

Remuneration Governance – Time Well Spent?

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INTRODUCTION

The remuneration governance environment, being the context in which boards make decisions on remuneration issues and communicate with stakeholders, has changed dramatically since the 2011 Corporations Act amendments. On the one hand, a new level of dialogue between boards and stakeholders has opened up, leading to deep and considered thinking around remuneration issues at both the individual company level and across the country. On the other hand, the complexities and compliance issues that boards now face have led to them and especially their Remuneration Committees spending what some consider to be a disproportionate amount of time on remuneration matters. So how can boards get the basics put to rest so that they can focus on the heart of remuneration issues? By setting and documenting durable policies, boards can focus on critical issues that will engender stakeholder trust, understanding and support for decisions. This article examines the elements that all boards should have in place under a remuneration governance framework so that the focus can be on salient emergent issues rather than having to constantly revisit the basics of key management personnel (KMP) remuneration. Except in cases of the most experienced Remuneration Committees with exceptional support from internal HR experts, this is a challenge for boards.

DEVELOPING A REMUNERATION GOVERNANCE FRAMEWORK

Expectations around what should now be disclosed as part of the Remuneration Report have evolved and a description of the remuneration governance framework is becoming increasingly common. Proposed, but not yet passed, amendments to the Corporations Act require a description of a company's remuneration governance framework to be included in Remuneration Reports unless elsewhere included in the Annual Report. The remuneration governance framework is a description of the company's process for determining the remuneration of KMP. In essence the remuneration governance process represents the interaction of a series of KMP remuneration related policies and procedures that each company should have committed to formal documentation that has been approved by the Board. These policy documents should address at least the following:

1. Remuneration Committee charter,
2. Broad corporate governance framework statement,
3. Executive KMP remuneration strategy, policy and procedures,
4. Policy against hedging of long term incentive (LTI) grants of securities,
5. Short term incentive (STI) plan rules, standard offer letter and explanatory booklet,
6. LTI plan rules, standard offer letter and explanatory booklet,
7. Termination benefit limit for KMP and policy in relation to employment contracts, STI and LTI awards,
8. Takeover/change of control provisions in employment contracts and STI and LTI plans,
9. Non-executive director (NED) remuneration strategy, policy and procedures,
10. Policies regarding minimum holdings of shares by executives and NEDs,
11. Policy governing engagement of external remuneration consultants (ERCs), and
12. Communications strategy for shareholders and other stakeholders e.g. proxy advisors.

While many organisations do outline a KMP remuneration governance framework in their Remuneration Reports, it is often the case that the full range of policies required to support that framework have not been written, approved or implemented. When there is a description of such a framework in the Remuneration Reports, the auditors signing off on the Remuneration Report expect to see the relevant supporting documentation. More than that, these documents serve as tools to guide decision making and a framework for the basic processes of remuneration governance to run smoothly and with confidence. Many boards will approve or adopt an approach but do not get to the point of

translating it into formal policies and procedures. In order to ensure that these supporting documents are covered off and that boards can focus on the heart of remuneration governance issues, instead of constantly revisiting the basics, GRG recommends Boards develop and adopt the following:

- a) A Remuneration Committee charter which delegates some of the responsibilities of the Board in relation to KMP remuneration to a Remuneration Committee, and which outlines the roles and responsibilities of that committee and how it will be formed,
- b) A formal remuneration governance framework document describing the elements and parties involved in KMP remuneration setting, how their interactions will be governed, the general methodology behind determining appropriate remuneration and the various policies that support the framework,
- c) A formal executive KMP remuneration policy document that outlines the process of remuneration setting for executive roles, how remuneration should be positioned in the market and how the elements of remuneration should be mixed, - it may also include aspects that need to be reflected in multiples policies e.g. termination benefit and takeover provisions which should be covered in STI and LTI plan rules as well as employment agreements,
- d) A formal NED KMP remuneration policy that outlines the process of remuneration setting for NEDs, how remuneration should be positioned in the market, the use of committee fees to recognise differences in workloads, grants of securities to enable NEDs to build meaningful stakes in the company and seeking shareholder approval for the aggregate fees limit,
- e) A formal policy document to govern interactions between ERCs and the company. The Corporations Act requires the Board to make a statement regarding whether or not the advice received from an ERC was independent and if so why that view was formed. The most robust method for achieving this is to have a policy in place which ensures independence and to require compliance with this policy. This fact can then be disclosed as part of the Remuneration Report as the justification for the determination that the advice was independent. This method is robust over time and requires little, if any, further explanation to shareholders,
- f) Formal documentation regarding the operation of STI and/or LTI plans. Most organisations already have these in place as these are necessary for the operation of the incentive plans,
- g) A policy governing minimum shareholdings by KMP and how building such shareholdings is assisted through remuneration policies,
- h) A checklist for the Remuneration Committee to consider to assist the members to ensure that the key governance issues have been addressed and obligations have been met, and
- i) A communications policy to ensure that shareholders and other stakeholders are informed as to KMP remuneration policies, why they are appropriate for the company and how they relate to improving company performance.

Summaries of the foregoing should be part of Remuneration Reports. They should be sufficiently detailed to demonstrate good governance principles have been applied, but sufficiently general to be resilient over time.

It should be noted that while LTI plans are generally well documented, GRG has observed that STI plans are rarely covered by comprehensive rules, documentation or explanatory material. This may be because unlike LTI, STI generally does not require shareholder approval. However it is no less important for there to be clarity on the principles, operation and rules of STI plans which may give rise to significant remuneration.

CONCLUSION

In addition to the elements that form a formal and documented remuneration governance framework GRG recommends that the Remuneration Committee be regularly briefed on emerging issues regarding remuneration governance, regulation and market practices.

If your Remuneration Committee has only some of the documents outlined in place, or perhaps none of them, we would be happy to provide assistance in filling the gaps so that the committee can get on with dealing with salient emergent issues. In working with many clients from small listed explorers to blue-chip household names GRG has been able to develop a number of comprehensive remuneration governance frameworks and the ability to draft and tailor the component policies, procedures and charters for clients.