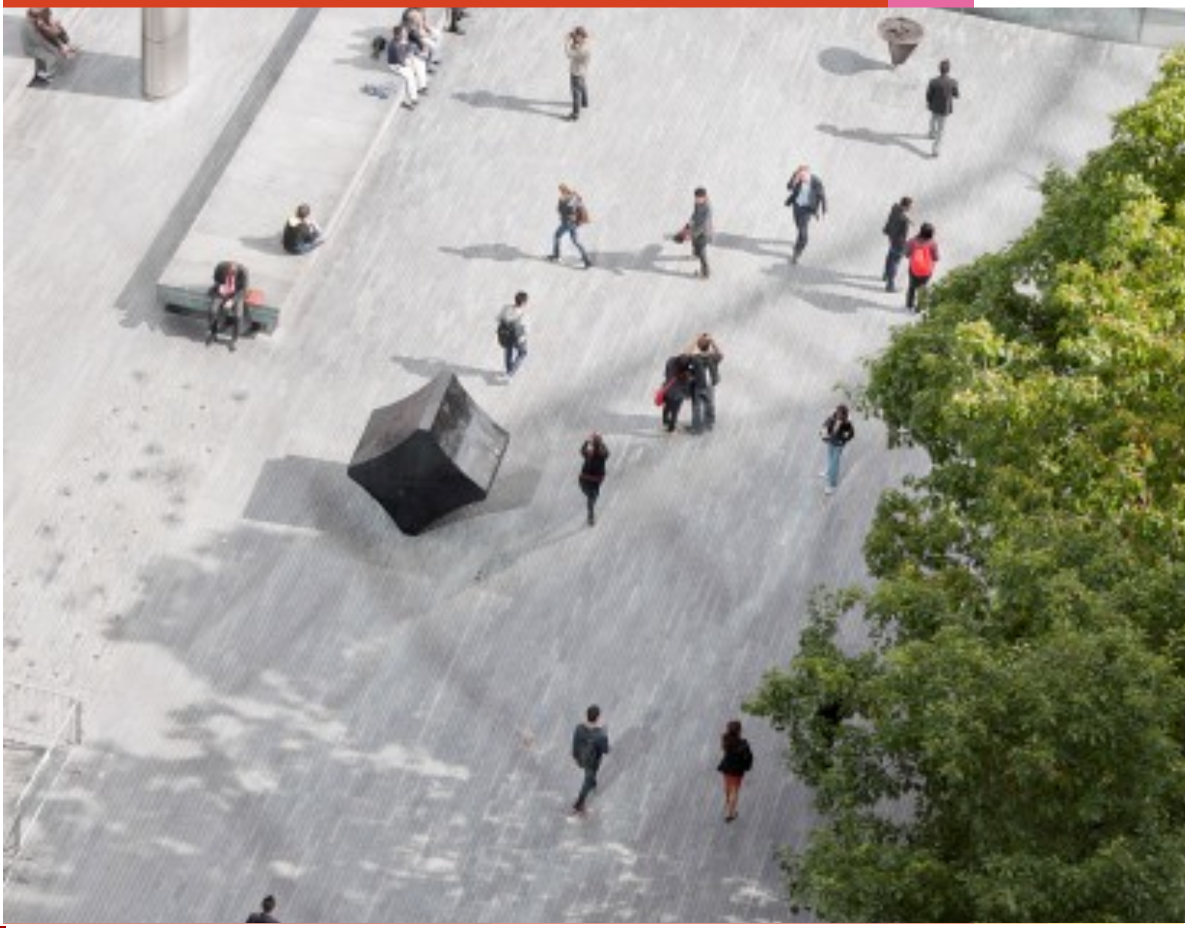
Streamlining Remuneration Reporting

December 2016



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Executive remuneration is an emotive topic. Each reporting season there is intense public scrutiny of executive remuneration, as investors and other stakeholders look for assurance that executive pay practices are driving sustainable shareholder value. The introduction of the 'two strikes' rule has provided a strong incentive for companies to ensure they are communicating their remuneration practices clearly to their investors.

Remuneration strategies vary over time and between companies. Some entities focus purely on financial performance whereas others put more emphasis on intangible measures like customer satisfaction, employee morale, and health and safety. Strategies also vary in the types of instruments used, like options or direct shareholdings. The lines between short-term and long-term benefits are becoming increasingly blurred and the focus is shifting to understanding what remuneration is 'at risk' versus what is fixed, but deferred. Reporting of remuneration needs to adequately reflect these changing trends.

Companies and the readers of their remuneration report therefore have a common interest: the clear communication of remuneration practices. Yet there is a consensus that remuneration reports remain unwieldy and ineffective, and that this is driven, at least in part, by the current regulatory requirements.

Why is change needed?

Remuneration reports make up approximately 14% of the length of annual reports, with an average length of 21 pages. Users complain that reports are 'impenetrable', with information based on technical accounting rules contained in an array of tables and footnotes – as many as a hundred footnotes in some cases.

Boards and report preparers struggle to clearly explain the links between pay and performance while meeting detailed and often repetitive disclosure requirements. Consequently, more and more companies are including additional information in the form of a Chairman's letter or a summary, in addition to the 'required' information.

This paper is intended to spark a dialogue on achieving a workable solution to the problem of impenetrable reports on the basis that all stakeholders – companies, investors, the public and others – agree change is required. PwC has worked with Cochlear Limited and the Group of 100 to create a real-life example of what a more streamlined remuneration report could look like. Here, we set out:

- issues with the current requirements and how these could be resolved; and
- an illustrative report – based on the actual 2015 Cochlear Limited remuneration report – which demonstrates how companies could more effectively communicate their remuneration practices if our recommendations were implemented. This is not intended to be a definitive model but simply an example of a report that we consider could provide useful information to investors in an accessible way.

