



**ICGN**

International Corporate Governance Network

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# ICGN Guidance on Executive Director Remuneration

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# ICGN Guidance on Executive Director Remuneration



## Preamble

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Executive director remuneration is an important field of corporate governance, and is of relevance to companies and investors. Remuneration structures should provide meaningful and rigorous incentives for a company's executive management. With the growing trend of investor "say on pay" votes in many markets, investors have taken a more active role in the remuneration debate. Moreover remuneration also features as a subject of engagement between investors and companies. At the same time, many investors remain concerned about remuneration structures that are unduly complex, employ inadequate performance metrics, or provide a disproportionate quantum of reward that is difficult to justify.

The ICGN Guidance on Executive Director Remuneration (2016) has been developed by the ICGN Remuneration Committee in consultation with ICGN members. It replaces guidance published in 2012 and aims to provide a consistent and global perspective focused on major aspects of remuneration policy and practice that will assist companies in better understanding long-term shareholders' views, as well as serve as a tool for investors when engaging with companies.

This version of the Guidance includes four main changes from the previous edition:

- Greater clarity has been provided on committee leadership.
- Reference is made to the consideration of intrinsic motivational considerations beyond financial remuneration when determining effective remuneration structures.
- It is made explicit that base salary is payment for achieving what is expected of the executive, and that variable remuneration is payment for out-performance.
- Environmental, social and governance factors have been included in the assessment of performance to help achieve sustainable long-term value creation. This social sensitivity has particular relevance given public concerns about the high quantum of pay for executives in the context of building social awareness of the problems of economic inequality.

Each section of this document outlines the ICGN guidance related to the particular topic and, separately, a list of suggested disclosure points. The guidance provides minimum standards the ICGN believes are critical in setting, evaluating and overseeing remuneration programmes. As such, they are oriented towards structure. The suggested disclosure points are intended to assist companies to develop and disclose their remuneration policies.



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# Part 1: The Remuneration Committee

## 1.1 Role

The remuneration committee (“the committee”) is responsible for all aspects of the remuneration arrangements from drafting to implement on it is also responsible for integrating all components of remuneration into a cohesive structure. This structure must be aligned with, and support, the strategic objectives of the company over both the short-term and the long-term.

### Disclosure points

- The role and responsibilities of the committee, including its authority and interaction with the full board, and the role of consultants and management in regard to designing, implementing, monitoring and evaluating the executive remuneration arrangements.
- How the committee monitors and evaluates the effectiveness of remuneration arrangements over time, integrates risk into the remuneration programme, and discloses the results of this analysis to shareholders on a periodic basis.

## 1.2 Composition and leadership

Ideally, the committee should be comprised of entirely independent non-executive directors or supervisory board members. At a minimum, a majority of its members should be independent. In particular, the chair of the committee should be independent.

To ensure that there is not too much power vested in any one individual and to ensure adequate time to fulfil both functions, the chair of the board, or a senior independent director if the chair role is not filled by an independent board member, should not also be the chair of the committee.

The committee should consist of at least three members. Special care should be taken to ensure that the committee as a whole has adequate qualifications, experience and expertise, together with diverse perspectives.

Current serving CEOs of other companies may have a potential conflict or bias in setting their peers’ remuneration. As such, committees should be aware that many investors prefer a strict limit on the number of CEOs on the committee (such as one),

or an outright ban.

### **Disclosure points**

- How committee composition is determined, including the process for appointing members and how the committee evaluates its effectiveness. This should include how both director evaluation and committee evaluation is used in the nomination and re-nomination process, the rationale for rotating committee membership, and how the committee ensures that it maintains the appropriate skill sets, perspectives and independence.
- Whether the remuneration committee is chaired by an independent and objective board member. The policy should endorse this concept, include its definition of independence and provide a summary of the board's selection process for the Committee's chair. It should also include the policy and procedure for ensuring that appropriate succession planning is in place.
- The committee's policy on meetings, including the minimum number of times/ frequency the committee may meet and the circumstances in which the committee may act by written consent. In cases where the committee may act by consent, which should be limited, the policy should specify how the committee will ensure full discussion and review of pertinent information.

