Behaviour

In popular financial press there is a perception that the higher the risk the higher the return. It is true that high returns are often associated with high risk investments, however, the same can be said about big losses. The perception that pursuing the riskier option will generate a better return for the investor overall, is at best dubious. It follows that when a manager is required to produce a better than market return he will have to accept greater risk in order to do so. What the manager is required to do suddenly becomes all important because if the manager is already going to deliver a return equal to, or better than, market return then a percentage of the capital may be exposed to high risk investments increasing exposure to loss.

It is not the target that will influence the executive’s investment decisions, but rather, the incentives attached to it. The extent to which this incentive may influence the investment and other decisions made by an executive to his own benefit, whilst increasing the organisation’s exposure to loss, is the focus of this first discussion. Testing for a link between incentives and corporate decision making is difficult because it is determined by the behaviour and influence of individuals. The subjective nature of individual behaviour introduces a host of variables that must be dealt with in the analysis of the effects produced by incentives within corporate structures. It is the intent of this paper to question the effectiveness of incentive schemes and frameworks that may attempt to govern such broadly different practices.

Historically managers have been more concerned with the loss quantum than the probability of risk (March & Shapira 1987). They may base their decisions on what they can bear to lose rather than the mathematics of risk analysis. They view the risk as real loss rather than a probability calculation. This is acceptable so long as the shareholders are aligned to the risk profile adopted by the executive team and the respective board. If the shareholders are not in agreement with the risk profile, or the intentions of the business in relation to the business’s appetite for risk is not properly communicated, then the shareholders may have been denied the opportunity to divest their holdings and acquire stock more in keeping with their individual risk/return preferences.

When the CEO of a solid performing company is set higher than market growth targets by the board the CEO will have to develop an investment strategy to achieve the growth target. Such an investment strategy is likely to involve investment in projects rated at higher than average risk by the market. The CEO may also believe he has superior skills in specific areas that can be exploited to drive higher than market return. He may, for example, identify another business for acquisition that

would deliver revenue growth immediately and potential productivity savings due to his superior skills and exploitation of synergies.

If the Board indicates to the CEO that failure to achieve his performance targets may affect tenure as well as loss of incentives then there is no downside for the CEO in taking significant risks with shareholder assets. In this situation the CEO has two options, he can invest in a high risk project that may deliver a high return or he can invest in a secure project that does not place the shareholder's assets at risk, but also, will not deliver the growth required to satisfy the incentive targets set by the board. Taking the risk may either deliver the growth targets required or, if the downside is realised, erode shareholder assets. This scenario is unproblematic where the risk taken is in line with the risk appetite of the shareholders and the expected outcome of the respective incentive scheme.

The downside to investing in a high risk project is no different than the downside to conservative investment for the CEO as it will result in a reduced incentive and potential removal. The downside for the shareholders, however, involves the destruction of assets that when managed well produce strong dividends and competitive capital growth. If a CEO is incentivised to deliver better than market growth an unintended consequence is the potential for the CEO to make investment decisions which benefit the CEO to the detriment of the shareholders. The difficulty confronting shareholders, in this event, is how to determine what performance targets have been set by the board. Company annual reports are all too often vague at best when providing such guidance to shareholders. When shareholders do not expect the organisation to experience a loss, or perhaps not a loss of significant magnitude, market commentary may soon question the executive remuneration package. When such events strike an industry there are some commentators who will call for regulation.

Risk based decisions taken by the executive team need not be entirely financial but, dependent on the incentives available, may include: health and safety risk; reputational risk; environmental risk or political risk. Typically risks falling in these categories are often not directly connected with the incentive scheme or structure but, rather, are indirect risks that manifest as unintended consequences such as when asset management is compromised due to cost cutting initiatives leading to unsafe plant. Whilst not financial in essence all of these risks may be quantified and assessed based on a financial measure. In the development of a remuneration structure for executives, key personnel and others the board is well advised to seek the advice and input of the companies risk and governance professionals in order to effectively identify and either eliminate or treat the risks arising from the strategy.

