PowerTalk #5
Institute of Corporate Directors Malaysia (ICDM)
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EXECUTIVE SUMMARY

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Institute of Corporate Directors Malaysia

Say On Pay:
What Do Boards Need To Know?

Insights Sharing by Shai Ganu
Managing Director, Rewards Business Leader – Asia Pacific
Willis Towers Watson

Insights Xchange: Balancing Shareholders' Expectations and Board Remuneration
An ideation session between the panel and audience to exchange insights, discuss possibilities and find solutions.

PANELLISTS

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

Jeremy Nasrulhaq
Independent Non-Executive Director, Kenanga Investment Bank

Lya Rahman
Advisor & Council Member, Institutional Investors Council

MODERATOR

Tan Juan Jim
Executive Director – Malaysia, Willis Towers Watson

INTRODUCTION

PowerTalk by Institute of Corporate Directors Malaysia (ICDM)
13 August 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.

The Institute of Corporate Directors Malaysia (ICDM) organised its fifth PowerTalk featuring Shai Ganu, Managing Director, Rewards Business Leader – Asia Pacific of Willis Towers Watson. Shai also serves on the Compensation Committee of a leading FMCG company in ASEAN, the Human Resource and Finance Committees of not-for-profit organisations in Singapore and, more recently, as a non-executive director of a listed company in Singapore.

The sharing session was followed by the Insights Xchange session joined by Shai Ganu himself, Lya Rahman, Advisor & Council Member of Institutional Investors Council, and Jeremy Nasrulhaq, Independent Non-Executive Director of Kenanga Investment Bank. The panel was moderated by Tan Juan Jim, Executive Director of Willis Towers Watson Malaysia.

This executive summary captures the salient points presented by each speaker at the PowerTalk.

POWERTALK BY SHAI GANU

It is Time to Pay Attention

- Arrival of Say on Pay
- SoP around the world
- Unintended consequences
- REMCO 2.0
- Stay engaged

> **There are always opportunities to future proof your compensation framework, irrespective of whether your market adopts the regulatory approach to remuneration governance.**

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

Does giving shareholders more power to influence board and executive fees help improve remuneration governance?

Combining his expertise in human capital solutions and experience as a corporate director, Shai Ganu unpacked the concept of Say on Pay and offered some recommendations to board directors in Malaysia on how they can strategically approach this increasingly popular policy.

ARRIVAL OF SAY ON PAY (SoP)

The call to give shareholders a voice in the determination of board and executive pay – or commonly known as Say on Pay – may be a relatively new notion in Asia. It has however been in existence two decades ago.

The first official consideration of such a policy came in July 1999 in the United Kingdom (UK) as a result of increased public scrutiny and enhanced pay disclosure. SoP then swiftly gained momentum in most Anglo-Saxon jurisdictions after the 2007-2008 global financial crisis, which many believe was caused by excessive risk-taking of executives, driven by unhealthy remuneration practices.

As macro-economic events such as rising populism and stagnation of the global economy continue to unfold, Shai opines that scrutiny on board and executive compensation will only intensify; and SoP will continue to gain momentum globally.

SoP AROUND THE WORLD

Remuneration is a multi-faceted issue. Therefore, the implementation of Say on Pay varies from country to country.

According to Shai, UK has the most advanced pay governance, with binding SoP votes that allow shareholders a legally binding vote on board and executive remuneration resolutions, including the company's backward-looking pay outcomes and forward-looking policy. The Government has also announced a number of corporate governance reforms, which include publishing the pay ratio between CEO and the average UK worker, creation of a public register of listed companies who received below 80% support, improvement to employee representation at board level in listed companies, as well as a new voluntary corporate governance code for large private companies.

The rest of Europe is also quickly catching up with the introduction of the Shareholder Rights Directive (SRD), which sets out to strengthen the position of shareholders and to ensure that decisions are made for the long-term stability of a company.

In the United States, non-binding, or advisory votes are adopted. It allows shareholders to vote on remuneration-related resolutions, but only to express their level of satisfaction. Their votes do not compel the company to act. Nonetheless, the regulatory landscape in the US is also rapidly changing, with pay for performance disclosure, CEO pay ratio disclosure and clawbacks for restatements being the priority areas.