In creating our illustrative remuneration report, we've examined a number of approaches to content, measurement and presentation. While we've chosen a particular approach in the illustrative report, there are several potential approaches that could be taken depending on a company's specific remuneration framework and their perspective on what information is of most relevance to their investors.

Rationalising reporting requirements

Much of the complexity in remuneration reports is driven by the detailed requirements in s300A of the *Corporations Act 2001* (the Act) and its related regulations. Rationalising these requirements could substantially improve reporting practices in Australia, resulting in more useful information for investors while reducing the cost of compliance.

The requirements came into force several years ago before corporate governance frameworks, such as the ASX's *Corporate Governance Principles and Recommendations*, and accounting rules for share-based payments were developed. As the corporate reporting environment has advanced, many of the provisions in the Act and the regulations have been superseded or now overlap other reporting requirements.

We set out our key proposals for rationalisation in the pages below.

Regina Fikkers
Partner, PwC

Zlatko Todorcevski
President, Group of 100

Consider the reporting context and provide flexibility

There should be a stronger focus on the disclosure objectives of the remuneration report instead of mandated lists of disclosures that may or may not be relevant in the context of the particular entity. Integration of reports could also be made easier by allowing companies to cross reference related information contained elsewhere in the annual report; for example, information on strategy and performance that is already contained in the operating and financial review (OFR). Information that changes little from year to year, such as the governance framework and operation of the company's remuneration committee, could be provided on the company's website instead of in the remuneration report.

Examples of current requirements:

- An important disclosure is the link between company performance and executive pay, and companies and analysts agree that it should be retained. However, the output could be improved. In particular, the specified measures of performance which must currently be disclosed for the past five years are often not the performance measures being used to determine incentive payments. The defined measures should be removed and companies should instead be required to disclose the measures they actually use. If, for example, customer satisfaction is a key driver of remuneration, then the measure of customer satisfaction should be disclosed and how it links to the pay received should be clear. The strategic and market context for this discussion is usually provided in some detail in the OFR. Linking the remuneration report and the relevant sections of the OFR may also help readers understand that context.
- The regulations require disclosure of the name, position and dates the position was held for each of the key management personnel (KMP). Most companies already provide this information in the directors' report.
- The remuneration report must describe the company's policy for determining the nature and amount of remuneration. When this disclosure covers static information such as the overall remuneration framework and operation of the remuneration committee, companies should be able to link to their corporate governance statement, which already contains this information. A remuneration report that focused on proposed or agreed changes to the remuneration framework and explained the current strategy would be more relevant for users.
- Under the current rules, companies must explain how the terms of the service contracts will affect future remuneration. Yet there is no requirement to disclose planned or agreed changes to the company's remuneration strategy for future periods. The specific disclosure requirement should be replaced with an overall objective to provide sufficient information so readers can assess the impact of such changes on future remuneration levels.

Our proposal: Allow flexible presentation by focusing on the objective of the disclosure rather than prescribing the disclosure of details that may or may not satisfy the objective. Allow information to be 'included' by cross referencing other sections of the annual report, and provide companies with the ability to post certain 'standing' information online.

Remove repetition

The financial report now contains a number of disclosures relating to share-based payments, transactions with KMPs and employee benefits. This overlap between disclosures in the financial report and those in the remuneration report results in duplication and, in some cases, inconsistency. The remuneration report requirements have also been added to in a piecemeal fashion, often as a result of legislators responding to requests for more information by particular stakeholder groups. Very few requirements have been removed, however, which means there is duplication even within the Act and the regulations themselves.

Examples of current requirements:

- Information about the terms and conditions of share-based payment schemes must already be provided in the notes to the financial statements under AASB 2 *Share-based Payment*. The same information is required in section 300A and also in three different places in the regulations.
- The regulations require disclosure of details of any loans to, and other transactions with, KMPs. This information must also be included in the financial report. While the financial report disclosures do not specifically require any individuals to be identified, we believe the general principles of materiality are sufficient to ensure relevant information is provided where necessary.

Our proposal: Delete regulations that duplicate requirements of accounting standards or other regulations.

Reduce detail

Some requirements of the regulations are unduly prescriptive and require information that is often not relevant or useful for investors. While the principles or headline numbers may be useful, detailed reconciliations or detailed information about calculation methodologies are not.

Examples of current requirements:

The regulations require:

- a detailed breakdown of remuneration for each KMP. This includes a requirement to separately disclose salary, cash bonus, non-monetary benefits received, contributions made to superannuation funds and leave obligations accrued. We think it would be simpler and more relevant to separately disclose fixed pay and variable pay (i.e. performance-based) amounts rather than the detailed accounting-based categories that are currently required;
- extensive information about equity holdings by KMPs, including reconciliations of holdings that have been granted, exercised and vested during the period. This could be rationalised to simply require disclosure of equity holdings as at the beginning and end of the year, together with an explanation of material changes during the financial year;
- detailed information about the fair value of options or rights granted, the exercise price payable, grant dates, and vesting and expiry dates. We believe this can be done more succinctly and a general description of the terms and conditions of each incentive scheme would be sufficient. Some of the information must also be provided in the notes to the financial statements and, as mentioned, such repetition should be avoided;
- disclosure of loans made to, and transactions with, individual KMP. This duplicates the requirements of accounting standard AASB 124 *Related Party Transactions*. Although the standard does not generally require each KMP to be separately identified, we think the requirements of AASB 124 are sufficient to ensure relevant information is provided, while at the same time avoiding the disclosure of immaterial information; and
- extensive information about remuneration consultants where they have made remuneration recommendations to the company. While investors and other stakeholders want to know whether external remuneration consultants have been engaged, our discussions with investors tell us it would be sufficient to disclose this fact, the name of the consultant and the amounts paid for any advice received.

