Remuneration policy and procedures for directors and senior management

MCCG Intended Outcome 6.0

The level and composition of remuneration of directors and senior management take into account the company's desire to attract and retain the right talent in the board and senior management to drive the company's long-term objectives.

Remuneration policies and decisions are made through a transparent and independent process.

MCCG Practice 6.1
The board has in place policies and procedures to determine the remuneration of directors and senior management, which takes into account the demands, complexities and performance of the company as well as skills and experience required. The policies and procedures are periodically reviewed and made available on the company's website.

*(The application of this Practice in its entirety entails the **establishment of directors and senior management's remuneration policies and procedures** as well as the **periodic review** and **publication of the said policies and procedures on the company's website**.)*

The internalisation and application of the content "Why" and "How" should be read in tandem with the line of sight outlined by the Intended Outcome.

The case for change

The issue of directors' remuneration is often a contentious subject between the shareholders and the board, especially if the board performance over the past years appears unsatisfactory. Shareholders often question the board and seek clarification on any increase to the tabled resolution on remuneration in order to ascertain whether the remuneration paid is commensurate with the performance of the directors.

The need for fair and transparent remuneration policy and procedures is now more apparent than ever, acknowledging that the current business environment is becoming more complex with rising stakeholder expectations, globalisation, technological advances and innovation in business models – all of which necessitate remuneration packages to be aligned with the company's long-term business sustainability.

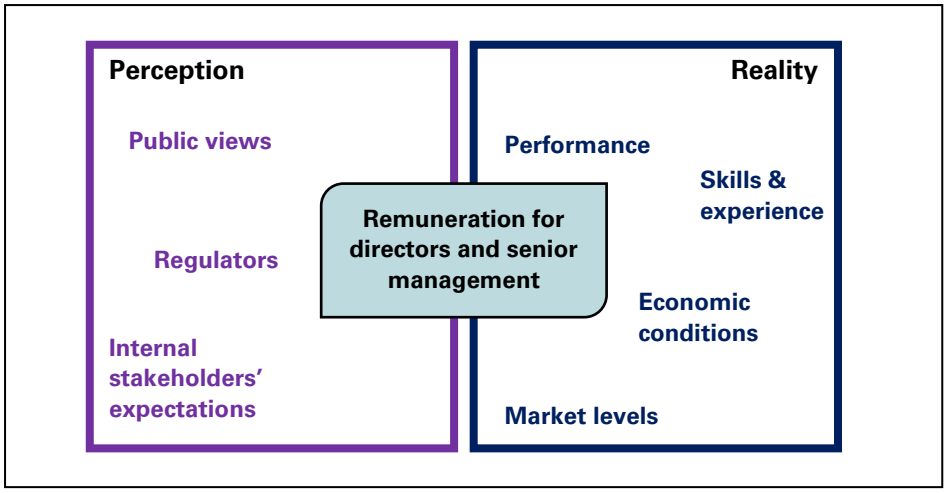
In order to ensure that their investments are well-managed, shareholders are demanding companies to be led by directors and executives of good calibre. To this end, remuneration plays a vital role in attracting and retaining highly skilled directors and executives. In attempting to hire and retain talent, it is important to understand that the complexity of remuneration is without doubt increasing

What could go wrong:

- Remuneration packages lead to imprudent risk-taking and "toxic behaviour" by directors and senior management personnel (e.g. venturing into new and risky business lines without appropriate due diligence in anticipation of unusually high profits).
- Conflict of interests between directors or senior management vis-à-vis the company.
- Objectivity of independent directors is compromised due to misaligned incentives (e.g. excessive payment via share schemes to independent directors).
- Failure of the company to attract and retain talent particularly at the leadership level.

with the ever growing forms of remuneration (cash, benefits, shares, etc.) and structure (short, medium or long term).