In many jurisdictions criminal conviction may follow from industrial accidents that result in severe employee injuries or fatalities. In some cases senior executives may escape prosecution due to the accountability of the 'organisation' rather than the individual. International experience has also shown that some companies may attempt to lay the blame for serious workplace accidents at the feet of junior employees (Hopkins 2008). The assessment of safety and reputational risk should be analysed with the same rigor as financial risk when testing for a relationship with incentives. The difference, of course, is that safety risk may injure a handful of people where as a significant write down may injure tens of thousands of shareholders albeit through an entirely different mechanism.

A future in depth analysis of public service organisations is expected to deliver insights into the risk motivation of boards and executives that are not able to structure incentive packages around share allocations. These organisations deal with many of the same issues in regard to project investment. The objective of a public sector analysis is to compare the incentive schemes employed in state owned corporations with publically listed corporations and the comparative performance results.

Section 2 – Why Governance

The Global Financial Crisis (GFC) and subsequent economic downturn has severely impacted world economic markets and continues to reverberate through global markets to this day. At the height of the crisis many large financial institutions, widely viewed as robust and resilient to market shocks, collapsed. The mechanics of these events will not be discussed here, however, these are important events when we seek to understand the escalating interest and commentary regarding the improved governance, and possibly, regulation of executive remuneration. Shareholders who were largely content with the growth and profit of these financial houses considered their investment safe and could not understand why these organisations put so much at risk. Governments not only responded to the

complaints of shareholders but also looked for ways to ensure such events were not repeated as the cost to many Governments, and ultimately their tax payers, has been extraordinary. Hence the widespread interest in regulation.

There is sufficient concern about the impact of incentive schemes in particular, at all levels within organisations, to cause regulatory bodies to comment on their management and governance. In 2010 the Australian Prudential Regulation Authority published the Prudential Practice Guideline PPG 511 – Remuneration (APRA 2009). The APRA Prudential Practice guide requires risk to be in line with the organisation's risk profile, however, this can be a difficult goal to achieve given the complexity of financial reports and risk disclosure statements. Other documents seek to explain the incentives and other remuneration payable to the organisation's executive team which is equally complex and challenging for many shareholders to understand, or as put by The Hon Chris Bowen "impenetrable and sometimes misleading" (Cited in Kolesnikoff 2011). The Hon Chris Bowen, Assistant Treasurer, commissioned two reports of interest to this discussion. The first is Executive Remuneration in Australia prepared by the Productivity Commission in December 2009 and the second is the recently released Executive Remuneration Report prepared by the Corporations and Markets Advisory Committee in April 2011.

The terms of reference for the Productivity Commission report were, in summary, to consider trends in remuneration in Australia; the effectiveness of frameworks for governance of remuneration practices; the role played by investors, ways to better align the interest of boards, executives, shareholders and the community at large, international practices; taxation; and to make recommendations as to how the existing framework governing remuneration practices could be strengthened (Productivity Commission 2009). The Commission responded with a substantial report informed by submissions from interested organisations and individuals following a process of consultation.

The Commission's report identified nine key points that sought to explain the past events, including factors that contributed to the evolution of remuneration and incentive packages. The Commission found that remuneration practices through the 1990s often delivered incentive payments partly for good luck and in later periods delivered an unexpected up side. The Commission expressed the opinion that some termination payments could be viewed as excessive.

Importantly the Commission was not keen to embrace regulation as a remedy for these perceived failures of the existing practices. Rather the Commission recommended that the corporate governance framework within organisations be improved by removing conflict of interest and increasing the independence of remuneration committees. The Commission also recommended that board accountability and shareholder engagement should be encouraged. Clearly the Commission concluded that better outcomes could be obtained through improved process and transparency than through regulation.

The most controversial recommendation made by the Commission was the so called 'two-strikes' rule designed to increase the board's accountability for remuneration practices. It was recommended that when a 'no' vote of at least 25% is recorded at the AGM against the remuneration report then the board must address shareholder's concerns in relation to the remuneration report. A second and subsequent 'no' vote of 25% results in a resolution that the directors who signed the remuneration report must stand for re-election. If the resolution attracts 50% of the vote it is carried and the associated directors must stand for re-election within 90 days (Productivity Commission 2009, p. XL).

In recent history several publically listed companies have attracted two consecutive 'no' votes against the remuneration report of greater than 25%. In these cases the 'two-strikes' rule had yet to be passed in legislation. Accordingly it is unclear if shareholders would have been so keen to vote 'no' if there was a legitimate likelihood that the company could be disrupted by the wholesale dismissal of directors. However, the adoption of this recommendation provides a very real mechanism through which shareholders may register their objection to the remuneration practices adopted by the firm.