Our proposal: Reconsider the volume of detailed information that's required by users of the report in light of the overriding objectives of the disclosure. Keep in mind that too much unnecessary information can clutter or obscure the information that is of use and relevance to report users.

Different perspectives on measurement of remuneration

Under the existing requirements, remuneration is measured using the rules contained in accounting standards. This approach has the benefits of providing a consistent picture of the 'cost to the company' of its remuneration arrangements, allowing comparability between companies and providing a framework within which the information can be audited.

Many companies, however, share a perspective that the complexity of the accounting rules can confuse users of the report. This is particularly the case where there are complex share-based payments and expenses are spread over a number of years. In their view, shareholders and other stakeholders want to understand the actual remuneration outcomes, being the remuneration that the executives have become entitled to during the year (i.e. their 'current' or vested pay) and their entitlement to future remuneration. As a result, a large number of companies provide 'voluntary' disclosure of 'actual remuneration outcomes', adding to the volume of disclosure in the remuneration report.

There are mixed views regarding the benefits of alternative remuneration disclosure and whether these are providing a better indication of the benefits received than the accounting expenses. However, having two different sets of numbers is confusing for investors and other stakeholders, particularly where the alternative remuneration measures are not defined and hence not comparable between companies.

We note that the UK uses a 'vested pay' approach to remuneration rather than disclosing accounting expenses. The UK rules are prescriptive about how the disclosed amounts must be calculated and performance-based incentives are included only when the performance conditions are met, or substantially met. The UK has gone through a thorough consultation process in developing their remuneration requirements and the experience and feedback to date has been positive.

Our proposal: The regulation should prescribe a standard measure of remuneration which is most useful to investors. The provision of alternative remuneration tables suggests there may be a better way to meet investor needs. We suggest consultation with preparers and investors to consider a pragmatic solution.

In our illustrative report, we've presented additional information about remuneration outcomes in Table 4 and information on future remuneration opportunities in Table 5.

This type of information, or that provided in the UK, may be more helpful to investors than the current statutory tables.

Possible quick wins to reduce red tape

Some of our proposals will need to be discussed and will take time to further develop. However, it is possible to simplify the existing requirements without substantially changing the current disclosures.

This could be achieved by removing all of the detailed disclosure requirements from section 300A of the Corporations Act. This section should merely provide the legal basis for the inclusion of a remuneration report in the directors' report and prescribe which entities are affected. If the requirements are not already covered in the Regulations, they could be added in the first instance. However, as many requirements are duplicated, we would expect only minimal changes to the Regulations.

Other quick wins could be the removal of overlapping requirements from the Regulations, and giving permission to satisfy disclosure requirements by cross-referencing other parts of the financial report and the corporate governance statement.

Comparison to current requirements

Current regulations require considerably more information than would be required in our proposals. Cochlear's remuneration report for 2015 was 25 pages long. We've shown that this could be reduced to 13 pages if the reporting requirements were streamlined in the way we've illustrated below.

Acknowledgement

We would like to thank the following people for sharing their time and views with us during the research, though acknowledge that all viewpoints contained in this publication are those of PwC and the G100:

- Neville Mitchell, Lyndal York and the team at Cochlear Limited
- Pru Bennett, BlackRock
- Martin Lawrence, Ownership Matters
- Ed John, Australian Council of Superannuation Investors
- Vas Kolesnikoff, ISS
- Andrew Fitzgerald, BHPBilliton
- Aaron Bertinetti, Glass Lewis
- Emma Grogan, Andrew Curcio and Cassandra Fung from PwC's Reward and Performance Consulting team
- Margot Le Bars and Meina Rose from PwC's Accounting Advisory team, co-authors of this publication.

The illustrative Cochlear remuneration report divides remuneration information into two sections: the Summary report and Supplementary information.

Summary report

This gives investors and other readers a snapshot of what remuneration was paid and how it relates to company performance. It contains two elements.

Overview of remuneration framework and link to performance, which provides an overview of the remuneration policies, including how the entity's strategic priorities have been reflected in the key performance measures, pay mix, and any changes to incentive schemes that were implemented during the year or which are planned for the coming year.

Remuneration tables, which show a summary of remuneration expenses recognised in relation to each KMP for the current financial year. These list separately fixed remuneration and variable remuneration, including amounts expensed for each of the incentive plans.

In addition, this section also shows:

- vested remuneration, being remuneration that the KMP became entitled to during the current year and that was either paid during the year or will be paid subsequent to the end of the year ('current pay'), including the intrinsic value of vested equity instruments;
- unvested awards which may vest in future periods, subject to the satisfaction of performance hurdles ('future pay'); and
- equity holdings and distributions received.

Supplementary information

This provides further information about:

- elements of remuneration, including a summary of the incentive schemes and performance conditions;
- how remuneration values are calculated;
- major contractual terms, in summary form; and
- remuneration policies for non-executive directors.

We recommend that companies have the flexibility to provide the supplementary information online. This would reduce the bulk of the remuneration report – while still providing critical information in the annual report – and also enable companies to deliver information in a flexible format.

