

# Executive Remuneration Governance

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## Introduction

Increasing regulation, scrutiny and activism in relation to key management personnel (KMP) remuneration in listed companies has been a growing issue for boards. Prior to 2011 it was common for Remuneration Committees to meet relatively infrequently, and the work of the committee tended to be relatively uncomplicated. With the changes to the Corporations Act that took effect in 2011, significant power was transferred to external stakeholders and proxy advisors, including minority but significant shareholders and activists. A range of remuneration compliance, disclosure and governance issues began to trouble many boards, with non-executive directors becoming the focal point for addressing emergent issues and the primary recipients of external remuneration advice.

Suddenly the Chair of the Remuneration Committee needed to be as much expert in KMP remuneration as are internal HR managers, perhaps even more so given the requirements of the Act. Yet there are often limited internal support frameworks and even fewer external resources available to assist Remuneration Committee members to meet this challenge. GRG's Remuneration Committee Companion is to our knowledge the only freely available resource tailored to the Australian context to assist directors with this challenge (please contact us for a free licensed copy). GRG has observed that many Remuneration Committees that have not yet adopted the GRG approach to Remuneration Governance continue to regularly reinvent the wheel, debating fundamental principles of KMP remuneration and how to manage the various demands of stakeholders in a changing business environment. All too often, responding to a "strike" is the first time fundamental principles are clarified and appropriately documented at the Board level, and procedures agreed for future reference.

This Remuneration Insight is intended to complement the Remuneration Committee Companion by briefly summarising some underlying principles that ought to be considered suitable, perhaps with some modification, for the majority of ASX listed companies and the benefits of good remuneration governance. Such matters should be recorded and adopted in a suite of Remuneration Governance Framework documents (see the GRG Remuneration Committee Companion for further details). Please note that this material is neither specific advice nor recommendations as defined under the Corporations Act and is intended to be information of a general nature regarding observable market best practices.

## Executive Remuneration Principles

The following are intended to assist in guiding decision making in relation to the remuneration of executives who are KMP:

1. Total Remuneration Packages (TRPs) inclusive of target levels of incentives should be set so as to:
  - a. Attract,
  - b. Retain, and
  - c. Influence,
 the calibre of executive talent required by the company to achieve its business goals.
2. TRPs policies should be based on achievement of targets which are challenging and achievable. Recognising that stretch goals would be rarely achieved and to communicate remuneration that will rarely be achieved may lead to dissatisfaction, frustration and distrust by the executives the company wishes to have fully engaged.
3. TRPs should be composed of fixed (Base Package) and variable remuneration so that company cost varies with company performance.
4. Variable remuneration should have elements that relate to short and long term performance. The time frame relates to the period over which performance is measured and is generally one year for short term incentives (STIs) and not less than three years for long term incentives (LTI).
5. STIs should be based on performance in relation to key performance indicators (KPIs) which should mainly focus on financial KPIs as the STI should be about rewarding success rather than for trying hard.
6. LTIs should relate to overall company performance and should assist executives to build a long term investment in the securities of the company to strongly align their interests with those of shareholders.
7. Base package policies should be set by reference to a market positioning that will assist the TRP to achieve its objectives yet provide executives with reasonable cash flow to meet day to day needs.
8. Base Package ranges should apply around policy mid-points to allow recognition of individual competence in the role.
9. TRP target policies should be set by reference to a market positioning that will assist the TRP to achieve its objectives, yet respond to under and over performance with lower and higher levels of actual TRP.
10. The mix of STI and LTI should reflect the timeframes and impacts of planning and decisions required of executive roles.

## Good Remuneration Governance

The Corporate Governance Principles and Recommendations (3<sup>rd</sup> edition) released by the ASX Corporate Governance Council describes corporate governance as *“the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account.”* It then goes on to state that: *“Good corporate governance promotes investor confidence, which is crucial to the ability of entities listed on the ASX to compete for capital.”*

GRG's experience in relation to key management personnel (KMP) remuneration indicates that there are various other advantages that arise from good governance of KMP remuneration.

These include:

1. **Control of KMP remuneration costs** such that they are market competitive and reflect performance. This ensures that company costs are managed at appropriate levels and therefore company resources are not wasted.
2. **Independence** is exhibited through the establishment of a Remuneration Committee, the leadership of the Committee via an independent non-executive director who is not the Board Chair, the composition of the committee being solely of non-executive directors and the undertaking of the Committee's functions largely independent of undue management influence.
3. **Transparency** is exhibited via policies and procedures that are comprehensive, integrated and made freely available to all stakeholders. Ideally this should be via the company's website which is then referred to in relevant publications such as the Remuneration Report which is contained in company Annual Reports.
4. **Comprehensive policies with integrated elements** are achieved by concurrently reviewing all KMP remuneration policies and recording all policies and procedures in writing. Dealing with remuneration elements or aspects of elements in isolation can lead to imbalances and/or inconsistencies.
5. **Consistent practical implementation** of KMP remuneration policies arises when implementation decisions are made within the framework of previously adopted policies.
6. **Communication clarity** with executives as to the terms of their remuneration particularly incentive award opportunities and with other stakeholders.
7. **Responsiveness** to changing circumstances (regulatory, market, etc.) should be evidenced by the Committee's preparedness to exercise discretions and to update policies, procedures and plan rules when appropriate.
8. **Stakeholder confidence** in the Committee and the Board will be enhanced through appropriate KMP remuneration policies, procedures and plan rules that have taken into consideration the preferences of stakeholders.
9. **Legal compliance and ethical decision making** should be principles that override all aspects of KMP remuneration.
10. **Accountability** for KMP remuneration policies and practices is a formal process for all ASX listed companies as shareholders have the opportunity to vote on Remuneration Reports. If 25% or more of the cast votes are against the Remuneration Report resolution then a "strike" is received. If two successive "strikes" are received then directors are exposed to a spill resolution provided such a resolution was not put at the prior AGM. If the spill resolution is passed then all director roles except for the Managing Director are spilled at a meeting to be held within 90 days of the meeting at which the spill resolution was passed.

## Conclusions

There are multiple benefits for companies, their Boards and Remuneration Committees from:

- Developing comprehensive and integrate remuneration strategies for KMP roles,
- Recording them in formal policies, procedures and rules, and
- Making them available to all stakeholders preferably via the company's website which may then be referenced in shareholder communications such as the Remuneration Report.

Accordingly, those companies that have not fully embraced the approaches outlined in this GRG Remuneration Insight should do so a priority. Particularly as many companies have recently completed reviews of their KMP remuneration practices for FY16, now may be a good time to consider documenting the decisions and the logic in suite of policy and procedure documents such as:

- Executive Remuneration Policy & Procedure,
- NED Remuneration Policy & Procedure,
- Short Term Incentive Policy & Procedure, and
- Long Term Incentive Policy & Procedure.

Other documentation that may be relevant considerations when reviewing the remuneration framework include:

- The Remuneration Committee Charter,
- STI and LTI Plan rules, offers and explanatory material for participants,
- Securities Trading Policy,
- Clawback Policy & Procedure, and
- Securities Holding Policy.

The ASX Corporate Governance Council appears to be encouraging the publication of such material on the Company website. If external advice or expertise is required on such matters, GRG can assist with the development or review of materials.