HaRe Group newsletter: 25 February 2010

Subject: GFC keeps talent engaged

To help retain their best people, market leaders recognise & reward good performance; **G**oal **F**ocused **C**ompensation should be a key element in your talent management plan – but what is the right approach this year?

After a tumultuous 2009, there are many employers still wondering what's been going on with market rates and performance-based pay. While market surveys prove that base pay rates have barely slowed, some companies have frozen salaries, some have shelved their incentive plans, a few have done both; what action is best in 2010? What will be necessary to keep your best people engaged?

In recent newsletters, I've underlined the importance of keeping your base pay management on track; but variable performance-based pay is also critical in a competitive economy.

In most organisations, financial incentives work because they keep employees focused on what's needed for success. However, the machinations of Government have changed the course of long term incentives – executive market practice has lost the pace of an Olympic downhill race; it's now more like a slalom course with the intervention of:

- new tax legislation on share and option plans;
- the Productivity Commission inquiry into executive remuneration,
- the Board of Taxation's review into the taxation of employee share schemes, and
- the impact of the Henry Tax Review on the upcoming Federal Budget.

Most stakeholders will appreciate regulations that stimulate good corporate governance (eg. independence of remuneration committees); but happily for employers, the Productivity Commission has found that "***remuneration structures are company and context-specific and a matter for boards to resolve***...".

The Commission has also found that current legislation may impede the longer term focus of senior executives; for example, the Commission has recommended that the Government should "***remove the cessation of employment trigger for taxation of equity or rights***..." – if this trigger stays, then there is a case to suggest that a CEO could make short-sighted decisions if s/he is in late tenure or planning an early departure.

Amongst the recent legislative changes, the deferred taxing point (date) is frequently criticised, especially in companies with low trading liquidity. For example, when share options have vested – eg. when performance hurdles have been cleared and there is no risk of forfeiture – an employee is liable to pay tax on the options, even though the right to equity has not been exercised.

Alternatively, a Performance Unit Plan (PUP) may provide a more favourable tax treatment. In particular circumstances – including a genuine restriction on unit disposal after vesting – the taxing point may be later than the vesting date. (Please note: any PUP design should be validated by a specialist tax adviser).

Despite the interventions of legislation and regulation, every employer should sustain a reward strategy that reflects business strategy. Your base & variable pay objectives should be the drivers of market alignment and reward system design – of course, your employees should know this and see the evidence for maximum impact on talent retention.

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