Illustrative Remuneration Report of the future

Cochlear Limited
30 June 2015

In the spirit of innovation, Cochlear Limited have kindly allowed the use of their 30 June 2015 Remuneration Report as a base for illustrating what a remuneration report could look like in the future based on proposed ideas for changing the legislation. This is not intended to comply with all current requirements, but to aid the question: 'Is this information enough for users?'

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1 Summary report

1.1 Key management personnel

Cochlear's key management personnel (KMP) include the non-executive directors, the executive director and other senior executives named in this report (see page xx for details).

1.2 Remuneration framework and link to performance

1.2.1 Our remuneration framework

Cochlear's remuneration strategy is approved by the Board, following recommendations from the Human Resources Committee (HRC). The role of the HRC is set out in its charter, which is reviewed annually. The HRC terms of reference can be viewed in the Investor Centre, Corporate Governance section of the Cochlear website, www.cochlear.com. Further details about the role and operation of the HRC and the use of external remuneration consultants are included in our Remuneration Policy [provide link].

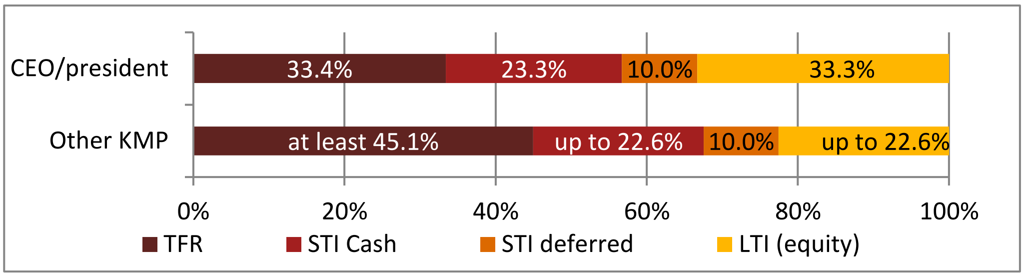
Cochlear's remuneration objectives			
Attract, motivate and retain executive talent	The creation of reward differentiation to drive performance values and behaviours	An appropriate balance of fixed and at risk components	Shareholder value creation through equity

Table 1 Executive remuneration framework

	Fixed remuneration (TFR)	Variable remuneration (Cash and deferred STI)	Variable remuneration (LTI)
Determination	TFR is set based on relevant market relativities, reflecting responsibilities, performance, qualifications, experience and geographic location	STI performance criteria are set by reference to Cochlear group and/or regional revenue and EBIT and individual performance targets relevant to the specific position	LTI targets are linked to both Cochlear group internal EPS growth and external relative TSR outperformance measures
Delivery	Base salary plus any fixed elements related to local markets, including superannuation or equivalents	Part cash and part equity (performance rights). The equity component will be subject to service and deferred for 2 years.	Equity in options and/or performance rights. All equity is held subject to service and performance for 3 years from grant date. The equity is at risk until vesting. Performance is tested once at the vesting date.
Strategic intent and market positioning	TFR will generally be positioned at the median compared to relevant market based data considering expertise and performance in the role.	Performance incentive is directed to achieving Board approved targets, reflective of market circumstances. TFR & STI is intended to be positioned in the 3rd quartile of the relevant benchmark comparisons.	LTI is intended to reward executive KMP for sustainable long-term growth aligned to shareholders' interests. LTI allocation values are intended to be positioned at the top of the 3rd quartile of the relevant benchmark comparisons.

	Fixed remuneration (TFR)	Variable remuneration (Cash and deferred STI)	Variable remuneration (LTI)

Total target mix:



Total target remuneration (TTR)	Set by reference to the relevant geographic market. Intended to be positioned in the 3rd quartile compared to relevant market benchmark comparisons. 4th quartile TTR may result if outperformance is achieved.
Changes for 2016	No changes will be made for 2016, STI and LTI plans are to be reviewed in 2016.

Cochlear's performance hurdles, particularly for the LTI, are at the higher end of the market (S&P/ASX 100 companies) in terms of degree of difficulty. Any LTI award will only have value to the executive if the performance hurdles are met to enable vesting to occur, and for option related awards, if the share price on vesting exceeds the exercise price.

In the event of serious misconduct or a material misstatement in the company's financial statements, the HRC can cancel or defer performance-based remuneration and may also claw back performance-based remuneration paid in previous financial years.

The information disclosed in section 1.2.2 is not currently required. However, we think it provides a better explanation of the link between remuneration and performance than what is currently mandatory under CA 300A(1)(b), (1AA) and (1AB).

