PowerTalk #3
Institute of Corporate Directors Malaysia (ICDM)
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EXECUTIVE SUMMARY

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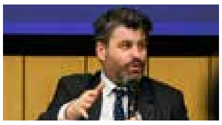
Revisiting the Misconception of Board Remuneration

Insights sharing by Mark Reid, Global Head of Reward, Willis Towers Watson

A DEBATE ON NEDs' FEE TO COMMENSURATE WITH EFFORT, RESPONSIBILITY AND RISKS ASSOCIATED WITH THE ROLE

PANELLISTS



Mark Reid
Global Head of Reward, Willis Towers Watson

Nik Mohd Hasyudeen Yusoff
Director, Bank Islam Malaysia Berhad

Rowina Ghazali
Director, UEM Edgenta Berhad

MODERATORS

Tan Juan Jim
Executive Director & Head of HR Advisory, Willis Towers Watson, Malaysia

Michele Kythe Lim
President/CEO, ICDM

INTERACTIVE SESSION

UNDERSTANDING THE PSYCHOLOGY OF PAY: BALANCING THE CARROT AND STICK

Shai Ganu
Managing Director, Rewards Business Leader - Asia Pacific, Willis Towers Watson, Singapore

INTRODUCTION

PowerTalk by Institute of Corporate Directors Malaysia (ICDM)
13 March 2019, Kuala Lumpur, Malaysia

The PowerTalk is a platform for inspiring conversations around local, regional and global board effectiveness. The series of talks aim to create an environment where directors from diverse backgrounds can exchange ideas, share insights and discover new perspectives that can lead to actionable outcomes that help shape the future.

ICDM organised its third PowerTalk featuring Mark Reid, the Global Head of Reward at Willis Towers Watson, the world's largest executive and non-executive compensation advisory firm serving over 30 countries across the globe, and a special interactive session by Shai Ganu, the Managing Director, Rewards Business Leader in Asia Pacific for Willis Towers Watson, Singapore.

The sharing sessions were followed by a panel discussion and Q&A session joined by Mark, Shai, Rowina Ghazali, Director of UEM Edgenta Berhad, and Nik Mohd Hasyudeen Yusoff, Director of Bank Islam Malaysia Berhad. The panel discussion was moderated by Tan Juan Jim, Executive Director & Head of HR Advisory, Willis Towers Watson, Malaysia and Michele Kythe Lim, President/CEO of ICDM.

This executive summary captures the salient points presented by each of the speakers.

POWERTALK BY MARK REID

Finding the Right Balance

- Expanding commitment
- Structure, pay model & company size matter
- Emerging requirements
- Equity compensation: yay or nay?
- What is enough?

> **"The key to a fair board remuneration is to get the balance right. It must reflect the commitment required of the director and risk exposure that comes with increased external scrutiny."**

MARK REID, GLOBAL HEAD OF REWARD, WILLIS TOWERS WATSON

Designing a fair board remuneration package requires a closer look into the evolutionary journey of boards.

Mark Reid had spent most of his time in the last 30 years advising a variety of companies, including Fortune 500 companies, on board pay. Drawing from his vast experience, he helped the audience see better clarity on the topic by examining how the roles of board, its structures, demographics and the pay models have evolved over the past decades.

EXPANDING COMMITMENT

In the last ten years, time commitment of non-executive directors (NEDs) has notably ramped up. This is partly in response to greater governance requirement. A change to a governance code would set out additional responsibilities for board members; and this is especially true in markets with an activist governance regime. NEDs are also increasingly expected to engage with the shareholders and other stakeholders, such as employees and customers, directly.

Furthermore, there is an increasing number of committees being created at board level as the business landscape grows more complex. Traditionally, listed companies have three committees at the top: nomination, remuneration and audit. Over the last decade, we now see that companies are adding at least one or two specialist committees, such as risk & finance, research & development, and sustainability. Boards are also expected to undergo formal effectiveness reviews by external experts at both individual and group levels.

These shifting trends call for NEDs to carve out more time and effort to fulfil their duties. Thus, it is only fair to rightsize their remuneration to reflect these new developments.

STRUCTURE, PAY MODEL & COMPANY SIZE MATTER

Boards are typically distinguished by their structure, pay model, company size and industry - these factors play an essential role in determining NEDs pay package.

Malaysian corporate boards, similar to those in Asia, North America, and half of Europe, are built on a unitary structure with one single board overseeing the whole organisation. Some countries in Europe, such as Germany and the Netherlands, practise the less common dual board structure, separating the supervisory board and management board.