Some of the factors to be taken into account in today's remuneration policy and procedures for companies are shown below:



A study carried out by the Institute of Directors ("IOD") on shareholders in the United Kingdom (2015) revealed that pay for big business leaders is the biggest threat to public trust in business. In the survey, shareholders opined that the remuneration of directors has grown disproportionately large and has become largely divorced from performance. It would not be a surprise if such concerns are amplified for companies operating in less competitive industries.

In a free market economy, it is almost inconceivable to think that companies need to defer to some form of legislation or restriction when it comes to attracting and remunerating the "best and brightest". However, it is important to note that companies do have to earn the right to operate from the community in which they reside, and part of this invariably involves the structuring of appropriate remuneration schemes.

The **MCCG** has called upon companies to make known their remuneration levels for directors and senior management in detail. **Bursa Securities Listing Requirements**[1], likewise, also require detailed disclosure of directors' remuneration on a named basis for listed issuers. With the **Companies Act 2016** mandating the approval of directors' fees and benefits by shareholders at a general meeting[2], remuneration levels will no longer be hidden from view. As remuneration becomes plainly visible, the next question naturally asked by stakeholders will be regarding the link between the company's performance and the remuneration of its directors and senior management.

Hot-button issue

Concern is often raised by shareholders when remuneration for directors and senior management increases whilst remuneration for general staff remains the same or decreases.

Such a clash of directions have no doubt fanned popular anger and some countries have even gone to the extent of attempting to regulate pay ratios, although without success.

For example, Switzerland in 2013 held a referendum in relation to whether legislation should limit executive pay to 12 times that of lowest within any particular company. The referendum was defeated.

It is therefore important for companies to ensure that remuneration packages for directors and senior management are structured based on strong fundamentals (e.g. linked to the company's objectives) and they do not diminish shareholders' returns or the confidence of the public in the business.

[1] **Paragraph 11, Part A, Appendix 9C of Bursa Securities Listing Requirements**
[2] **Section 230 of Companies Act 2016**

HOW The practice in substance

Bursa Securities Listing Requirements have outlined some factors on how remuneration should be structured for executive and non-executive directors.

Paragraph 7.23 of Bursa Securities Listing Requirements

Fees payable to non-executive directors shall be by a fixed sum, and not by a commission on or percentage of profits or turnover. Salaries payable to executive directors may not include a commission on or percentage of turnover.

Under the **Companies Act 2016,** listed issuers are required to seek shareholders' approval at a general meeting for directors' fees and benefits.

Section 230(1) of the Companies Act 2016 – Approvals for fees of directors

The fees of the directors, and any benefits payable to the directors including any compensation for loss of employment of a director or former director:

(a) of a public company; or

(b) of a listed company and its subsidiaries,

shall be approved at a general meeting.

Section 340(1)(c) of the Companies Act 2016 – Annual General Meeting

Every public company shall hold an annual general meeting in every calendar year in addition to any other meetings held during that period, to transact the following business:

(c) the appointment and the fixing of the fee of directors.

A listed issuer must reflect in its constitution, the provision with regards to annual shareholder approval for director's fees, and any benefits payable to directors pursuant to **paragraph 7.24 of Bursa Securities Listing Requirements**.

Paragraph 7.24 of Bursa Securities Listing Requirements

The fees of directors, and any benefits payable to directors shall be subject to annual shareholder approval at a general meeting.

In order to ensure financial institutions are well governed and transparent, **Bank Negara Malaysia** has outlined guiding principles for remuneration paid to directors as primarily outlined in **Standards 19.2 and 19.4 of Bank Negara Malaysia's Policy Document on Corporate Governance**.

Dos

- ✓ Ensuring that the remuneration policy and procedures are also in line with the risk strategy and corporate values of the company.
- ✓ Drawing input from those in charge of internal control and risk management functions to ensure that risk exposures and risk outcomes are adequately considered in the design of remuneration policies and procedures.

Don'ts

The following would render the application of this practice ineffective:

- × Exempting certain directors from the company's remuneration scheme (e.g. nominee directors).
- × Not having in place any remuneration policy and being deliberately vague on how executive directors' remuneration is determined.
- × Remunerating all directors with a fixed sum which does not commensurate with their workload and responsibilities.