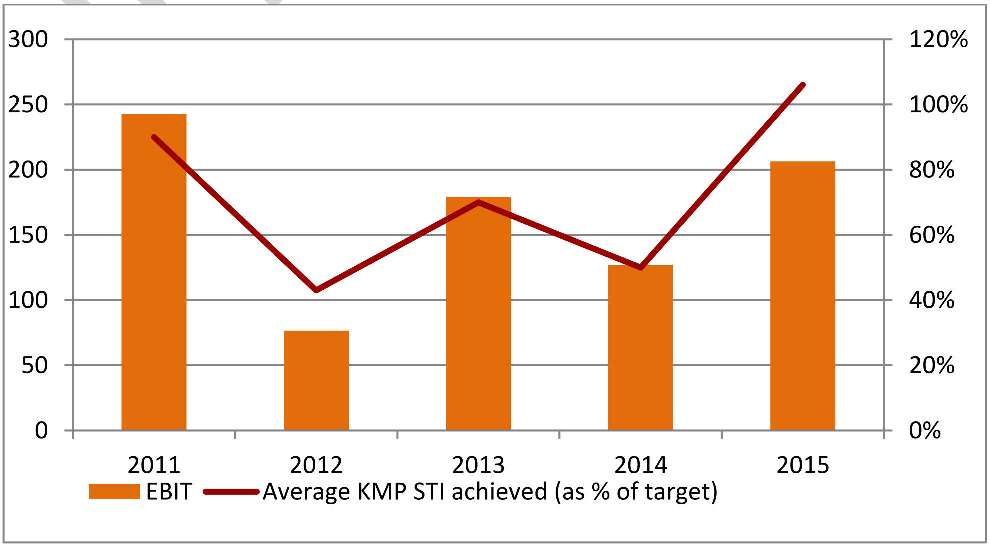
Some companies may choose to provide more detailed information; for example, specific financial and non-financial KPIs by individual KMP. Other graphs could also be included to show EPS and relative TSR rankings over the previous x years. However, this should be a matter for each company to decide.

1.2.2 F15 performance and impact on remuneration

Cochlear sales revenue grew 15% year on year. This was driven by new product launches combined with investments in market growth initiatives. Earnings per share in F15 of 256.1 cents were 56% above that for F14. This is reflected in the STI and LTI outcomes as set out below.

Graph 1 below shows the link between EBIT and the average STI awarded as a % of the target STI and table 2 shows how EPS and TSR performance has affected the vesting outcomes for options and performance rights granted under the LTI scheme. Information about STI and LTI vesting by individual is provided in table 4 below.

Graph 1: EBIT and average KMP STI achieved as % of target



F15 STI payments are higher than those paid in F14 for the KMP due to the fact that last year payments reflected lower than target performance and this year payments reflect outperformance against targets. The increases are the result of:

- strong business performance with sales revenue growth of 15%, EBIT growth of 62% and accomplishment of individual outcomes to support long-term growth resulting in payments within a range between 97.9% and 120.0% of target; and
- currency fluctuations for KMP that receive remuneration in a foreign currency.

Table 2 Vesting outcomes for LTI options and performance shares granted F11 to F13

Grant date	Vesting timeframe [1]	EPS 3 year CAGR [2]	Vested [3]	For-feited	Relative 3 year TSR ranking percentile	Vested [3]	For-feited
16 Aug 2010	Vested June 2013	-5.5%	0%	100%	28th	0%	100%
15 Aug 2011	Vested June 2014	-19.7%	0%	100%	32nd	0%	100%
13 Aug 2012	Vested June 2015 [4]	36.8%	100%	0%	38th	0%	100%

For the instruments that vested during the year, the market price of the performance rights at the date of vesting was $80.15 and the net market value of the options was $17.37.

1. While the vesting period ends on 30 June of each year, participants are not able to exercise any awards until the Board approves the opening of the first trading window under the Cochlear Trading Policy (typically immediately following the Cochlear full-year results announcement).
2. Compound annual growth rate.
3. All plan participants had the same vesting and forfeiture percentage outcome.
4. The performance hurdles for the LTI plans are considered demanding such that this is the first time in the last three years that the plan has provided executives with an award.

1.2.3 Maintaining sustainable performance – future approach

Cochlear's approach to STI and LTI performance hurdles will remain largely unchanged in F16, but Cochlear intends to conduct a review of the structure of its STI and LTI plans during F16.

Where applicable, this section (ie. 1.2.3) should explain future changes that the company intends to make to the remuneration framework and structure, and the rationale for those changes. This will allow readers to assess the likely levels of remuneration in future years.

There is currently no explicit requirement to provide this type of information, other than a requirement to disclose how the terms of service contracts affect remuneration in future periods (CR2M.3.03(1) item 13).

1.3 *Remuneration tables*

For explanations on how the amounts disclosed in tables 3, 4 and 5 are calculated please refer to section 2.3 below.

1.3.1 Statutory remuneration expense

Table 3 shows the amounts recognised as expense, determined in accordance with the accounting standards.

Table 3 Remuneration expensed during the period

	F2015							F2014	
KMP	**Fixed remune-ration**	**STI cash**	**STI deferred**	**LTI**	**Once-off pay-ments**	**Total F15**	**Perfor-mance related %**	**Total**	**Perfor-mance related %**
Chris Roberts	1,482,161	1,338,462	518,549	1,055,244	1,548,418	5,942,834	49%	2,853,452	49.5
Richard Brook			(the individual remuneration of each KMP would be included here)						
Dig Howitt									
Jan Janssen									
Neville Mitchell									
Mark Salmon									
Chris Smith									
Total executives	4,938,778	3,074,726	755,240	2,262,596	1,548,418	12,579,758	48.4	8,048,849	42.0
Rick Holliday-Smith	456,783					456,783	-	455,775	-
Yasmin Allen									
Glen Boreham									
Paul Bell									
Edward Byrne									
Alison Deans									
Andrew Denver									
Donal O'Dwyer									
Non-executive directors	1,528,625	-	-	-	-	1,528,625	-	1,480,575	-
Total remune-ration	6,467,403	3,074,726	755,240	2,262,596	1,548,418	14,108,383		9,529,424	

The table above discloses accounting expense, but not broken down into the categories currently prescribed in the Regulations. Rather, we have focused on the difference between fixed and variable remuneration and once-off payments.

We have not disclosed full comparatives but only the aggregate compensation for each KMP for the prior period. We think this will provide sufficient context to users.