## **1.3 Committee support**

In order to fulfil its duties and obligations, the committee should be permitted to employ any necessary resources, such as remuneration consultants. The committee should control all aspects of the engagement of any resources that are employed, including their selection, terms of engagement and eventual release.

The committee should meet regularly with the company's senior risk officer(s), or others as may be appropriate, to help fully integrate the concept of risk into the remuneration programme.

### **Disclosure points**

- How the committee ensures that it receives all complete and relevant information needed to support its role and responsibilities. This should extend to the committee's policy regarding the use of external advisors and specialist training providers and how it ensures that they are independent.
- Any potential role that management may play in executive remuneration, such as the CEO's role in recommending design characteristics, should be explained. This should include, for example, the degree to which the committee relies on management recommendations in identifying specific performance metrics that may be included in the remuneration plans.
- How the committee provides for continuing education of its members relating to remuneration matters.

## 1.4 Conflicts of interest

It is important that special care be taken to avoid conflicts of interest among committee members, and between the committee and its advisors and members of management. For example, an advisor to the committee would not be considered independent if he or she is also engaged by the company's management.

### Disclosure points

- The committee's approach to identifying and avoiding conflicts of interest that may be present amongst its members and between the committee and its advisors and members of management.
- How the committee ensures the effectiveness, objectivity and independence of its contract negotiations, including who will be responsible for this role, and if the committee used any outside resources to facilitate negotiations.
- Whether any fees were paid to remuneration advisors for work unrelated to remuneration plan work.

### Disclosure points

- The committee's policy on communicating with shareholders and how the committee ensures that it captures shareholders' views in regards to remuneration plan design and outcomes of the remuneration process.
- In circumstances where a company has received a significant vote against any aspect of their remuneration, the feedback provided by shareholders and any changes made by the committee in response to this feedback.

## 1.5 Communication

It is the committee's responsibility to communicate with shareholders on issues concerning remuneration, either directly or via the board. This includes a responsibility to provide full disclosure regarding the remuneration arrangements, as well as maintaining an ongoing dialogue with and seeking input from shareholders as appropriate.

# Part 2: Remuneration Structure

## 2.1 Design

Well-structured remuneration arrangements should facilitate the creation and sustainability of long-term shareholder value. They should also help to support a culture that is aligned with the company's strategic objectives as well as the company's values. Within the context described, "guaranteed" elements of variable remuneration are inappropriate in a well-thought out and effective remuneration plan. It is incumbent upon the remuneration committee to ensure that only the necessary level of remuneration is paid and that under-performance is not rewarded.

In designing an effective remuneration structure, elements beyond financial rewards should not be overlooked. Intrinsic motivational factors, such as the level of personal access and influence that comes with holding the position, should be recognised as significant incentives to an individual.

The committee should be mindful of the role of remuneration within the company, but also within society as a whole. Does remuneration, for example, encourage the individual and the organisation to

behave responsibly to its customers, shareholders and other stakeholders? Does it discourage excessive risk taking, either by an individual or by a group? Can the committee justify both the structure and the quantum of incentives without relying strictly on peer data as a means of explanation?

When reviewing a company's remuneration arrangements, shareholders should be able to clearly understand how management is being incentivised and remunerated to perform and how much this may cost.

Remuneration arrangements are typically comprised of short-term and long-term incentives. This ratio may vary based on market conditions and/or the specific circumstances of the company. It is incumbent upon the committee to carefully evaluate all relevant information in establishing the necessity and/or desired mix of short-term and long-term remuneration elements, and to update their evaluation from time to time.

The committee should establish goals for total remuneration, as well as each major sub-component of the plan. This should be done in the context of a total

compensation analysis. The committee should use appropriate tools to gain a complete perspective of the remuneration programme. Remuneration levels may take into account relevant benchmarks and market conditions but these criteria should not be used exclusively to justify levels of remuneration or plan design. Rather, each plan should be tailored to the unique circumstances of the company as well as the responsibilities of the position(s) in question and the experience, expertise and performance of the individual.