The two-strikes rule came into force in July 2011. The full impact of the change will not be clear until the end of the next AGM season as it is the second vote that will do more than send a message to the board. The preparedness of shareholders, and more to the point proxy managers, to take the two-strikes rule to its conclusion will demonstrate whether or not shareholders agree with current remuneration practices in light of organisational performance. The new dynamic may influence the

appetite of executive managers for high risk projects and investments. Popular commentary already suggests that there is some anxiety in Australian board rooms on the eve the policy's introduction (Ferguson 2011)

Anxiety may be prudent, although, early indicators suggest that the change is not be feared as Mayne reported there had been three close calls in large public companies early in this AGM season with the three highest no votes recording 24.3, 21.95 and 17.87 percent respectively at that time (2011). Not quite a first strike, however, a clear message that shareholders are dissatisfied with one or more aspects of the remuneration report. The clear inference being that the remuneration offered to the executive team is disproportionate to the performance of the company or value created for shareholders. The opportunity for directors is to demonstrate accountability for remuneration practices and the performance of the executive team over which they preside. Comprehensive no votes did occur during the AGM season and will be discussed in more detail later.

Shareholders are increasingly aware of remuneration practices and the performance of companies in which they invest. In time it will become increasingly difficult to change the remuneration plan or framework to protect the incentives of executives who deliver lack lustre performance or make bad investment decisions. Boards who seek to do so will expose themselves to adverse shareholders results at the AGM ballot box. The dilemma confronting directors is how to best manage executive performance through an incentive based framework.

Positivist agency theory is concerned with the relationship between a principal and an agent such as the relationship between the Board and the CEO of a company (Eisenhardt 1989). Agency theory seeks to provide a framework through which the goals and aspirations of the principal are aligned with the action of the agent. It is notoriously difficult for the principal to assess the actions of the agent, however, because the agent is usually in possession of information superior to that of the principal placing the principal at significant disadvantage. Agency theory acknowledges that the information in the relationship is asynchronous and proposes to overcome these difficulties through the application of governance frameworks. The governance arrangements that may be employed to align the divergent goals of the board and the CEO are the foundation of positivist agency theory.

Positivist agency theory contends that the action of the CEO can be aligned with the preferences of the board through the application of rewards and incentives. As with all incentives, however, the realisation of unintended consequences may be problematic adding an additional layer of complexity to the mechanics of governance. Whilst positivist agency theory is primarily concerned with the relationship between the board and the CEO (Eisenhardt 1989), focussing on aligning the behaviour in the first instance and implementing information systems to monitor behaviour in the second. The relationship between the board and the shareholders, however, is not so well examined.

It is equally important that the board is able to identify the preferences of the shareholders and act accordingly. It is the preferences of the shareholders that should determine the board's attitude to risk and, consequently, the CEO's appetite for risk in making risk based investment decisions. The agency theory approach has underpinned modern incentive payment remuneration which has most recently been criticised for lacking in governance, rather than providing a vehicle for it. As a governance tool agency theory requires that the board is the principal body which governs the chief executive. In the event that the board and the chief executive are in collusion agency theory fails because the shareholders collectively become the principal, as the line between board and CEO blurs, meaning that shareholders are not represented. Despite the independence of remuneration committees it is not uncommon for the chief executive and the chairman to work closely together. Importantly the two-strikes rule provides a feedback mechanism when shareholders conclude they have been failed by the traditional agency model approach.

The two-strikes rule may also provide opportunities for institutional investors holding more than 25% of the stock to exert pressure on the board, however, doing so would not come without its consequences as the disruption caused to the business due to a board spill is likely to be reflected negatively in the share price. Equally independent investors may be unable to take advantage of this new rule to make a statement where institutional investors choose to lobby the board in regard to remuneration instead of executing a no vote and effectively stifle any possibility of a no vote in order to protect the value of their equity holdings. Whilst the two-strikes rule is a regulatory change there is good reason to doubt that this will become a governance tool routinely executed by shareholders due to the damage such

an approach could inflict on the value of the stock. What it may well do is encourage improved governance practices by boards in managing the performance, incentives and remuneration of the executive team and other key management personnel.