1.3.2 *Alternative disclosures: current and future pay*

Table 4 shows the vested remuneration, being remuneration that the KMP became entitled to during the current year and that was either paid during the year or will be paid subsequent to the end of the year ("current pay"). Table 5 shows unvested awards (deferred STI shares, LTI options and performance shares) which may vest in future periods, subject to the satisfaction of performance hurdles ("future pay").

There are different views as to what type of information should be disclosed in alternative remuneration tables and how the relevant amounts should be determined.

We suggest showing (i) the value of benefits received during the year by the KMP ("current pay") and (ii) the value of benefits that may be received in future years, subject to the satisfaction of performance conditions (if any).

Table 4 Remuneration vested during the period

KMP	Fixed remune-ration	Cash STI payable	STI as % of target	Once-off pay-ments	Total cash	Intrinsic value of vested deferred STI	Intrinsic value of vested LTI	Actual remune-ration received
Chris Roberts [1]	1,482,161	1,338,462	120%	1,548,418	4,369,041	-	-	4,369,041
Richard Brook								
Dig Howitt								
Jan Janssen								
Neville Mitchell								
Mark Salmon								
Chris Smith								
Total executives								
Non-executive directors								
Total remuneration								

1. On 26 May 2015, the Company announced that Dr Roberts would be stepping down as CEO/President on 31 August 2015. In keeping with the terms of Dr Roberts' executive service contract entered into on 1 February 2004, Dr Roberts is entitled to an end of service payment of $137,617 in statutory entitlements and $1,410,801 in accordance with Cochlear's contractual obligations. In line with IFRS, these were accrued at 30 June 2015 and will be paid on 31 August 2015.

Table 5 Future remuneration opportunities

The question is how much detail is needed about remuneration yet to vest from prior years. Here we have opted for a succinct summary providing greater focus on the total.

KMP	Type	Conditions	Number	Years to vest/pay	Intrinsic value to vest
Chris Roberts [1]	STI – deferred perform. rights	Continuing service	2,781	2018	222,897
	LTI – options	EPS and TSR	414,955	2016-2018	7,305,546
	LTI – perform. rights	EPS and TSR	11,821	2016-2018	947,453
Richard Brook					
Dig Howitt					
Jan Janssen					
Neville Mitchell					
Mark Salmon [2]	LTI perform. shares	EPS and TSR	8,016	June 2015	642,482
Chris Smith					

1. The Board plans to use its discretion to permit Dr Roberts to retain 123,023 options from the 2013 CEIP and 2,781 performance rights from the 2013 CEIP (STI Deferral) subject to existing performance hurdles and timeframes. Existing awards from the 2014 CEIP LTI grant will be forfeited when Dr Roberts departs on 31 August 2015.

2. The Board used its discretion to permit Mr Salmon to retain 8,016 performance shares in the 2012 CELTIP subject to existing performance hurdles and timeframes. Existing awards from the 2013 CEIP were forfeited.

Table 6 Equity holdings and distributions received

Table 6 shows a reconciliation of all equity interests held by the KMP at the beginning and end of the period, reflecting the overall exposure of each KMP to the company's performance and share value. It also shows the amount of distributions received during the period. Options and performance rights include vested and unvested instruments. Other changes show forfeiture of rights or options and net purchases/sales of shares by the KMP.

Disclosure of distributions received is not currently required. However, investors have said they find this information useful.

While we have illustrated forfeitures net with sales/purchases we understand some investors may prefer to split out forfeitures.

KMP	Type	Held at 1 July 2014	Granted during year	Exer-cised	Other changes	Held 30 June 2015	Divi-dends
Chris Roberts	Options	471,804	60,771	-	(117,620)	414,955	-
	Perf. rights	-	14,602	-	-	14,602	-
	Perf. shares	719,803	-	-	(108,534)	611,269	Xx,xxx
Richard Brook							
Dig Howitt							
Jan Janssen							
Neville Mitchell							
Mark Salmon							
Chris Smith							
Rick Holliday-Smith	Ordinary shares	9,250	-	-	-	9,250	xx
Yasmin Allen							
Glen Boreham							
Paul Bell							
…							

2 Supplementary information

2.1 Executive remuneration components

2.1.1 Total fixed remuneration

Total fixed remuneration (TFR) includes all remuneration and benefits paid to executive KMP calculated on a total employment cost basis.

In addition to base salary, selected overseas executives receive benefits that may include health insurance, car allowances and relocation allowances. Retirement benefits are generally paid in line with local legislation and practice.

Executive KMP TFR is tested regularly for market competitiveness by reference to appropriate independent and externally sourced comparable benchmark information, including for comparable ASX listed companies, and based on a range of size criteria including market capitalisation, taking into account an executive's responsibilities, performance, qualifications, experience and geographic location.

Job evaluation methodologies are applied to assist with managing internal relativities.

TFR adjustments, if any, are made with reference to individual performance, an increase in job role or responsibility, and changing market circumstances as reflected through independent benchmark assessments or promotion.

Any adjustments to executive KMP remuneration are approved by the Board, based on HRC and CEO/President recommendations

2.1.2 Short-term incentives

<table>
<tr><th>Feature</th><th colspan="3">Description</th></tr>
<tr><td>Purpose and approval</td><td colspan="3">The STI arrangements at Cochlear are designed to reward executives for the achievement against annual performance targets set by the Board at the beginning of the performance period. The STI program is reviewed annually by the HRC and approved by the Board.