### Disclosure points

- How the committee conducts remuneration analysis (such as the use of tally sheets and internal pay equality analyses) and any other tools that may be employed in plan design and evaluation.
- The company's policy regarding overall remuneration targets and how the committee determines these levels and monitors them against the plan. This should include targets related to total remuneration as well as key elements of the plan.
- A discussion of the relative strengths and weaknesses of the various forms of remuneration in relation to the company's strategic objectives and specific circumstances.
- The role of risk in executive remuneration arrangements, which should include both a defensive perspective: how the committee ensures potential remuneration does not incentivise excessive risk, and an offensive perspective: how the arrangements are designed to incentivise appropriate risk. Discussion of risk should include how the company's risk appetite relates to compensation potential. Disclosures should describe the roles of those with responsibility for monitoring risk, incorporating how the company addresses any potential conflict of interest in the event that their compensation is at risk.
- How the committee mitigates or eliminates the potential for unintended consequences. This should include a discussion of how incentive plans are structured and monitored to mitigate unintended drivers. The policy should also discuss the company's provisions for recapturing unearned incentive remuneration (claw back or disgorgement policies, for example). As a related topic, the policy should discuss how the company will minimise the potential for manipulation of performance related metrics, and monitor performance for potential fraud (internal risk controls, for example).
- The company's rationale for the desired approach to remuneration including differences in the relative mix of remuneration between various levels of executive management.
- The degree to which the company may utilise peer comparison analysis or benchmarking, and how the committee will ensure these factors do not dominate the justification for plan design or remuneration levels, or give rise to ratcheting. This should also include the company's procedure for selecting relevant survey data, the rationale for the

methodology utilised and its process for disclosing the constituents of any survey data used.

- The extent of, and circumstances that may surround, any discretion that is afforded to the committee.

## 2.2 Base salaries

It is the expectation of investors that base salaries are payment for achieving what is expected (i.e. doing one's job), and that performance that meets or exceeds challenging targets should be rewarded with variable remuneration. When reviewing and changing base salaries for executives, the committee should take into consideration any merit increases that have been awarded across the company's broader employee population. Any peer comparison information should be just one factor that the committee takes into consideration in its deliberations.

### Disclosure points

- The committee should disclose how any changes in base salaries for executives relate to changes made to the broader employee population, and which factors were taken into consideration in making the change, including the extent to which comparative peer information has been used when determining base salary levels.
- Any increases in base salary should be justified by a supporting statement and include an assessment of the salary increase on the overall pay package.

- The CEO: median employee remuneration ratio should be disclosed as well as an explanation of any differences in the ratio over time. In addition, the salary level provided to a newly appointed executive should be explained.

## 2.3 Short-term incentives

The short-term incentive component of an individual's total remuneration is typically paid in cash, though it may consist of a mix of cash and/ or shares.

Generally, it is appropriate for short-term incentives to be reliant upon annual performance measures, though the time frame could be longer but should not be less than 1 year. Objectives should be set and recorded at the beginning of the performance period. Short-term performance measures should not be adjusted, except in very limited circumstances, and never after the performance period has past.

### Disclosure points

- The targeted annual performance measures and how management performed against these targets. Any discussion should include how the selected performance measures relate to the company's strategy.
- Insights into why the forms of incentive remuneration were selected.
- The circumstances in which the committee would consider amending incentive plans during their terms including the need for shareholder approval.

## 2.4 Long-term incentives

The long-term incentive component of an individual's total remuneration may consist of a mix of cash and/ or shares.

Any share-based remuneration plan and subsequent potential dilution of shareholders should require prior shareholder approval. Committees should also seek shareholder approval regarding key amendments to long-term incentive arrangements, including changes to performance targets.

Long-term incentives should have vesting terms that are consistent with the company's capital allocation and investment horizon. As a general rule, vesting of long-term incentives should be a minimum of three years and be subject to the continuance of the performance condition under which the incentives were awarded.

Share repurchase plans that are strictly designed to offset share plan dilution should be discouraged. Share repurchase plans should be an integral component of the company's capital allocation decision and not be used to simply satisfy its remuneration arrangements.

Share grants should be scheduled at regular (annual) intervals. Companies should adopt and disclose a formal pricing methodology for establishing the exercise price of grants. In no circumstances should boards or management be allowed to backdate, reprice or rollover grants to achieve a more favourable exercise price.