It is important to appreciate that none of the aforementioned regulatory requirements are intended to suppress directors and executives' remuneration. A nation's economy depends greatly on the drive, motivation and entrepreneurial spirit of its business community, and fair and appropriate remuneration would only help to sustain this direction.

What is pertinent in relation to this Practice is that companies can articulate the design of their remuneration policies and procedures, and explain satisfactorily the drivers that had influenced its design.

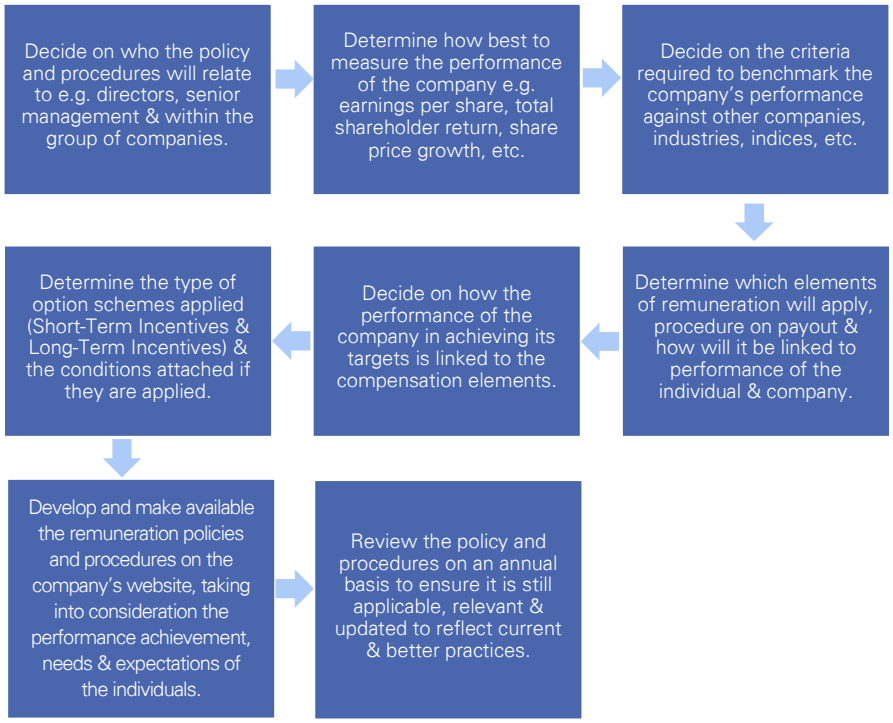
Some considerations with regards to such policy and procedures are provided below:

The rationale	The inputs	The implementation
There must be a clear goal for the policies and procedures and the rationale behind each element can be explained to, and understood by stakeholders.	Inputs include skillsets and experience requirements, company's position and performance, market rates, and stakeholders' expectations.	The remuneration committee has played its role. The scheme is implemented fairly, consistently and comprehensively.

Remuneration policies and procedures should be designed in such a way that they support the strategies and long-term vision of the company. They should be structured to provide incentives for directors and senior management to pursue the long-term growth objectives of the company. The main challenge faced by most remuneration committees in this regard is in relation to the process of developing remuneration policies and procedures which take into consideration the best practices, market benchmarks as well as the views of stakeholders.

The diagram on the following page illustrates the steps that can be considered by the remuneration committee in drawing up remuneration policies and procedures.

The growth of a company depends on the ability to attract and retain people of the quality required by the board on a long term basis (as depicted below):



The figure below provides an example of the process undertaken by BP PLC (United Kingdom) in determining the company's remuneration policies and procedures for 2016:

1	2	3	4
Assess performance	Review outcomes with board committees	Align with employees	Apply discretion
• Checked performance against safety and value measures. • Reviewed the measures against targets set.	• Sought views from audit and safety, ethics and environmental assurance committees to ensure a thorough review of performance.	• Considered outcomes in relation to BP's group leaders and the broader comparator group of United States and United Kingdom employees in professional and managerial roles.	• Used judgment to reflect the broader market environment and outcomes for shareholders.

