

Role of Remuneration Committee

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Introduction

This GRG Remuneration Insight discusses the need for Remuneration Committees and their role in compliance, governance and value creation for shareholders, in the context of ASX listed companies.

Which Boards Should Have Remuneration Committees and Why

ASX Listing Rule 12.8 (introduced 1/7/2011) requires companies that are included in the S&P/ASX300 Index on the first day of their financial year, to have a Remuneration Committee that is comprised solely of non-executive directors (NEDs). There are two legs to this Rule and they are:

1. That it is compulsory for S&P/ASX 300 companies to have Remuneration Committees, and
2. The Remuneration Committee must not have members who are not NEDs.

It should also be noted that Recommendation 8.1 of the Corporate Governance Principles and Recommendations (3rd Edition) (released March 2014) which was published by the ASX Corporate Governance Council specifies that:

- a) Boards of all ASX listed companies should have Remuneration Committees,
- b) Remuneration Committees should have at least three members, and
- c) The Chairs of Remuneration Committees should be independent NEDs.

Thus, unless there are sound reasons for not having a Remuneration Committee and those reasons are explained ("if not, why not" principle) each ASX listed company should have a Remuneration Committee.

These requirements plus others (two strikes rule and external remuneration consultant engagement laws) were triggered by major concerns among shareholders and other stakeholders about the diligence and independence of Boards/Remuneration Committees in fulfilling their role in relation to remuneration of senior executives. Of particular concern was that Boards/Remuneration Committees were often perceived as simply acquiescing to management's self-interest.

Proxy advisor and other stakeholder monitoring of senior executive remuneration policies and practices has become enhanced by the introduction of voting on Remuneration Reports which can lead to "strikes" and Board spills.

As a consequence of changes to the law, governance guidelines and stakeholder activism the traditional approach of Remuneration Committees simply receiving, considering and approving recommendations from management with little, if any, direct advice from independent external remuneration consultants (ERCs) has been replaced by approaches that reflect strong corporate governance including transparent two way communication with stakeholders and a focus on obtaining independent advice.

In GRG's significant experience, it is those companies that view the remuneration committee as a rubber stamping process for the decisions of management, and which devote insufficient time and resources to governing remuneration on behalf of shareholders, that are typically the subject of stakeholder activism.

Role of Remuneration Committees

The commentary in relation to Recommendation 8.1 of the Corporate Governance Principles and Recommendations states that the role of the Remuneration Committee is to “review and make recommendations to the Board in relation to:

- the entity’s remuneration framework for directors, including the process by which any pool of directors’ fees approved by security holders is allocated to directors;
- the remuneration packages to be awarded to senior executives; equity-based remuneration plans for senior executives and other employees;
- superannuation arrangements for directors, senior executives and other employees; and
- whether there is any gender or other inappropriate bias in remuneration for directors, senior executives or other employees.”

While input may be sought from the Managing Director, the CFO, the Head of Human Resources etc. in relation to key management personnel (KMP) remuneration including incentives for the Direct Report roles, none of these executives can be part of the Remuneration Committee and should not be delegated any of the responsibilities of the Remuneration Committee.

In essence, the role of the Remuneration Committee is to develop and maintain the director and senior executive remuneration governance frameworks including specific policies and plan rules and then to ensure that the framework is applied taking into account performance. To fulfil this role each member of the Remuneration Committee needs to: keep up to date with regulatory and corporate governance developments, regularly review policies and procedures, take a pro-active approach to sourcing information and advice necessary to discharge the role, ensure that practices are consistent with policies and appropriate to the company’s circumstances as well as engage in two way communication with key stakeholders including proxy advisors.

Recommendation 1.3 of the Corporate Governance Principles and Recommendations provides that each company “should have a written agreement with each executive director and senior executive setting out the terms of their appointment.” Given the potential for a conflict of interest it is essential for the Remuneration Committee to negotiate the terms of such agreements with executive directors and to approve the terms of such agreements with senior executives.

Recommendations 1.6 and 1.7 of the Corporate Governance Principles and Recommendations require periodic reviews/evaluations of directors and senior executive performance. Such reviews/evaluations naturally fall to the Remuneration Committee to ensure they are undertaken on a comprehensive and professional basis.

Engagement of External Remuneration Consultants

It is best practice for Remuneration Committees to engage the services of ERCs to ensure that their decisions in relation to senior executive remuneration achieve the high levels of corporate governance they recognise as supporting superior corporate performance. The use of ERCs also assists Boards to form views on the reasonableness of remuneration for directors (executive and non-executive). Remuneration for directors may not be paid unless it is reasonable or shareholder approval is obtained. It is usual for Boards to rely on the reasonableness exception to needing shareholder approval and to obtain formal opinions from external experts to the effect that the proposed remuneration is reasonable for purposes of s211 of the Corporations Act. Failure to obtain independent professional advice on reasonableness will leave the Board exposed in relation to a breach of the Corporations Act.

The need for ERCs to be engaged by Remuneration Committees is confirmed by the commentary on Recommendation 8.1 of the Corporate Governance Principles and Recommendations which prescribes that Remuneration Committees should have the right to “seek advice from external consultants or specialists”.

As recommendations from management cannot be seen to be independent and cannot be based on external advice, it presents a risk of being biased or seen as self-interested by external stakeholders. Thus, the

Corporations Act prescribes that recommendations by ERCs on senior executive remuneration must be provided to non-executive directors who are typically members of Remuneration Committees.

In addition the Corporations Act recognises and endorses the use of ERCs by requiring that:

- a) the Board or Remuneration Committee approve the ERC before it is engaged to provide KMP remuneration recommendations (s206K),
- b) ERCs confirm via a declaration that any KMP remuneration recommendations are free from undue influence from the KMP to whom the recommendations relate (s206L), which effectively requires they not interact with management other than to obtain factual information relevant to considerations, and
- c) each Board indicate in its Remuneration Report whether it is satisfied that an ERC's KMP remuneration recommendations were made free of undue influence from the KMP to whom the remuneration recommendations related and if so why it is of that view (s300A(1)(h)).

Conclusion

The traditional approach of Remuneration Committees simply receiving, considering and approving recommendations from management with little, if any, direct advice from independent ERCs has been replaced by approaches that reflect strong corporate governance including transparent two way communication with stakeholders. The modern approaches have been embraced by Remuneration Committees and Board because of the “two strike” legislation and the increased power of proxy advisors to influence voting on resolutions that are put to general meetings with many such resolutions relating to KMP remuneration and the Remuneration Report. Evidence from the Annual Reports of ASX listed companies indicates that most Remuneration Committees are obtaining independent external advice regularly in relation to KMP remuneration, and are developing significant remuneration governance frameworks administered by the committee, as evidenced by the length and detail of documented committee policies, practices and procedures. In this way governance is strongly improved and will lead to improved company performance.