Each member of team or board should be prohibited from hedging, or otherwise manipulating, any financial exposure that they may have to any of the company's shares.

### Disclosure points

- The targeted performance measures and how management performed against these targets. Any discussion should include how the selected performance measures relate to the company's strategy.
- Insights into why the forms of incentive remuneration were selected.
- The maximum annual limit on individual participation and the planned distribution ratio of awards between senior executives and other employees. Where various forms of equity are utilized, the relative values of each in the context of the remuneration arrangement, including how the committee would determine a ratio of "value" between various equity tools.
- The circumstances in which the committee would consider amending incentive plans during their terms including the need for shareholder approval.

## 2.5 Performance-based methodologies

Performance measures that govern the vesting of short-term and long-term incentives should be strongly encouraged.

Time accelerated vesting (which allows awards to vest ahead of the established vesting timeframe and may ignore

predetermined performance hurdles ) should be discouraged as a legitimate or desirable performance vesting methodology.

Performance metrics should be consistent with the creation of sustainable long-term value and achieving superior performance. They should also support the strategic objectives of the company, and should include any relevant environmental, social or governance considerations.

For long-term incentives, it is expected that performance hurdles be established that measure sustained performance over long periods that span multiple accounting periods. Care should be taken to mitigate potential unintended negative incentives that may be associated with performance measures.

Performance hurdles should be designed to minimise or eliminate potential adverse incentives by including, for example:

- performance methodologies that encompass multiple periods, such that no opportunity to manipulate one accounting period over another exists;
- a “claw back” policy that provides for the re-capture of performance-related pay in cases of misconduct, financial re-statements or fraudulent reporting if either resulted in the vesting of an award;
- that the committee exercise downward discretion in situations where achievement of the set performance hurdles does not reflect an improvement in the underlying performance of the company; and
- limiting the level of pay-out at threshold or avoiding cliff-edge vesting given that this can encourage unnecessary risk taking. (Note that Cliff-edge vesting permits vesting of 100% of the award at a specified point in time, rather than allowing vesting to occur over multiple periods during which time performance criteria are maintained or met. )

Re-testing or re-pricing represents a potential fundamental shift in the relationship between long-term performance and remuneration. ‘Re-testing’, ‘re-pricing’ or the granting of additional time to meet performance hurdles should they not be achieved within the pre-determined time frame should be discouraged. In cases where companies wish to re-test or re-price unvested awards, this should be done only with prior explicit shareholder approval.

### Disclosure points

- The committee’s philosophy on performance. A company should disclose the performance metrics and target ranges that are used to govern the size of awards granted and those that govern the levels at which these awards vest, including the calculation methodology for each performance metric. The length of performance periods should also be disclosed. In addition, rationale should be provided that justifies the selection of these performance metrics as drivers of long-term sustainable value for shareholders.
- The performance metrics and target ranges that will be used to determine



the vesting of short-term and long-term components of the arrangements. If the company intends to utilise any adjusted performance measures (non GAAP/IFRS or not conforming to accepted accounting principles), the policy should contain as a minimum a detailed rationale for the use of adjusted performance measures. It should also include the role of the committee in approving the proposed adjustments and how it monitors the impacts of this approach.

- A line item reconciliation for each metric to GAAP or IFRS, clearly demonstrating the magnitude of the adjustment for each measure. How the company will achieve a consistent approach to incentive plan measurement.
- The company's policy on any non-financial performance metrics that may be utilised in an incentive arrangement. This should include the rationale for utilising non-financial metrics, their target weight in the overall plan and how the committee will ensure accuracy in measurement of non-financial metrics.
- The company's philosophy regarding the dilution of existing shareholders. The plan should contain a detailed description of how the company will treat share grants that expire or are not earned through vesting requirements, including if these awards would be returned to the pool of "eligible" shares under the plan.
- If the company's plan(s) permits re-pricing of any kind (assuming shareholder approval), the company's policy regarding

dilution should take re-pricing into account.

