Remuneration committee

**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 6.2**

The board has a Remuneration Committee to implement its policies and procedures on remuneration including reviewing and recommending matters relating to the remuneration of board and senior management.

The Committee has written Terms of Reference which deals with its authority and duties and these Terms are disclosed on the company’s website.

(What could go wrong: Involvement or influence of major or controlling shareholders in setting nominee directors’ remuneration. Lack of oversight in the design and implementation of directors and senior management’s remuneration framework. Absence of a well-defined remuneration policy or any transparent process in recommending the remuneration of directors and senior management. Lack of responsiveness to stakeholders’ concerns on remuneration matters. Involvement of executive directors in deciding their own remuneration.)

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.

**Why**

**The case for change**

Compared to the other board committees, the remuneration committee is often regarded as a singular purpose committee (i.e. its function is only in respect of remuneration for directors and senior management). Whilst this may be true, to view the remuneration committee of having less of a responsibility compared to other committees is to diminish its standing within the board ecosystem.

The logic behind the remuneration committee is for a group of individuals, familiar with the company but also responsive to the views of shareholders (and the other stakeholders), to be accountable in the determination of executive remuneration, but with no personal financial interest in the decisions thereof.

Oliver Williamson, in his now widely-referenced book, wryly commented that in the absence of a remuneration committee, “directors would appear to write their own contracts with one hand and sign them with the other”.

Consequently, it has become common for boards of listed issuers, as well as not-for-profit and non-governmental organisations, to constitute a committee tasked with reviewing the remuneration framework, policy and procedures. Typically, the coverage is for directors and senior management, but some committees choose to cover the entire company.

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1. Greenbury, R 1995, *Directors’ Remuneration*
The real challenge for this Practice is less about constituting a remuneration committee; it is more of whether the committee has a real say over the company’s remuneration affairs. Frequently, the committee functions only as a rubber stamp to gloss over remuneration already determined by the controlling shareholders and/or executive management.

**Bursa Securities Listing Requirements** do not prescribe a remuneration committee, but aspects of directors’ remuneration in terms of disclosure, types of remuneration payable and requirement for shareholder approval have been enumerated.

Meanwhile, **Standard 12.1 of Bank Negara Malaysia’s Policy Document on Corporate Governance** has mandated the establishment of a remuneration committee for financial institutions. **Guidance 12.2** of the said document allows them to combine the nominating committee and remuneration committee.

It is important to note that the remuneration committee’s meetings are typically planned well in advance to coincide with the review process over remuneration. The results and recommendations arising from the committee’s review are then tabled to the board for approval.

Some of the better practices adopted by the remuneration committee of companies are as follows:

- the committee is chaired by an independent director;
- it reviews and recommends remuneration scheme for directors that stretches over a few years, whilst annually reviewing remuneration for the wider employee group;
- the committee is cognisant that remuneration for certain groups may need to be looked at with due regard to specific consideration (e.g. remuneration of internal auditors should be determined by the audit committee so as not to impair the objectivity); and
- separate sessions are held with the nominating committee as a formal forum to gather insights on the performance of directors and senior management with a view of integrating these considerations in recommending the remuneration of directors and senior management.

**Dos**

- Nominate an independent chairman to lead the committee.
- Spend adequate time to fully comprehend the complexities of remuneration scheme (e.g. clawback and vesting provisions).
- Avoid overlapping advisors – in some companies, it was observed that the management team had engaged the same consultants that the committee had enlisted. Although this could be beneficial to the company, it could also lead the committee to an impasse if conflicting reports are received.
- Conduct periodic review of the remuneration structure and policy to ensure retention of key personnel.

**Don’ts**

The following would render the application of this practice ineffective:

- Overriding the work of the remuneration committee (e.g. bonuses are paid out before the committee has met).
Facets of well-run remuneration committees:

**Objective**
The committee members exercise objectivity and are not conflicted in determining remuneration.

**Principled**
The committee has adopted a framework that is based on sound principles (e.g., *Principles for Sound Compensation Practices and Implementation Standards by the Financial Stability Board*).

**Counselled**
Professional assistance is sought, when required, to lend objectivity to the committee’s review.

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**Point for reflection**
Remuneration, whilst a great motivating factor for employees, should not be viewed in isolation. Often, dissatisfaction with remuneration is a symptom of a wider malaise, and the remuneration committee may sometimes find it useful to consider wider issues on culture, ethics and strategic direction. This is where interaction with the nominating committee can be useful.

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

**What are the key responsibilities of a remuneration committee?**

A remuneration committee should have a charter or terms of reference that clearly sets out its role and provides it with all the necessary powers to perform that role. Some of the suggested responsibility areas that can be considered when outlining the terms of reference of a remuneration committee are as follows:

- support the board in actively overseeing the design and operation of the company’s remuneration system;
- review and recommend to the board on the remuneration of non-executive directors, particularly on whether the remuneration remains appropriate to each director’s contribution, by taking into account the level of expertise, commitment and responsibilities undertaken;
- review and recommend to the board on the total individual remuneration package for executive directors and senior management personnel including, where appropriate, bonuses, incentive payments within the terms of the agreed remuneration policy and based on individual performance;
- oversee the qualitative and quantitative disclosures of remuneration made in the annual report and notice to general meetings; and
- provide clarification to shareholders during general meetings on matters pertaining to remuneration of directors and senior management as well as the overall remuneration framework of the company.
An illustrative disclosure on the terms of reference of a remuneration committee that serves to assist the board in developing and administrating a fair and transparent remuneration procedure for directors, senior management and other key personnel is provided below:

Illustrative disclosure

Terms of reference of the remuneration committee:

a) to review and make recommendations to the Board in relation to the Westpac Group Remuneration Policy (Group Remuneration Policy) and to assess the Group Remuneration Policy’s effectiveness and its compliance with Prudential Standards;

b) to review and make recommendations to the Board in relation to the individual remuneration levels of the Chief Executive Officer (CEO), Non-executive Directors, Group Executives, other executives who report directly to the CEO, other persons whose activities in the Committee’s opinion affect the financial soundness of Westpac, any person specified by Australian Prudential Regulatory Authority, and any other person the Board determines;

c) to review and make recommendations to the Board in relation to the remuneration structures for each category of persons covered by the Group Remuneration Policy;

d) to review and make recommendations to the Board on corporate goals and objectives relevant to the remuneration of the CEO, and the performance of the CEO in light of these objectives;

e) to review and make recommendations to the Board on short-term incentive (STI) and long-term incentive (LTI) plans and outcomes for Westpac’s Group Executives;

f) to review and make recommendations to the Board in relation to approving any and all equity based plans (Equity Plans); and

g) to oversee general remuneration practices across the Westpac Group; and

h) to oversee the enterprise-wide programme of work known as the “Workforce Revolution” (i.e. high-performance workforce and culture).

Source: Westpac Banking Corporation Ltd.’s website 2017 (Australia)

It is also important for the board to ensure that the committee comprises board members who will not benefit personally from their decisions (i.e. individuals concerned must abstain from discussing their own remuneration) and who will give due regard to the interest of shareholders and other stakeholders.

Can the remuneration committee be combined with the nominating committee?

Some listed issuers choose to combine the nominating and remuneration committees (calling them as such). Indeed, a cursory review of the top ten largest listed issuers on Bursa Malaysia (based on market capitalisation) revealed that seven listed issuers have combined the committees³.

Given the increased workload of a combined committee, the ability of the committee to accord due attention on the matters discussed and time

³ Of the ten largest listed issuers on Bursa Malaysia, by market capitalisation as at 31 December 2016, seven listed issuers have combined their nominating and remuneration committee. This includes a financial services group (the combining of such committees is permitted by Bank Negara Malaysia).
commitment of the members would need to be considered accordingly in deciding as to whether a stand-alone remuneration committee should be established.

**How should the remuneration committee be composed?**

As stated in the *Guidance to Practice 6.2 of MCCG*, in order to foster objectivity in the deliberations and decision-making of the remuneration committee, it is essential to ensure that the committee consist of only non-executive directors with a majority of them being independent directors. At all times, it is important to ensure that executive directors are not involved in deciding their own remuneration.

Executive directors may, however, be invited to participate in selected meetings of the remuneration committee to provide insights, particularly on considerations relating to the performance of the company. The committee may also draw advice and enlist the professional services of experts, if necessary.

The size of the remuneration committee may differ depending upon the requirement of the company and the extent of responsibilities delegated to the committee. The objective is to allow the committee to function efficiently and for all members with appropriate levels of experience and knowledge to participate. Companies may also have a policy of rotating its remuneration committee members whilst taking into account the need to weigh a member’s experience and knowledge against the risk of complacency.

**How often should the remuneration committee meet?**

The frequency of meetings for a remuneration committee is not prescribed. This should be driven by the needs of the committee, in line with the complexities involved in determining the remuneration packages of directors and senior management.

More frequent meetings may be called as the need arises, especially when there are major changes to the composition of executive directors and/or changes to the corporate structure of the company or its group.

A review of annual reports across the top 50 Malaysian listed issuers (by market capitalisation) in 2016 revealed that remuneration committees averaged 4 meetings a year.

**What are some of the common challenges that are faced by the remuneration committee?**

Examples of commonly faced challenges in this regard include:

- Recommending the remuneration of directors whose appointments are made outside the purview of the nominating committee, i.e. directors appointed by major shareholders or the government;
- Presence of dominant directors or controlling shareholders who could influence the committee’s decisions; and
- Small boards may find it difficult to rotate members of remuneration committee to bring in fresh perspectives.
Regional/international perspectives

Similar to Malaysia, many jurisdictions including United Kingdom, Singapore and Australia have enumerated provisions for the establishment of a remuneration committee.

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<th>Country</th>
<th>Provision(s)</th>
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<td>Singapore</td>
<td>The Board should establish a remuneration committee with written terms of reference which clearly set out its authority and duties. The remuneration committee should comprise at least three directors, the majority of whom, including the remuneration committee chairman, should be independent. All of the members of the remuneration committee should be non-executive directors <em>(Guideline 7.1).</em></td>
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<td>Australia</td>
<td>The board of a listed entity should:</td>
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<td>(a) have a remuneration committee which:</td>
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<td>(1) has at least three members, a majority of whom are independent directors; and</td>
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<td>(2) is chaired by an independent director.</td>
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<td><em>(Recommendation 8.1)</em></td>
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<td>United Kingdom</td>
<td>The board should establish a remuneration committee of at least three, or in the case of smaller companies, two independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board <em>(Provision D.2.1).</em></td>
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