Improving Remuneration Governance

By Jon Robinson

There has always been interest by shareholders and the general public in the remuneration of boards and management. Since the Code of Corporate Governance was revised in 2012, there has been a greater emphasis on the governance of remuneration, reflecting this interest and its importance in the fair treatment of shareholders. This raises the question: how can boards ensure that there are effective remuneration governance processes in place?

Clarifying responsibilities

The first step in effective remuneration governance is to have a clear understanding of how remuneration will be managed.

What is the role of the remuneration committee (RC) versus that of management? Which executives are "covered" by the RC? What are the different responsibilities of management and the remuneration committee? Which elements of the pay package are set by the RC and when are they reviewed?

For example, one model is for the RC to determine the pay of the CEO and executive directors and the overall quantum of bonus for everyone else, and then leave it to the CEO to work out how to pay the other executives and employees.

Having clarity on the scope for the RC also allows its agenda to be sensibly structured with different topics considered at different times of the year.

Aligning compensation with company objectives

The next step in effective governance is to ensure that remuneration policies are aligned with the business.

When making complex decisions, it always helps to have clearly articulated and agreed objectives – and this certainly applies to remuneration decisions. A clear statement of objectives will help clarify when the RC needs to apply judgment and, importantly, provide a foundation when communicating compensation issues to stakeholders.

A leaf can be taken from General Electric's well-thought-out and clear statement to investors of their remuneration objectives in 2015:

- Reward sustained financial and operating performance, and leadership excellence
- Align executives' interests with those of share owners to create long-term value
- Motivate executives to remain with the company for long and productive careers built on expertise.

In my view, the most critical decision that an RC has to make is how to measure performance.

Performance measures should support strategic goals and time frames. Is short-term financial performance critical or should executives be rewarded for creating long-term shareholder value or, in many cases, both? Whatever is used, a board does need to recognise that measures and targets should not be static. Strategies change and, when they do, performance measures should change as well.

It does seem that Singapore boards are most comfortable when they set bonuses based on a specified formula using an objective measure such as profits before tax or economic value added. The advantage of this approach is that it allows the board to avoid difficult conversations with the executives about performance and reward. The disadvantage is that it allows the board to avoid these difficult conversations when they may well be needed.

The interaction between boards and executives works best when there are frank conversations around financial expectations and softer qualitative factors and goals. For example, having rewards, in part, tied to developing a talent pool of potential successors will give the CEO the message that this is important to the board and that he will benefit from working on it.

Disclosure, disclosure, disclosure

Good remuneration governance alone will not necessarily score a company top marks with external stakeholders. Assessors of corporate governance scorecards and investors see only what is disclosed.

Most developed markets now require substantial remuneration disclosure. In countries where shareholders are given the right to have a "say-on-pay", comprehensive remuneration disclosure is a pre-requisite.

Many directors still do not understand that remuneration disclosure is required under the SGX listing rules. Rules 1207 (12) and (13) state: "The issuer should make disclosure as recommended in the Code of Corporate Governance, or otherwise disclose and explain any deviation from the recommendation. The remuneration must include all forms of remuneration from the issuer and any of its subsidiaries."

Simply, companies should disclose the dollar amount of individual directors' and CEO's remuneration and the link between remuneration and performance, or explain and justify any deviation from such disclosure.

By explaining the link between remuneration and performance, the board is reaffirming the company's strategic goals and demonstrating that these goals are reinforced by its remuneration policies.

Disclosing levels of remuneration can be more of a challenge although the experience from other countries is that this becomes a focus of shareholder and media interest only if the amounts are seen to be unreasonably high.

According to the SID-ISCA's *Singapore Directorship Report 2014*, only 31 per cent of listed entities had precise disclosure of directors' annual fees and remuneration. Those that do not disclose should be aware that they may be suspected of concealing remuneration levels that they find embarrassing.

Regardless, it is surely good practice that the remuneration of executives who are also controlling shareholders be specifically disclosed as it is a type of interested-party transaction that ought to be transparent to other shareholders.

Poor practices in a few companies have a tendency to lead to intrusive and burdensome regulation for all. It is for the collective benefit that more Singapore companies be good corporate citizens and, where needed, bring their remuneration governance up to an acceptable standard.

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