Source: BP PLC (United Kingdom) annual report for the financial year end 31 December 2016

One of the remuneration committee's key tasks is to develop and agree on the remuneration policy and procedures with the board, including the fee structure and level of remuneration for executive directors of the board and senior management. The board should determine who makes up senior management and if any other group of employees should be covered by the remuneration policy and procedures.

Point for reflection

The ambit of a well-considered remuneration policy and procedures should not only be limited to directors and senior management, but also include other groups within the company's ecosystem (e.g. gatekeepers).

Gatekeepers

Gatekeepers refer to the group of individuals who act in a risk management and internal controls capacity, such as internal auditors. Remuneration of gatekeepers should be independent of the business lines or functions that they have a responsibility over.

Key considerations relating to the application of this Practice are discussed below:

How should remuneration policy and procedures be determined?

The board should consider the need for the remuneration to commensurate with the level of responsibility of its directors and senior management. There should be appropriate incentives to attract talent as well as nurture and retain high calibre directors and senior management, whilst taking into account the interests of other stakeholders, including shareholders and employees. In addition, the remuneration policy and procedures should also be aligned with the business strategy and long-term objectives of the company.

It is perhaps useful to consider the elements that can be incorporated in a remuneration policy, particularly for directors and senior management:

Suggestions for the content of a remuneration policy (non-exhaustive):

- Scope of coverage to clarify who is covered by the remuneration policy (i.e. directors, senior management and other group of employees deemed necessary by the remuneration committee and board).
- Link between the remuneration policy and business strategy (i.e. what the current remuneration strategy is, what the overall business strategy entails and whether the remuneration strategy supports the business strategy).
- Criteria for determining pay levels (e.g. market benchmarks, level of responsibility, individual's experience, expertise and performance as well as the company's performance).
- Components of remuneration packages (e.g. fixed components covering fees or salary and variable components such as short-term and long-term incentives).
- Nature of commitments that would entail in the event of early termination of directors and senior management (e.g. severance payment).
- Description of the ways in which current and future risks are taken into account in the remuneration packages and how the company seeks to adjust remuneration to consider long-term performance (e.g. deferred remuneration that is vesting upon performance conditions, clawback provisions or downward revaluation of remuneration awards in the event of the untoward).
- An outline of the procedures for ensuring executive incentives are subjected to stress testing and modelling to ensure their appropriateness under different performance outcomes.
- A protocol for assessing the integrity of remuneration proposals submitted by management and external advisors.

Remuneration packages for executive directors and senior management should involve a balance between fixed and performance-linked (variable) elements. The relative weightage of fixed and variable remuneration for performance varies with level of responsibility, complexity of the role and typical market practice.

The executive remuneration should be set at a competitive level for similar roles within comparable markets to recruit and retain high quality executive directors and senior management. Individual pay levels should reflect the performance of the individual, skills and experience as well as responsibility undertaken. It is the remuneration committee's duty, when recommending incentive schemes, to ensure that the linkage between pay and performance is robust.

A summary of the main components of the typical remuneration package for executive directors and senior management as well as their key objectives is set out below.

Base salary and benefits

- consists of base salary and benefits
- includes payment for performing the day job
- recognises status and responsibilities
- provides basic benefits, including retirement funding, vehicle and/or housing allowances, etc.
- has in place severance arrangements

Short term incentives

- creates a performance culture
- supports short-term operational objectives
- rewards achievement of financial and short-term personal targets

Long term incentives retention

- long-term focus
- purports to align executives to shareholders
- retains key talents
- addresses skills shortages

As for non-executive directors, the remuneration should take into account fee levels and trends for similar positions in the market and the time commitment required from the director (estimated number of days per year). Such packages should take into consideration any additional responsibilities undertaken such as a director acting as chairman of the board, chairman of a board committee or as the senior independent director.