Any STI award in excess of the 100% budget opportunity is individually approved by the HRC. All STI awards to the CEO/President and other executive KMP are approved by the HRC and Board.</td></tr>
<tr><td rowspan="3">Performance targets</td><th>Peformance indicator</th><th>Weighting</th><th>Description</th></tr>
<tr><td>Sales revenue and EBIT</td><td>80%</td><td>For the current year, sales revenue and EBIT targets had equal weighting. The weighting between Cochlear group and regional sales revenue and EBIT will depend on the responsibilities and scope of influence of the individual executive KMP.

Financial targets are set by the Board having regard to prior year performance, global market conditions, competitive environment, future prospects and the Board approved budgets.</td></tr>
<tr><td>Individual performance goals</td><td>20%</td><td>These are based on a range of individual performance objectives including strategic objectives determined each year.</td></tr>
<tr><td>Delivery</td><td colspan="3">For KMP, Cochlear has a policy of mandatory deferral of a portion of the STI in the form of performance rights with a 2 year vesting period. This is intended to reinforce alignment with shareholder interests. The deferred STI component related to F14 was granted in August 2014.

For 2015, 77% of the total STI amount awarded will be paid in cash and 23% will be deferred.

The equity component will be independently determined based on the gross contract value using Cochlear's five day volume weighted average price following the announcement of full year results in August 2015, that is, based on a Black-Scholes-Merton pricing model without discounting for service or performance hurdles.

Once the STI awarded as performance rights has been granted, there are no further performance measures attached to the performance rights other than continued tenure for the vesting period (two years).</td></tr>
</table>

2.1.3 Long-term incentives

Feature	Description
Types of equity awarded	LTI up to F13 was provided under the Cochlear Executive Long Term Incentive Plan (CELTIP). The Cochlear Executive Incentive Plan (CEIP) was introduced in July 2013. Under the CEIP, selected senior executives are offered options (being an option at a pre-set exercise price to acquire ordinary shares of Cochlear Limited) or performance rights (being a nil exercise price right to fully paid ordinary shares of Cochlear Limited) or a combination of both.
Time of grant	All equity grants will be made after the AGM each year but based on values determined in the preceding August.
Time restrictions	Equity grants awarded to the executive KMP are tested against the performance hurdles set, at the end of three financial years. If the performance hurdles are not met at the vesting date, options or performance rights lapse. For awards granted prior to F14, options expire two years after the vesting date if they have not been exercised. For awards granted inF14 and onwards, options expire seven months after the vesting date if they have not been exercised.
Peformance hurdles and vesting schedule	Equity grants to the executive KMP are in two equal tranches assigned 50% to compound annual growth in EPS and 50% subject to ranking of TSR against the S&P/ASX 100. The performance conditions applying to the latest grant (F15) were as follows:

Compound annual growth in EPS (3 years)		**Ranking of TSR against S&P/ASX 100 (3 years)**	
Performance	**% of equity to vest**	**Performance**	**% of equity to vest**
< 1-%	0 %	< 50^{th} percentile	0%
10% to 20%	50% to 100% pro rata	50^{th} to 75^{th} percentile	40% to 100% pro rata
20%	100%	75^{th} percentile	100%

Feature	Description
	Options and performance rights vest if the time restrictions and relevant performance hurdles are met. The Board must approve any special provisions, in accordance with Company policies, in the event of termination of employment or a change of control.
Dividends	No dividends are attached to options or performance rights.
Voting rights	There are no voting rights attached to options or performance rights.
Retesting	There is no retesting of performance hurdles under Cochlear LTI.
LTI Allocation	The size of individual LTI grants for the CEO/President and other executive KMP is determined in accordance with the Board approved remuneration strategy mix, see table 1 above. The target LTI dollar value for each executive is converted to options and/or performance rights according to LTI allocation values independently determined based on the gross contract value of the relevant equity instrument and based on a Black-Scholes-Merton pricing model without discounting for service or EPS and TSR performance hurdles. Details about the inputs used in the valuation of the options and performance rights are provided in note 4.2 of the financial statements.

2.2 *How values are calculated*

2.2.1 *Remuneration expense (table 3)*

Overall remuneration

The amounts disclosed in table 3 reflect the expenses recognised in relation to each KMP for the reporting period. Their values have been determined as follows.

Fixed remuneration

Fixed remuneration includes cash salaries, the taxable value of non-monetary benefits received, movements in the provisions for annual and long service leave and contributions to superannuation plans.

Short-term incentives

- The cash STI benefits represent the bonuses that were awarded to each KMP in relation to F15 and which were paid in February and will be paid in August 2015. This does not include the deferred STI which will be granted as performance rights in August 2015.

- The performance rights for deferred STI are expensed over the performance period, which includes the year to which the STI calculation relates and the subsequent vesting period of the rights. The expenses are measured based on the fair value of the performance rights at the grant date. Expenses are reversed where rights are forfeited following a failure to satisfy the service conditions.

Long-term incentives

The fair value of the performance rights or options is expensed over the performance period based on the number of instruments that are expected to vest as a result of meeting the service and non-market conditions (eg an EPS hurdle). This estimate is revised at the end of each reporting period and the expenses are adjusted accordingly. The expected satisfaction of market conditions such as a TSR hurdle is factored in the calculation of the fair value of the instruments. The fair value is not subsequently adjusted and expenses are not reversed where the instruments do not vest because a market-based performance condition is not satisfied.

Once-off payments

Once-off payments include sign-on bonuses and termination benefits.