Asian markets, with the exception of Japan, has neither of these systems as SoP has not yet been adopted in the East. Currently, Malaysia and other countries, such as China, Indonesia and Singapore, embrace a "comply or explain" approach to board and executive compensation. Shai believes this is the most ideal practice as over-regulation may result in unforeseen setbacks.



UNINTENDED CONSEQUENCES

Shai dubs these setbacks as "unintended consequences" as there have been several instances where a well-intended regulation gives rise to negative outcomes in the overall corporate governance environment. He details it in the table below.

#	Regulation	Original intent	Unintended consequences
1	2-strikes rule in Australia	• More authority to shareholders • First strike to signal discontent; second to dissolve the Board	• Votes impacted by matters other than remuneration • Board spill contrary to investors' interest
2	Capital Requirements Directive (CRD) IV in the UK	• Curb bankers' compensation • All incentives capped to 1x on annual base salary (2x with shareholder approval)	• Base pay went up!
3	CEO pay ratios in US	• Disclosure of ratio of CEO pay to average worker compensation; with intent to curb CEO pay • Original drafting to link corporate tax rates and funding to ratios	• Outsource low-paid jobs!
4	Prudential Standard CPS 511 on Remuneration in Australia (currently proposed)	• New deferral requirements for up to 11 years (7+2+2) • Special category for all executives whose earning potential is A$1m	• Some executives likely to turn down promotions • Australian bankers may move overseas or to different industries; foreign talent may not find this attractive

REMCO 2.0

With or without the enforcement of SoP, remuneration governance in Asia will continue to evolve, with a majority of markets already working to enhance pay disclosure, director oversight and pay for performance. Shai emphasises that there are always opportunities for boards to future proof their pay framework ahead of the arrival of policy such as SoP.

He recommends a four-step approach to meeting the new demands in remuneration governance, which can ultimately be summed up as fair and transparent pay practices.

First and foremost, the role of remuneration committee (REMCO) in Asia needs to be upgraded. They typically are not as involved or as decisive in pay decisions as the West. With ever-rising scrutiny on pay, the responsibilities of REMCO will naturally increase. It may be prudent to consider moving the role to an external committee. REMCO of the future needs to develop the ability to align internal focus with external vision effectively.

Secondly, any incentives accorded to boards or executives must align with the company's long-term strategy and are not reliant on a narrow view of performance. Most importantly, they must be derived in alignment with shareholders and the rest of the organisation.

Thirdly, REMCO must understand the risks of the pay framework. They need to ensure metrics are properly calibrated, history of actual pay against performance is considered and any potential post-employment benefits under various scenarios must be thoroughly quantified.

Lastly, a clear governance structure must be set in place to help board members formulate a sound decision-making framework for pay and rewards decisions. It is also crucial to ensure REMCO receive independent advice and appropriate support.

STAY ENGAGED

In conclusion, in order to develop a well-rounded remuneration structure that balances performance, risk and shareholders' interest, companies must make stakeholder engagement an integral part of the company culture. In fact, not only should companies engage their stakeholders in pay issues, but also in board selection, business priorities, sustainability and other areas that are essential to the long-term success of the company. Engage with stakeholders across the board – that is the one key message Shai would like the audience to take home from the talk.

INSIGHTS XCHANGE

Pay Issues in Malaysia

- Shareholder awakening
- Overpaid or underpaid?
- Benchmarking directors' fees
- Pay for performance
- Robust nomination process

> **"The contention is not about reducing board pay, but rather it is about having a robust nomination framework to ensure compensation is fair and transparent."**

LYA RAHMAN, ADVISER & COUNCIL MEMBER, INSTITUTIONAL INVESTORS COUNCIL

To move forward, companies must learn to balance shareholders' expectations and board remuneration.

Lya Rahman, Advisor at the Institutional Investors Council of Malaysia, and Jeremy Nasrulhaq, Independent Non-Executive Director of Kenanga Investment Bank, joined Shai Ganu to discuss a variety of issues related to board and executive compensation in Malaysia.