Non-executive directors are normally remunerated by way of fees and other benefits payable (in the form of cash and by a fixed sum) that are approved by shareholders on an annual basis.

In determining the fees for non-executive directors, the following approaches have been commonly identified:

Fee approach	Details
Fixed fees	A simplistic approach that sees an all-inclusive lump sum fee being paid to directors. Chairpersons typically receive a fixed fee irrespective of the committees they serve on, or the additional responsibilities that they assume.
Fixed board fee plus set fees for either chairperson or member of a committee	This is the most common approach used to determine non-executive fees.
Fixed fees for each category of meeting, based on a pre-arranged agenda for the ensuing year	The determination of fees is based on an aggregated fee per meeting.
Fixed fees for each category of meeting, with the provision that there is no payment for non-attendance	The determination of fees based on an aggregated fee per meeting, with a condition that attendance is a pre-requisite for payment.

The illustrative disclosure on the following page outlines examples of the components in the remuneration packages for executive directors and non-executive directors.

Illustrative disclosure

Executive directors' remuneration consists of the following components:

The total reward framework has three components and, in aggregate, is benchmarked against relevant financial services competitors:

- Fixed remuneration – takes into account the size and complexity of the role, individual responsibilities, experience, skills and disclosed market-related pay levels in the financial services industry;
- Short-term incentives ("STI") – are determined based on an STI target set using similar principles to those used for fixed remuneration, and on individual, divisional and Group performance objectives for the year. Performance is measured against risk-adjusted financial targets and non-financial targets that support the Group's strategy; and
- Long-term incentives ("LTI") – are designed to align the remuneration of executives to the long-term performance of the Group and the interests of shareholders. The amount of the award takes into account market benchmarks, individual performance over time, succession potential and key skills.

<table>
<tr><th>Fixed remuneration (34%)</th><th colspan="3">At risk remuneration (variable reward) (66%)</th></tr>
<tr><td rowspan="3">Comprises:
• cash salary;
• salary sacrificed items (items such as cars, electronic devices and other personal expenses; and
• employer superannuation contributions in line with statutory obligations</td><td colspan="2">Short-term incentive (STI) (34%)</td><td>Long-term incentive (LTI) (32%)</td></tr>
<tr><td colspan="2">Maximum opportunity = 150% of Target STI</td><td rowspan="2">Comprises performance share rights which vest over a four-year period if performance hurdles are achieved.</td></tr>
<tr><td>Cash STI

50% of Total STI</td><td>Deferred STI

Restricted shares or share rights

50% of Total STI</td></tr>
</table>

Non-executive directors' remuneration consists of the following components:

Remuneration component	Paid as	Detail
Base fee	Cash	This fee is for service on the Westpac Banking Corporation board. The base fee for the chairman covers all responsibilities, including all board committees.
Committee fees	Cash	Additional fees are paid to other non-executive directors for chairing or participating in board committees.
Employer superannuation contributions	Superannuation	Reflects statutory superannuation contributions which are capped at the superannuation maximum contributions base as prescribed under the Superannuation Guarantee legislation.
Subsidiary board and advisory board fees	Cash	Fees are for service on subsidiary boards and advisory boards. These fees are paid by the relevant subsidiary.

Source: Westpac Group Annual Report 2016 (Australia)

Where — Regional/international perspectives

As with Malaysia, many jurisdictions have enumerated provisions for companies to put in place fair and transparent remuneration policy and procedures as well as to disclose them.

Country	Provision(s)
Singapore	There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors ***(Principle 7)***. The remuneration committee should review and recommend to the Board a general framework of remuneration for the Board and key management personnel ***(Guideline 7.2)***.
Australia	A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders ***(Principle 8)***.
United Kingdom	Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied ***(Principle D1)***. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors ***(Principle D2)***. Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role ***(Provision D.1.3)***.
South Africa	The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic and positive outcomes in the short, medium and long term ***(Principle 14)***.