Board pay models

PRO-BONO
- No fee
- DIrectors volunteer
- No differentiation in pay

PER DIEM
- Often no fixed fees for "governance" role
- Per diem rate for additional Board activities
- Differentiation in pay

SINGLE "BUNDLED" FEE
- Single fee for all work required
- No differentiation in pay

STRUCTURED "UNBUNDLED" FEE
- Fixed fee
+
- Committee fees
- Attendance fees
- Fees for additional Board activities
- Differentiation in pay

- Fixed fee
+
- Committee fees
- Fees for additional Board activities
- Differentiation in pay

France; Germany; Spain; Malaysia; Netherlands; UK

US

Japan; Taiwan; Australia

When it comes to pay model, most Asian countries, including Malaysia, adopt the structured "unbundled" fee with attendance fee, where NEDs receive a fixed fee, attendance fee and additional fees for any role they may take on. In North America and Europe, the structured "unbundled" fee without attendance fee is preferred as they opine that the symbolism of attendance fee implies the fact that attending meeting is NEDs' primary responsibility, undermining their other larger professional contributions.

Other pay models observed are: (1) pro-bono, where directors contribute their time voluntarily; (2) per diem, where there is no fixed fee and directors are compensated for additional board activities; (3) single "bundled" fee, where there is only a single fee for all work required. Among all the pay models, the structured "unbundled" fee model is the most popular and, according to Mark, the most ideal one, for it is comprehensive and able to address the matter of increasing board roles and responsibilities.

Company size also plays a big role in determining board remuneration. It must be taken into consideration when choosing a reference point. For example, an average NED pay in Malaysia's top 30 companies is RM467K (US$100K) per annum, whilst the equivalent number for the top 300 companies is RM162K (US$40K). Therefore, fee levels must be benchmarked against similar sized companies and ideally operating in similar sectors.

EMERGING REQUIREMENTS

Driven by regulatory framework or sheer business force, board composition is changing across the world, most notably in North America and Europe. Guidelines and targets are being set for equal gender representation. Many companies are interestingly looking to have more nationalities represented on board, with Asian NEDs amongst the most sought after. Increasingly, companies are also looking to recruit younger, more tech-savvy NEDs. There is also a marginal increase in number of active non-retired individuals joining the board rather than individuals after their executive life.

EQUITY COMPENSATION: YAY OR NAY?

The topic of equity compensation for NEDs attracts rather diverging views with most governance regimes, like the UK, strictly prohibiting it, while some others like the US and Switzerland, encouraging it. On the one hand, there is a very strong view that given the roles and responsibilities of NEDS, it is very important to have their interest in line with the shareholders.

On the contrary, a lot of regulators feel that to be truly aligned with the interest of a diversified shareholder base, NEDs should not have too much of their wealth tied up in the shares of the company. They reckon that NEDs' independence of thoughts would be impinged if there is too much equity at stake, especially when it comes to decisions around merger & acquisition and other key investment decisions.

Mark suggests that having a modest amount of equity is healthy, where a balance can be struck between alignment and independence. He is more relaxed about awarding a small proportion of NEDs' annual fees as simple equity with no conditions or encouraging NEDs to buy equity with their cash fees with shareholding guidelines. However, Mark stresses that NEDs should not receive share options and any performance-linked equity. Such programmes come with leverage and require careful supervision of performance targets; hence, they do run the risk of compromising independence.

WHAT IS ENOUGH?

There is no one simple way to answer whether NEDs are being paid enough. As Mark concludes the session, he expresses that it is all about balances. Determination of NED fees requires careful consideration from multiple perspectives such as company size and structure, availability of talent, increasing time commitment, professionalism, external scrutiny and risk exposure. In order to achieve greater objectivity and unbiased assessments, companies may engage an independent, professional and experienced party to help navigate these complex issues in a more structured manner.

He, however, emphasises that while NEDs should be compensated fairly, they should not be relying too much on the money to ensure sound, objective decisions can be made in the best interest of the company.

SPECIAL INTERACTIVE SESSION WITH SHAI GANU

The Psychology of Pay

Challenging the conventionally accepted models of pay and performance, Shai Ganu from Willis Towers Watson examined what drives and motivates people.

The current executive compensation models adopted by most companies today are derived based on the risk-reward profile that is more representative of an anglo-saxon risk-reward profile, which favours the "high risk, high reward" model. These compensation models work well in North America and Europe. But what about in Asia?

Through an interactive, anonymous, live-polling session, the participants validated some key findings:

We need to challenge the conventional models and design pay models that are more relevant to our cultural context. Best fit is more important than best practice.

SHAI GANU, MANAGING DIRECTOR, REWARDS BUSINESS LEADER – ASIA PACIFIC, WILLIS TOWERS WATSON, SINGAPORE

DIRECTORS' DEBATE

Board Remuneration: A Reality Check

- Make it mutual
- Just the right amount
- Keep it simple
- Skill-based pay
- Clawback on NEDs
- Regulations on remuneration
- Scandals are good

Examining NED's pay from multiple perspectives.

Rowina Ghazali, second year into her directorship journey, and Nik Mohd Hasyudeen Yusoff, a veteran director with deep knowledge in the financial sector, joined Mark and Shai to examine the state of board remuneration in Malaysia and discuss steps moving forward.