SHAREHOLDER AWAKENING

For many years, Lya has been a powerful voice for the shareholder community in Malaysia. In the beginning of the conversation, Lya affirms that shareholder activism in the country has indeed evolved. In the past, be it retail or institutional, investors were more reserved in their call for change. Today, they are paying close attention, asking relevant questions and more willing to raise any risk issues that come to mind. Lya stresses that shareholders' rights should not be taken for granted, and effective strategies should be adopted by companies to ensure they continuously engage the shareholders in a wide variety of issues.

OVERPAID OR UNDERPAID?

In Lya's opinion, most corporate directors in Malaysia are being paid more than they should be. However, Jeremy and Shai believe otherwise. Shai says that the pay levels in Asian markets are relatively low when compared to the western markets. He cautions that low pay levels may lead to brain drain, where top talents leave Malaysia to join a more competitive markets with better pay. Jeremy, on the other hand, brings to attention that there are more than 900 public listed companies in the country, and the cases of overpaid boards are the exceptions. Generally, Jeremy believes board pay levels in Malaysia are low, especially in light of directors' increasing roles and responsibilities.

BENCHMARKING DIRECTORS' FEES

Shai highlights an important point in benchmarking a company's compensation policy. Ideally, it should be driven by a company's talent pool, i.e., companies should consider where they would like to hire people from, and where they could lose people to. If the company would like to hire from, for example, civil services, then they should use civil services as your comparators. If they are going to hire from Silicon Valley's tech giants, those companies should be in their peer group. The fundamental question is — where is the talent pool?

PAY FOR PERFORMANCE

All three panellists agree in unison that pay for performance is the way forward for executive compensation. Shai goes further to raise the question of whether CEOs should be paid for absolute performance or relative performance. The answer is both. You want to reward them for wealth creation and wealth preservation. If the overall market grows by 25% and you grow by 30%, the CEO should be rewarded.

ROBUST NOMINATION PROCESS

Remuneration is closely related to the way directors are being nominated. Lya mentions that the contention is not about reducing the pay, but it is for the pay to be justifiable; and it all starts with having a transparent nomination framework. Lya stresses that most companies have policies that allow them to acquire director talents from independent sources. However, they are largely neglected and, for many years, boards in Malaysia would rather nominate someone they know.

Shai agrees that companies need to be more professional in their director searches. In Asia, tapping on friends has been a common practice in director recruitment; and that needs to change. In most cases, companies would spend hundreds of thousands to run an executive search, but ironically not a few thousands for a non-executive director search. The same rigour that is being put into an executive search should be applied to a director nomination as well.

ACTIONABLE OUTCOMES

Moving Forward

1 **FAMILIARISE YOUR BOARD WITH THE LATEST SENTIMENTS AND DEVELOPMENTS AROUND REMUNERATION GOVERNANCE** so that the leadership is equipped with the necessary insights to take the next course of actions.

2 **GAIN A FULL UNDERSTANDING ON THE IMPACT OF SAY ON PAY** in your market and the future of corporate governance so that you are able to make sound changes to improve remuneration governance.

3 **FUTURE PROOF YOUR COMPENSATION FRAMEWORK** in view of rising scrutiny on pay, and ahead of the arrival of Say on Pay policy in your market.

4 **UPGRADE THE ROLE OF REMUNERATION COMMITTEE,** allowing it to effectively adapt to the changing landscape of board and executive pay.

5 **REVIEW YOUR COMPANY'S STAKEHOLDER ENGAGEMENT INITIATIVES.** Are you doing enough to incorporate the sentiments of shareholders and the rest of the organisation in your growth journey?

6 **REVISIT YOUR COMPANY'S NOMINATION AND REMUNERATION PRACTICES.** Are they fair, robust and transparent?

7 **RE-EVALUATE YOUR GOVERNANCE STRUCTURE** to ensure it has what it takes for board members to make sound decisions pertaining to compensation.

> **"When discussing board pay, we should not generalise. There are more than 900 public listed companies. The unhealthy pay cases we hear in the news are the exceptions."**

JEREMY NASRULHAQ, INDEPENDENT NON-EXECUTIVE DIRECTOR, KENANGA INVESTMENT BANK