2.2.2 *Vested remuneration (table 4)*

The amounts disclosed in table 4 reflect the value of benefits that have vested during the current financial year, being the benefits that the KMP became entitled to. They have been determined as follows:

Fixed remuneration and cash incentives

Fixed remuneration includes cash salaries, the taxable value of non-monetary benefits received, contributions to superannuation plans and any annual leave and long service leave that the KMP became entitled to during the year, but did not take (being reflected through movements in the relevant provisions).

The cash incentives show the cash portion of the STI bonus that is payable for F15.

Intrinsic value of vested equity instruments

The intrinsic values are calculated on the vesting date as follows:

- options: difference between the share price and the exercise price payable by the KMP on the date of vesting.
- performance shares: share price on the date of vesting.

While the vesting period for LTIP options and performance rights ends in June, the instruments are only shown as received in table 5 once the KMP can exercise the awards. This will be when the board has approved the opening of the first trading window following Cochlear's full year results announcement. Therefore, the instruments that vested in June 2015 will be included in remuneration received for F16.

2.2.3 *Future remuneration opportunities (table 5)*

Table 5 shows the amount of benefits a KMP may be able to receive in future periods, whether these benefits are subject to any performance hurdles or other conditions and when those benefits may be received.

The intrinsic values of unvested STI deferred performance rights and unvested performance shares are calculated using Cochlear's share price as at 30 June 2015. The intrinsic value of unvested options is calculated based on the share price as at 30 June 2015 less the exercise price of the options.

2.3 *Contractual arrangements*

Terms	Description – CEO/President	Description – other KMPs
Length of contract	No fixed term	No fixed terms
Notice period	6 months for the CEO	Between 60 days and 6 months for the KMP
Resignation	Unless the Board determines otherwise, all unvested STI or LTI benefits are forfeited.	
Termination on notice by Cochlear	6 months' notice or payment in lieu of notice period. In this case, the CEO shall receive • payment equivalent to 12 months TFR • pro-rated STI benefits for the months of service • if determined by the Board at its sole discretion, the entitlements (if any) to LTI benefits.	Between 60 days and 12 months' notice or payment in lieu of the notice period. Unvested STI and LTI may be exercised or paid within 30 days of notice being given.
Redundancy	n/a	Severance payment of up to 12 months TFR. All STI and LTI benefits are either released in full or on a pro-rata basis, or remain subject to performance criteria and vesting date, at the discretion of the Board with regard to the circumstances.

Terms	Description – CEO/President	Description – other KMPs
Termination for serious misconduct	• TFR paid up to the date of termination • all unvested STI or LTI benefits will be forfeited; and • any Employee Share Scheme instruments provided to the employee on vesting of STI or LTI awards that are held in trust, will be forfeited.	
Death or total and permanent disability	Severance payment equal to 12 months' TFR. All STI and LTI benefits are either: • released in full or on a pro-rata basis; or • remain subject to performance requirements clawback and are released at the original vesting date, at the discretion of the Board with regard to the circumstances. The Board has discretion to allow unvested STI and LTI benefits to vest.	The Board has discretion to allow all unvested STI and LTI benefits to vest.
Statutory entitlements	Payment of statutory entitlements of long service leave and annual leave applies in all events of separation.	
Post-employment restraints	For a period of 12 months after termination date without the consent of Cochlear for engagement in business competition, or to induce Cochlear NEDs or staff to terminate their employment.	All other executive KMP are subject to post-employment restraints for up to 12 months.
Minimum shareholding requirement	KMP are required to build and retain a shareholding equivalent to one year's fixed pay.	
Clawback	Board retains discretion to claw back any incentive payments that resulted from misstatement of financial results.	
Other arrangements	n/a	Richard Brook – President, European, Middle East and African Regions will receive a maximum of CHF 30,000 for repatriation costs in the case of termination or resignation.

2.4 *Non-executive directors*

Principle	Comment
Remuneration is structured to preserve independence whilst creating alignment	To preserve independence and impartiality, NEDs are not entitled to any form of incentive payments including options and the level of their fees is not set with reference to measures of Cochlear performance. However, to create alignment between NEDs and shareholders, the Board has adopted guidelines that request NEDs to hold (or have a benefit in) shares in Cochlear equivalent in value to one year's fees. Cochlear does not offer loans to fund share ownership.
Aggregate Board and committee fees are approved by shareholders	The total amount of fees and other benefits paid to NEDs in F15 amounted to $1,528,625 in total which is 76.4% of the aggregate amount approved by shareholders at the AGM in October 2011 of $2,000,000 per year.

Element	Details
Board/committee fees per annum – F15	See table below

Board chairman fee [1]	$438,000	
Board NED base fee	$146,000	
Committee fees	**Chair**	**Member**
Audit	$40,000	$20,000
Human resources	$30,000	$10,000
Medical Science	$20,000	$10,000
Nomination	No fee	No fee
Technology and innovation	$20,000	$10,000

Post-employment benefits	
Superannuation	Superannuation contributions have been made at a rate of 9.5% of the base fee (but only up to the Australian Government's prescribed maximum contributions limit) which satisfies the Company's statutory superannuation contributions. Contributions are not included in the base fee.
Retirement scheme	Until 2003, Cochlear had a retirement scheme for non-executive directors. Edward Byrne is the only remaining NED who is entitled to benefits under this scheme. As at 30 June 2015, his accrued entitlement was $432,448. This amount reflects three times his annual remuneration over the three years up to 30 June 2007, indexed by reference to the bank bill rate since that date.
Other benefits	
Equity instruments	NEDs do not receive any performance related remuneration, options or performance shares/rights.
Other fees/benefits	NEDs receive reimbursement for costs directly related to Cochlear business.

[1] Committee fees are not paid to the Chairman of the Board.

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