In the adoption of an incentive scheme to motivate executive managers the Commission warns that the more remuneration put at risk, through either short term or long term incentives, the more likely it becomes that the executive will demand a risk premium further increasing the value of the incentives (2009, p. 99). This combined with the potential for executives to influence favourable hurdles, due to their superior knowledge, can turn an at risk incentive into an almost certain reward, even rewarding failure. Consequently boards need to exercise caution and skill in the careful crafting of incentive packages and the overall corporate governance of executive remuneration. It must be emphasised that the objective is to motivate the chief executive and the executive team to pursue the stated goals and objectives of the organisation with professional competence and an appropriate measure of risk. Subsequent to Productivity Commission report the Hon Chris Bowen MP requested that Corporations and Markets Advisory Committee Report Summary (CAMAC) consider how existing remuneration frameworks could be simplified or revised and to make recommendations on how to revise existing legislation to simplify the incentive component of executive remuneration. The scope of the report was limited to the executive and key personnel of entities subject to the financial reporting requirements of the Corporations Act (CAMAC 2011, p. 5).

In the introduction to the report CAMAC expressed the view that individual companies are best placed to determine the remuneration policies and governance that should apply to their executive and key management personnel. The notion that companies should not be bound by regulation and should be free to manage remuneration practice as they see fit is a continuing theme throughout the document. CAMAC's position is largely supported by submissions received from a group of interests during the review period. Even if there was value perceived in the regulation of remuneration in some form the effective application of regulation is problematic due to the differences between organisations, divergent goals and leadership behaviour. Combined these difficulties provide further justification for the management of executive remuneration through governance measures administered by the board of the respective company, rather than regulation.

CAMAC, was not in favour the current Corporations Act requirement to apply accounting standards to the preparation of the remuneration report. CAMAC argued that applying the same accounting standards as used in the financial report, of which the remuneration report is part, would likely confuse and mislead shareholders. Several submissions to CAMAC lobbied for removal of the requirement suggesting that the information was already available in the financial report. This is true, however, it should be noted that such amounts are recorded in the financial statements in the aggregate and would not identify which individual was the recipient. Whilst the report recommended that the requirement to apply accounting standards to the remuneration report be abolished it did recommend that the report should be independently audited for accuracy of calculations. One could be forgiven for concluding that an independent audit of a remuneration reports that includes an assessment of fair value for future vesting incentives is somewhat moot in the absence of an accounting standard.

Removing the requirement to apply accounting standards to the remuneration report would also make it more difficult and challenging to compare organisations as each would be entitled to adopt whatever valuation methodology it chose to value future vesting incentives and equities. It seems odd that future vesting investments adopted by the company and reporting using current accounting standards make good sense to investors but they would be confused by valuing similar financial instruments that apply to executive remuneration in the same way. The application of accounting standards to the remuneration report, or any other aspect of the annual report, provides a consistent and standard method of valuing a future benefit. Such valuation can then be employed, by shareholders, to compare the remuneration practices of other companies, and importantly, assess the value attributed to these benefits by the board in a way consistent with the valuation of other company investments and assets. Retaining this transparency in reporting would appear dependent on the maintenance of current regulation as the preference of many submissions to CAMAC was that the requirement be removed.

CAMAC suggest that companies should explain the link between executive incentives and company performance claiming that failure to do so may cause shareholders to question how the incentives work in their favour and vote against the remuneration report on that basis. This suggestion is

particularly poignant given the introduction of the two-strikes rule has already been exercised by some shareholders. Financial commentators have suggested that the rule is being used sensibly by shareholders and, in some cases, the organisation is taking notice (Frith 2011; McCrann 2011). Transurban, for example, faced the rejection of its remuneration report in the two years immediately prior to the introduction of the two-strikes rule. Since then the organisation has addressed the concerns of shareholders and redesigned their executive remuneration packages to place more emphasis on incentive rather than fixed pay and make better use of equity payments rather than cash. The result was a resounding vote of confidence in the new arrangements.

