Enhancing disclosures on exec pay

Executive remuneration is closely scrutinised by shareholders. Here are tips to improve a company's annual pay report

By **SHAI GANU**

SAMUEL Johnson, the celebrated English author, once said: "What is written without effort is in general read without pleasure." Johnson's counsel seems as applicable to seventeenth century English literature as it does to modern-day company annual reports. One particular section in the annual report that is read with much interest is the company's remuneration report. Executive remuneration issues are closely scrutinised by shareholders, proxy advisers, and the business media. However, shareholders often express concerns about the amount and clarity of information provided on this subject.

This article suggests six effective tips for boards of Asian companies to enhance their remuneration disclosures, and in doing so, comply with their relevant listing rules or corporate governance codes.

The first tip and probably the easiest to implement is a letter from the remuneration committee chairman to shareholders. These opening remarks should introduce the remuneration report and provide shareholders with important information like business context, executive pay issues reviewed by the committee in the past year, and likely focus areas for the next year. It should also explain the rationale for any changes to the executive remuneration framework. Not only does such a letter add a personal touch, it also sets the scene for reading the remainder of the remuneration report.

Second, and this logically follows the committee chairman's comments, is a discussion of the company's executive remuneration framework. Most companies do this in some shape or form, but progressive companies provide detailed information on their remuneration philosophy: the role of each remuneration element and how each of these is intended to drive the company's business objectives. Discussion about the peer groups used for pay benchmarking, the committee's assessment of the executive talent pool (that is, where they hire people from or lose people to), and the construct and execution of incentive arrangements, all provide shareholders with a better understanding of the company's remuneration philosophy. It is also prudent to split this section into two parts: one focusing on past year's outcomes, and the other on next year's policies, particularly if there have been changes.

Third is the issue of disclosing actual pay levels for the CEO and senior executives. Regulators in most jurisdictions suggest that companies disclose pay levels for the CEO and at least the top five executives. Progressive companies, however, disclose remuneration details for all key management personnel (KMP). From an executive's perspective, the most important pay driver is a sense of fairness (not greed, as is a popular belief). Increased remuneration disclosures may actually help with the assessment of fairness – particularly if companies start disclosing actual take-home pay – which is the next point.

It adds up: *From an executive's perspective, the most important pay driver is a sense of fairness (not greed, as is a popular belief). Increased remuneration disclosures may actually help with the assessment of fairness – particularly if companies start disclosing actual take-home pay.* ST FILE PHOTO

Fourth is the practice of disclosing realised pay. Most jurisdictions require companies to disclose the accounting values of certain pay components, particularly equity-based payments, which can end up being different from the actual economic value received by executives. Realised pay includes the executive's annual base salary, the cash component of the bonus paid during the year (that is, non-deferred element), and the value of any equity that may have vested from prior years' awards. This is different from target pay levels, which reflect the earning opportunity if certain performance conditions are met. Companies are beginning to disclose realised pay for their senior executives, as this is more representative of their annual "take-home" pay. Realised pay disclosures can also help quell perceptions of egregious pay levels, particularly in cases where the accounting disclosures are much higher than actual take-home pay. This can occur due to the accounting treatment of equity awarded during the year that may, or may not, vest three or five years down the line.

Fifth is demonstrating the alignment between pay and performance. Many companies claim to practise pay for performance, however, it is important to understand where performance truly lies. Generally, shareholders want to understand two things: the impact of the executive team's actions on the value of their shareholding, and whether they would have been better or worse off had they invested in a peer company instead. The remuneration report can help address these issues in the following ways:

Better disclosure of KPIs: without divulging commercially sensitive targets or strategic objectives, companies should share how they fared against targets for key KPIs. Provided shareholders have confidence in the board's ability to set appropriately stretched targets, understanding actual performance against said targets helps shareholders assess the effectiveness of the executive team.

Detailed peer comparisons of relative pay and performance: assessments of executive pay and corresponding performance indicators in relation to the company's peers. For instance, relative ranking of fixed pay against company size (market cap, revenue); fixed pay plus annual incentives against one-year performance measures (revenue growth, profits, economic value), and total package against long-term shareholder value measures (relative total shareholder return, earnings per share, wealth added, return on equity).

Time orientation of executive pay: assessment relative to peers regarding what proportion of the total package is delivered as equity or deferred bonuses versus the length of the deferral or vesting period.

Proxy advisors are increasingly using such pay-for-performance analyses to inform their voting decisions. Leading companies are being proactive and including these analyses in their remuneration reports.

The sixth and final tip relates to disclosures of non-executive director (NED) fees. While companies are required to disclose the base and committee fees paid to NEDs, only a few disclose the philosophy behind NED pay; for example, peer group for pay benchmarking, desired positioning after considering the workload and reputational risks, and delivery of fees via shares to help increase NED shareholding. Companies should also disclose the target fees for chairing and membership of the board and committees. This helps shareholders assess the company's cost of governance vis-a-vis its peers.

Implementing these tips will help Asian companies satisfy, and in most cases exceed, the disclosure requirements included in their jurisdiction's listing rules or corporate governance codes. Singaporean companies implementing these tips will likely meet the requirements of the Monetary Authority of Singapore's revised Code of Corporate Governance. Within the region, Singapore's code and Hong Kong Stock Exchange's listing rules and Corporate Governance Code are perhaps the most comprehensive, and at par with global practice. It is important to note that Asian countries follow the "comply or explain" model rather than the legislative route adopted by their Western counterparts, which while difficult to enforce, does minimise the risk of unintended consequences.

Asian companies generally lag their Western counterparts when it comes to remuneration-related disclosures. A concise, well-structured remuneration report with the ideas discussed in this article will go a long way towards bridging the gap, enhancing the company's reputation, and bolstering shareholder confidence regarding the governance of Asian companies.

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