- If the company plans to repurchase shares through share buyback programmes to reduce dilution from share-based remuneration plans, the policy should articulate how the repurchase decision is made in relation to other capital allocation decisions.
- In relation to re-testing, re-pricing or the granting of additional time to meet performance hurdles, provide clear policies and to consider the serious concerns of shareholders in regards to this topic. In cases where companies wish to re-test or re-price unvested awards, this should be done only with prior explicit shareholder approval.

## 2.6 Change in control

In the event of a change in control, or other corporate event where a loss of employment is realised, only pro-rata performance criteria that reflect a real measure of underlying achievement should be awarded. The ICGN is opposed to a blanket acceleration of the vesting of share awards based on corporate events. The remaining long-term incentive awards should be subject to the long-term success of the new entity, not the execution of the transaction.

### Disclosure points

- Companies should disclose the cost to shareholders that changes in control will have in regards to remuneration systems.

## 2.7 Post employment and other benefits

Post employment and other benefits include pensions, healthcare and other benefits that may be provided during and after employment. Should companies utilise any of these forms of remuneration, care should be taken to integrate these structures within the overall philosophy and structure of the total plan. In addition, the benefit to long-term shareholders in relation to the potential cost should be evaluated. In this context, certain benefits, for example tax gross-ups and post death benefits (golden coffins), would weaken, significantly, the alignment with shareholders and should be avoided.

Post employment and other benefits can give rise to significant liability for the company and may represent significant portions of the total value of the remuneration arrangements. As such, the alignment and incentive characteristics of these elements of the remuneration arrangements can have a material impact on its overall effectiveness. These competing interests must be balanced in the best long-term interests of shareholders.

### Disclosure points

- The parameters by which the company will utilise post-employment and other benefits as forms of remuneration, including all forms of healthcare cover and any deferred remuneration arrangements or retirement benefits.
- The existence of all retirement programmes for executives, noting clearly any supplemental benefits or sweeteners provided beyond those offered to other company employees (such as above market earnings on account balances or additional years of service credit, for example). Disclosures related to defined benefit pension programmes should include an estimate of the actuarial present value accrued during the applicable year and an estimate of the expected benefit at normal retirement age. These disclosures should be specific to each individual executive covered in the disclosures.
- If any portion of post employment benefits (retirement, healthcare, other benefits) are unfunded, the company should provide adequate detail as to the potential liability to the company under these programmes. This section should include:
  - The company's use of 'other' forms of remuneration and post-employment benefits, including the expected weight of these forms of remuneration relative to total remuneration.
  - The committee's rationale for these forms of remuneration, including the justification and link to the company's overall performance and business objectives.
  - Any limitations placed on retirement or other benefits, including amounts and time period for executives.
  - Eligibility of family or other beneficiaries to receive benefits.

- The company's policy on benefit calculations and how the executive plans are consistent with all other plans. Any differences, such as the basis for calculating eligible income and additional multipliers available to executives, should be explained.
- A general list of appropriate types of benefits that may be included in future remuneration plans.
- The company's policy and procedure for valuing benefits, including the rationale for the method and why it is considered accurate.

## 2.8 Shareholding guidelines

Shareholding guidelines and requirements should be an integral component of a company's share plan and overall remuneration philosophy. Ownership guidelines can serve to align the interests of the management team with the interests of long-term shareholders.

The guidelines should require significant ownership levels over an appropriate period of time. Generally, holding requirements require executives to hold portions of share grants for extended periods, which should include requirements to hold a significant portion of grants for a fixed period of time after separation (such as retirement or other event in which employment is ceased).

Individuals subject to shareholding guidelines should be prohibited from

entering into derivative contracts in order to hedge against their exposure to the company's shares.

Management should buy shares in the market rather than waiting for share-based remuneration awards to vest.

### Disclosure points

- For each level of management, the company's approach to ownership and retention guidelines, including the objectives, ownership levels targeted over specific time frames, periods in which retention would apply (including post retirement), and how it will be monitored and enforced.
- The expected value of the alignment from share ownership, most specifically in relation to long-term investors, and how the role of shares may evolve over time. For example, are there levels at which the value of shares in the remuneration plan reaches a saturation point and the incremental alignment and motivation is mitigated?
- Policies regarding prohibited activities such as hedging, together with how such a policy is monitored.