Transurban's new approach is in line with emerging trends in executive remuneration. The migration of fixed cash remuneration to short and long term incentive schemes has been growing in popularity over several decades, as has the future vesting of longer term incentives over several years. Whilst the merit of future vesting short and long term incentives is beyond the scope of this paper it is noteworthy that Transurban found these practices most acceptable to shareholders. More generally not only are longer averaging periods increasing in popularity but claw back provisions are more common and now feature in the board's suite of executive remuneration management tools.

Lindsay Maxsted, Chairman of Transurban, in his address at Transurban's AGM (Maxsted & Lynch 2011) spoke about the approach of Transurban's board in managing executive remuneration including the issues that contributed to two prior rejections of the remuneration report by shareholders. Whilst he argued that the previous approach to remuneration was sound he acknowledged that this was not the view of some shareholders to the extent that change was necessary. So significant was his concern regarding the acceptability of the remuneration report Maxsted included the following sentence; "It is the Board's hope that security holders take into account the Board's actions in implementing a new remuneration framework in their voting decisions today" (Maxsted & Lynch 2011, p. 5). Given the power of the two-strikes rule this is surely a sign of things to come.

Several companies have had their remuneration report voted down so far this AGM season. The common theme for all of these organisations is that generous incentive payments, or salary increases, were paid to senior executive teams that have either recorded a profit or loss on prior years or have failed to achieve the hurdles required for a bonus payment that was paid just the same (Frith 2011). Whilst these events are made possible by the legislative changes they are arguably driven by the corporate governance practices of these organisations. Shareholders of at least one organisation have made it clear that near enough (to the target) is not good enough when it comes to the payment of generous rewards to the chief executive. The value of robust and transparent corporate governance practices may be seen in the Transurban result, an outcome that will be reviewed closely by other organisations as they review their own approach to corporate governance and shareholder engagement.

The use of tools such as the balance scorecard approach to reporting and corporate governance may also enjoy a resurgence as boards consider the best methods through which to inform, engage, and earn the patronage of their shareholders. The attraction of a balanced scorecard approach is the inclusion of a range of measures beyond the typical financial suite of metrics. These measures may include environmental sustainability, reputation, employee satisfaction and safety among others. There is good reason to include such measures given the financial savings that may be derived through associated benefits including reduced energy consumption, improved staff attrition and a reduction in lost time injury rates. The financial objectives set must also be perceived as achievable dependent on the external conditions at the time. For example any competent executive should be able to create value for shareholders in a bull market. Creating shareholder value in a bear market, however, can be very difficult. A tool such as the Capital Asset Pricing Model could be applied in some circumstances to measure executive performance

Ideally a remuneration committee charged with determining the remuneration arrangements for senior executives, ultimately on behalf of shareholders, should be comprised of independent non-executive directors. Despite the prevailing wisdom it is not unknown for executive directors to participate in the deliberations of the remuneration committee. This changed, at least overtly, from July (2011) when the remuneration committee of every S&P/ASX300 company must be comprised solely of non-executive directors (CAMAC 2011). The intent of installing independent non-executive directors is to distance the remuneration committee from the influence of the chief executive and other senior

executives. The trade off is that independent directors are also less likely to have the information necessary to set effective remuneration targets and hurdles. An independent director is described as:

“An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement.”

(ASX Corporate Governance Council 2007, p. 16)

In a recent study Capezio, Shields & O'Donnell (2011), concluded that staffing the remuneration committee with independent directors does not necessarily improve outcomes. They argue that the value of a director's independence may well be offset by their ignorance of the business, as executive directors will possess a comprehensive knowledge of the business permitting a far better evaluation of performance hurdles. The lack of information available to the board may result in the board adopting outcome based evaluation measures which are easily monitored but lack a behavioural element in the assessment of executive performance. They suggest that the chief executive's remuneration may be better set by the executive team who have intimate knowledge of how the business may perform. On first assessment this may seem akin to putting the cat in charge of the cream, however, the behaviour of the executive should be tempered by the potential for industry critique and reputational damage if they were to act irresponsibly. Furthermore, the remuneration arrangements would attract the scrutiny of shareholders who now have the power to bring about change.