MAKE IT MUTUAL

Right from the beginning of the discussion, Rowina agrees that directors' fees should reflect the time they put in. She, however, stresses the importance of setting mutual expectations between the NED and the company, "what would you remunerate me for the time I put in and what are you expecting of me as an independent director on the time I should put in?" From the vantage point of her having made the transition from management to board recently, she emphasises that the subject of pay must be considered from those two perspectives. Nik concurs and states that "expectations should be set before appointment and assessment must be made before NEDs are reappointed."

JUST THE RIGHT AMOUNT

There is a consensus from the panel that directors' fees should not be too high that they become beholden to the company nor should it be too low that directors feel demotivated to put in 110% for their roles. "An independent NED should remain independent. When one becomes dependent on the fee, you tend to agree on everything," says Nik. Mark concurs on this point and says that companies must avoid directors' dependence on higher fees and it is key to get the right balance that reflects the directors' commitment, skills and risks.

KEEP IT SIMPLE

Conventional compensation theory often focuses on seeking ways to incentivise the right behaviours. While it works effectively at the executive level, it does not necessarily deliver the same outcomes when it comes to the NEDs. NEDs pay structure is a lot more complex. Therefore, instead of pulling resources to incentivise the right behaviours, Mark says, "companies should focus on avoiding incentivising the wrong behaviours. Keep the pay structure simple to avoid the many potential pitfalls".

SKILL-BASED PAY

As the roles of board evolve, many wonder if NEDs should be compensated based on their individual skill sets. On this point, Nik shares that such an approach is not currently being practised in Malaysia. Nonetheless, he is open for this topic to be explored further. Nik also highlights that while it is key to have individuals with the right skills, it is imperative to consider the board as a collective. Essentially, the board needs to work as an effective team to deliver the performance.

CLAWBACK ON NEDs

A clawback is a contractual provision whereby money already paid to an employee must be returned to an employer in the event of fraud or malfeasance. Clawback policies are usually used for incentive-based pay circumstances like bonuses. Given the trend of NEDs having higher remuneration and blurring of lines between the executive directors and the NED, should clawback be applied to the NEDs too? Mark however disagrees that clawback should be imposed on the NEDs because there is a big distinction between fees for conducting a role and pay given as an incentive for performance. These are two fundamentally different principles and therefore, at this point, NEDs should not be subject to clawback.

REGULATIONS ON REMUNERATION

The panel unanimously agree that while it is useful for regulators to set broad remuneration principles, covering matters such as the acceptability of equity grants for NEDs, they should not be involved in determining the levels of pay. The actual quantum of pay should be decided by market forces.

SCANDALS ARE GOOD

Malaysia is in a midst of many ongoing corporate scandals involving directors being taken to court due to negligence. The panel agrees that the cases serve as a wake-up call and a reminder for NEDs to be more attentive and conscientious. They are optimistic that with greater transparency being called for by the Securities Commission, corporate Malaysia will be able to mature with steadily increasing board effectiveness and professionalism.

> **"What is a good level of fee? It shouldn't be so high that you become beholden to the giver and it shouldn't be too low that you feel demotivated to put in 110%."**

ROWINA GHAZALI, DIRECTOR, UEM EDGENTA BERHAD

In the interest of time, some of the online questions put forward during the Q&A session were not addressed. We have incorporated responses for some of the relevant questions within this report.

> **It is the director's responsibility to assess the type of commitment you are able to provide to your company, and that you have the skills and ability to perform your roles well.**

NIK MOHD HASYUDEEN YUSOFF, DIRECTOR, BANK ISLAM MALAYSIA BERHAD

ACTIONABLE OUTCOMES

Moving Forward

1 SET MUTUAL EXPECTATIONS WITH YOUR COMPANY
to ensure the two parties are in agreement of the time and effort required in performing your role.

2 TAKE LOCAL CULTURE CONTEXT INTO CONSIDERATION TO CREATE A RELEVANT COMPENSATION PACKAGE.
It is the first step in ensuring good corporate governance.

3 RE-EXAMINE YOUR COMPANY'S BOARD PAY MODEL
to ensure it has taken into consideration the increased time commitment, scrutiny and risks.

4 KEEP BOARD PAY STRUCTURE SIMPLE
to avoid incentivising the wrong behaviours and creating fee-dependent directors.

5 LEARN FROM THE EXISTING CORPORATE SCANDALS
to improve regulations and practices, paving ways for better governance and effectiveness.

6 CHOOSE THE RIGHT NED PAY BENCHMARK BY CONSIDERING MULTIPLE FACTORS
because benchmarks differ vastly between different companies and industries.

7 ENGAGE AN INDEPENDENT PARTY TO HELP NAVIGATE THE COMPLEX PAY ISSUES
to obtain greater objectivity and unbiased assessments.