# Part 3: Contractual Provisions

## 3.1 Employment contracts, severance, change in control

Contracts, employment agreements, severance and change in control arrangements should be strictly limited. As a rule, these arrangements should not affect, adversely, the executive's alignment of interest with shareholders or their incentive to pursue superior long-term value.

Employment contracts should not extend longer than one year and should not be open-ended or renewed on an "automatic" basis. Where it is deemed essential that contracts run for a multi-year period for the purpose of recruitment, these should revert to a one-year contract after the initial contract period. Within this context, boards should seek to minimise the cost of post-employment generally.

Employment arrangements should not provide guaranteed raises, bonuses, or other incentives such as share grants. Guaranteed provisions have a negative impact on the alignment and incentive characteristics of the remuneration arrangement.

Severance payments should be limited to situations where the company terminates employment without cause, death, or disability. Remuneration committees should ensure that the company has a policy that caps or limits the amount of severance that can be paid.

Companies should not compensate executives for any excise or additional taxes payable as a result of any employment, severance or other agreement.

### **Disclosure points:**

- Disclosure of the existence of all employment agreements, severance arrangements, change in control agreements and any other contractual agreements with key executives. Disclosure should include a description of the agreements, which contain sufficient detail of all material factors such that shareholders have a complete understanding of their terms. Companies should provide estimated payments under specific scenarios such that shareholders can determine the potential pay-outs under each agreement. This section should include:

- A definitive statement of the company's philosophy on employment agreements, severance arrangements, change in control contracts and any other contractual employment or benefit-related arrangements.
- Justification for the use of these arrangements specific to the company's circumstances, while also being consistent with the overall purpose of the remuneration arrangement. Special care should be taken to explain the rationale for these arrangements within the overall context of a performance-based plan.
- Disclosure of the overall parameters of how benefits, severance and change in control provisions will be used. These should include specific detail regarding the positions within the company that may receive these provisions. At a minimum, disclosure should extend to the maximum periods covered by the arrangements; the circumstances by which the arrangements will be reviewed, renewed or eliminated.
- A clear description of the company's philosophy related to key terms of the arrangements, such as triggering events, and how the company intends to define terms such as termination for cause. Companies should also disclose where investors can view the entire text of the applicable agreements or contracts.

## Annex 1: Acknowledgments

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The ICGN acknowledges and is grateful to the Remuneration Committee: Pru Bennett, Ian Burger, Francesco Chiappetta, Andrea Di Segni, Natacha Dimitrijevic, Catherine Jackson, Andrew Johnston, Escher Luanda, Jadi Manurung, Aisha Mastagni, Mike McCauley, Geof Stapledon, Rebecca Vine, George Dallas and Kerrie Waring.

## Annex 2: About ICGN

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Established in 1995, ICGN Members include investor's responsible for assets under management of US\$26 trillion. ICGN's mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide. This sets the tone for our work programme which is centered around:

- Influencing policy by providing a reliable source of investor-led opinion and experience around governance and stewardship;
- Connecting peers at global events to provide a forum for dialogue between companies, investors and other stakeholders; and
- Informing debate through knowledge and education to enhance the professionalism of corporate governance and investor stewardship.

For more information, contact the ICGN Secretariat by telephone: +44 (0) 207 612 7011, email: [secretariat@icgn.org](mailto:secretariat@icgn.org) or visit [www.icgn.org](http://www.icgn.org).

## Annex 3: ICGN Principles & Guidance

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### Principles

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Global Stewardship Principles (2016)

Global Governance Principles (2015)

### Guidance

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Anti-corruption Practices (2012)

Corporate Risk Oversight (2015)

Diversity on Boards (2016)

Executive Remuneration (2016)

Gender Diversity on Boards (2013)

Integrated Business Reporting (2015)

Model Mandate: Contract Terms between Asset Owners and Managers (2012)

Non-executive Director Remuneration (2016)

Political Lobbying and Donations (2012)

Securities Lending (2016)



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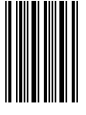
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