In regard to driving change shareholders have demonstrated a preparedness to vote down the remuneration report of the companies with which they are less than satisfied. The following is a list of the companies that have attracted a no vote against the remuneration report of greater than 25% as this paper goes to press sourced from The Australian (Frost 2011):

| Company | Votes Against |
|---------------------|----------------------|
| Crown Limited | 55% |
| Foster's Group | 42% |
| Globe International | 74% |
| GUD Holdings | 42% |
| Pacific Brands | 53% |
| Sirtex Medical | 33% |
| Tassal Group | 37% |
| UGL Limited | 30% |
| Watpac Limited | 34% |

The final word on the two-strikes rule is left to the respected fund manager John Sevier who said, as cited by Frost (2011, p. 30), in endorsement of the two-strikes rule: “It's not perfect, of course, but the more boards are forced to justify some quite absurd remuneration requests on open ground, the faster we will get to a position where fairness and objectivity are the main influences on remuneration policies.”

Section 3 – Conclusion

The value of corporate governance is that it offers a viable alternative to regulation. Effective corporate self governance may well demonstrate to shareholders and regulators that companies can manage executive remuneration in the best interest of all stakeholders and, in particular,

shareholders. Corporate governance is an especially effective self regulation approach where a strong link is demonstrated between the executive incentive structure and company performance.

Effective corporate governance relies on transparency rather than regulation. Regulation is likely to result in the application of inflexible remuneration frameworks that retard innovation in remuneration practices and prevent organisations from determining the most appropriate approach to remuneration based on the organisations objectives and industry. Strong governance frameworks founded on non-binding guidance and sound principles are demonstrably effective delivering responsible remuneration practices that overcome agency issues and influence the creation of value for shareholders in most cases.

Shareholders have immediate access to a variety of publically available and subscriber information services that provide detailed information about listed companies. It is common place for listed companies to maintain a shareholder or investor centre as part of an internet presence that provides information about the company and often an overview of strategic intent combined with both long term and short term goals. An assessment of these objectives, against company performance, would provide most shareholders with a view as to the effectiveness of incentives in influencing the decisions and performance of key managers in the company. As demonstrated by the events of the current AGM season shareholders are well informed about the remuneration practices of the companies in which they invest and are prepared to reject dubious behaviour in the expectation of future change. At this early stage voting down the remuneration report is still akin to a protest vote, however, given the potential future consequences it would be prudent for directors that have received one protest vote to respond in order to avoid a second.

Executive remuneration is the outcome of a complex decision making process (Capezio & Sheilds 2009). A process that the board should adequately explain to the shareholders it represents. The remuneration report provides all listed companies with the opportunity to inform shareholders about the corporate governance provisions maintained by the board, the rationale behind the remuneration structure and the linkages, if any, between performance and incentives. The effective use of the remuneration report to inform shareholders will be essential if the notion that boards struggle to fulfil their fiduciary responsibilities due to the influence of senior executives (Waring 2009) especially in respect to the payment of bonuses and incentives, is to be overcome.

Despite much public commentary suggesting that executive remuneration should be reined in the current trend is to avoid regulation as demonstrated by the recent Productivity Commission and CAMAC reports advocating self regulation through robust corporate governance rather than the implementation of additional regulation. The CAMAC report called for changes to relax the regulatory requirements that apply to remuneration reporting rather than to tighten regulation. Both of these reports commissioned by the federal government have avoided the introduction of new regulations that aim to control or regulate executive remuneration arrangements, rather they have sought to either provide better information to shareholders or provide shareholders with opportunities to provide direct and consequential feedback through mechanisms such as the 'two-strikes' rule. In addition both reports have considered the cost of placing additional reporting burdens on listed companies and have sought to minimise the cost of compliance, in some cases, by recommending a reduction in current regulatory requirements for remuneration reporting.

Whilst there is a trend against the introduction of more regulation there remains considerable body of regulation under a range of instruments that pertains to listed organisations with an additional array of requirements which apply to financial institutions. Risk professionals must remain informed of these requirements and regulations and the associated risks with which the organisation is exposed. Arguably there is a growing need for corporate risk professionals to be actively engaged in assisting the board to identify and mitigate commercial and operational risk associated with both the design of executive remuneration and the governance of executive remuneration practices.

In the absence of regulation corporate governance will continue as the principal mechanism through which executive remuneration is reviewed and controlled. Organisations that maintain robust and effective corporate governance disciplines will be most likely to ensure that executive remuneration is commensurate with organisational performance and shareholders expectations.

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