

Checklist for Remuneration Committees

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Introduction

With the ever increasing focus on key management personnel (KMP) remuneration 2013 will, no doubt, be a year in which Remuneration Committees need to ensure that their KMP remuneration practices, policies and governance processes are appropriate, performance related and well communicated to various stakeholders. New requirements were released in December 2012 for public comment evidencing that this will continue to be a dynamic area for some time. It is clear that the intention of regulators is to make KMP remuneration more transparent for unsophisticated investors although arguably many of the regulations do not, in practice, support this outcome. In order to respond appropriately to this intention, it is the view of GRG that boards should consider moving beyond compliance based approaches to KMP remuneration and communication, and instead consider what else should be done to ensure that the issues are governed and communicated effectively. The following checklist outlines some of the issues that should be considered by the Remuneration Committee in particular when undertaking this task.

Remuneration Committee Planning for the 2013 Year

Following is a list of questions and issues that need to be considered by Remuneration Committees and particularly Chairs of Remuneration Committees as preparations are being made for work to be undertaken in 2013. Of course, we recommend an independent external remuneration consultant be engaged by the Remuneration Committee to assist with the work and to provide guidance, counsel and recommendations on KMP remuneration matters.

1. Were comments made at the 2012 annual general meeting (AGM) in relation to the Remuneration Report resolution? Note that if they were and the resolution resulted in a “strike” then the company is required by law to have recorded those comments and to indicate in the next Remuneration Report what action has been taken in relation to those comments, or if no action has been taken the reasons for inaction. In any case GRG recommends recording comments on this resolution and addressing those comments in subsequent communications.
2. Were adverse comments made by proxy advisors, major shareholders or the Australian Shareholders Association in relation to remuneration related resolutions submitted to shareholders in 2012 including the Remuneration Report resolution? If so then what action needs to be taken in 2013 to address the issues raised (e.g. meeting with shareholders, proxy advisors or reviewing practices/policies and positioning).
3. Was a “strike” received on the Remuneration Report? If so then action needs to be taken to either;
 - a. Review KMP remuneration policies and practices, if they are inconsistent with best practice, and/or
 - b. Review the content and wording of the Remuneration Report and other shareholder communications so as to ensure that shareholders better appreciate the logic behind KMP remuneration policies and why they are appropriate to the company’s circumstances. Even if the strike was the result of a protest vote, effective communication should lead to a lower negative vote in future which may be enough to avoid a strike or will at least allow the board to point to an improvement in the numbers.

4. Are the provisions of employment agreements and STI and LTI plan rules structured so as to allow the Board in relation to the CEO and the CEO in relation to Direct Reports to fairly and efficiently meet the challenge of ensuring that the right talent is in the right roles? As the one year's base salary limit under the Corporations Act on termination benefits that may be paid to KMP without shareholder approval covers more and more KMP roles, it is important to ensure that contracts and plan rules do not inhibit the ability to manage executive talent to optimise company performance.
5. Similarly, are the takeover provisions in STI and LTI plan rules and employment contracts structured to so as to provide protection for executives who are most at risk of losing their jobs following a takeover. Benefits in the event of a takeover are not subject to the termination benefit limit. When seeking to appoint an executive at a time when a takeover is a possibility the takeover provisions of employment contracts and rules for STI and LTI plans can be critical in terms of minimising risk of a job change for the executive. It should also be noted that the one times base salary termination benefit for an executive who has served for less than 12 months is limited to a pro-rata amount based on the time served. Thus a termination benefit will be unlikely to provide the risk minimisation that may be reasonably expected by an executive considering changing jobs.
6. Are the terms of executive KMP employment contracts consistent with the termination benefit limit and integrated with the STI and LTI plan rules such that termination benefit limit problems will not arise for "good leavers" and appropriate provisions cover takeover situations?
7. Are the Company's remuneration practices reasonable in terms of quantum for
 - a. Base Package (fixed annual remuneration), and
 - b. Total Remuneration Package (TRP i.e. Base + short term incentive (STI) + long term incentive (LTI)?
8. Do executive KMP TRPs include the appropriate elements of remuneration (Base Package, STI, LTI etc)?
9. Are the mixes of the remuneration elements appropriately weighted e.g. do those roles with the greatest degree of control over long term outcomes receive the largest LTIs? Is the weighting on STI reasonable?
10. Are the key performance indicators (KPIs) used in the STI plan appropriate to support pursuit of value growth?
11. Are the vesting conditions for the LTI plan directly aligned with delivering shareholder value at or above investor expectations while remaining acceptable to observers and appropriate to the company's circumstances?
 - a. If relative TSR is used, what is the spread of Betas in the peer group (correlation with overall market movements)? Are the Betas of constituents similar to the Beta of your organisation? If not, is the group unfairly advantaging or disadvantaging participants?
 - i. Is the peer group large enough to be statistically robust over time?
12. Are there gates or provisions in place to ensure that the STI or LTI will not be paid in circumstances where shareholders would reasonably have an expectation that they would be withheld (e.g. in relation to LTI, if relative TSR is positive but absolute TSR is negative due to a falling market?)
13. Do the Company's Remuneration Report, notice of meeting (NOM), explanations of resolutions in relation to the Remuneration Report, grants of equity to directors and the LTI plan and other shareholder communications clearly communicate executive remuneration strategies, their appropriateness to the Company's circumstances and linkage to growth in shareholder value?
 - a. Could a typical retail shareholder easily understand actual remuneration outcomes including "Take home pay" and the relationship with company performance, based only on disclosures?
14. Are the Company's executive remuneration strategies and incentive plan design details likely to be supported by major shareholders, funds managers and proxy advisors?
15. What is the level of understanding and competence of each of the members of the Remuneration Committee with regards to remuneration issues and practices? Should the board consider a consultant briefing on KMP remuneration principles, background and technical aspects so as to support the competence of the board in governing issues?
16. Has the Remuneration Committee discussed the draft amendments to the Corporations Act that have been released for comment which suggests it may be necessary to (among other things):
 - a. Address the issue of clawback of incentives where there has been a material misstatement within the financial reports?

- b. Disclose the remuneration governance framework (implying there must be a formal framework in place)?
- c. Disclose the qualifications and experience of each member of the remuneration committee?
- d. Disclose management's advice to the remuneration committee

It has emerged that some clients are not aware that GRG's services extend to communication programs, writing of explanatory letters, Remuneration Report disclosures, notices of meeting (NOM) and resolutions, as well as presenting to or meeting with shareholder groups as required. To support boards with addressing this checklist, GRG can also undertake a pilot study to review the Company's executive KMP remuneration practices using publically available information as disclosed in Remuneration Reports, NOMs and other shareholder communication released to the ASX. Broad market data would be used as a guide to market competitiveness of remuneration levels, and the experience of our consultants would be applied to determine whether the disclosures provide complete, clear and reasonable explanations of practices. A report would be prepared outlining the assessment of the Company's position in relation to the above questions and recommending follow-up work, if any, that should be undertaken. GRG can also assist in the drafting of policy documents or material relating to remuneration governance frameworks as may be necessary.