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## Should shareholders have a say on executive pay?

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By DAVID SMITH

RECENT developments in the United States have once again drawn attention to executive remuneration. Earlier this year US insurer Aflac stated that, from 2009, it will allow shareholders an advisory vote on executive compensation - a so-called 'say on pay' - in a move that could eventually have ramifications for listed companies in Singapore.

Since Aflac's statement, more than a dozen US companies have faced shareholder proposals for an annual advisory vote on pay, with such proposals receiving significant shareholder support. Indeed, a recent proposal seeking an annual advisory vote on executive pay tabled by the New York City Employees' Retirement System (NYCERS) received 57 per cent support at Blockbuster's May9th AGM.

A similar proposal received 48.4 per cent support at Occidental Petroleum on May4th, whilst Merck's meeting on April24th saw a remuneration advisory vote proposal garner 49.2 per cent support. Verizon's meeting on May3rd may well have broken the 50 per cent mark - the company says it is too close to call, and that votes are still being counted.

What are the implications for companies listed here? Such moves show growing momentum for shareholder votes on pay around the world, reflecting the growing importance that institutional investors place on the stewardship of companies. Shareholders are becoming increasingly involved in the monitoring of companies and their executives in the belief that good corporate governance is a value adding proposition, as opposed to a cost.

Elsewhere, the United Kingdom, Sweden, and Australia already have advisory votes on executive pay, whilst shareholders in the Netherlands have binding votes on compensation. The increasing pace of financial globalisation and integration suggests that investors may turn their attention to Asia next.

The advisory vote is a chance for shareholders to voice their views on executive remuneration at a company, usually taking the form of a vote on the remuneration report of a company. Whilst the advisory vote is necessarily non-binding, it does provide the company with an illustration of the views of shareholders on executive remuneration packages.

Robert Nardelli and HenryAMcKinnell, formerly of Home Depot and Pfizer respectively, put severance pay on the agenda earlier this year when it became apparent that, according to company filings with the Securities and Exchange Commission, Mr Nardelli's severance package was valued at about US\$210 million and Mr McKinnell's at almost US\$200 million.

In contrast, shareholders in Singapore listed-companies are currently only required to

approve directors' fees, whilst only aggregated remuneration figures are released for top executives. Performance related pay schemes are approved at inception, whilst subsequent grants of options and shares need to be approved annually.

However, these form only a fraction of total emoluments. Often times, executives are eligible to receive corporate benefits including life cover, the use of a company car or cash equivalent, medical insurance and such like. Other benefits can include the use of a company jet for personal activities, apartments, and the retention of a personal secretary.

Whilst some of these may not be common in Singapore, what shareholders typically want to know are details of clauses that may affect the amount of money paid out. If there is a change of control, what happens to stock options? If the CEO's contract is terminated, how much is the company contractually required to pay out?

Excessive payouts to terminate contracts may result in ineffective executives remaining in jobs simply because the company cannot afford to terminate their contract.

The reality is that the advisory vote in many countries rarely results in significant public dissent. In the UK, the only significant dissent since the adoption of a say on pay was the defeat of the GlaxoSmithKline remuneration report in 2003. What this has shown is that shareholders are willing to use the vote when necessary. Shareholders should not ultimately decide executive pay packages - this is the responsibility of the remuneration committee, and ultimately the board.

However, sustained dialogue between the board and investors can lead to packages that are both sufficiently testing so as to align the interests of executives and shareholders, and sufficiently structured so as to attract suitably talented individuals.

Has this worked in the UK, where the advisory vote has been in place since 2002?

Whilst there has not been a decline in the value of executive remuneration, there has been a marked slowing in the rate of increase in such packages. More significantly, by putting emphasis on issues such as performance related pay and severance packages, shareholders can be reassured that their interests are aligned with those of the executive.

The most visible evidence that the advisory vote on pay has worked in the UK is the involvement of UK-based investors in current US developments. Could it work in Singapore?

There is no reason why such an initiative could not work in Singapore, given its success elsewhere. Moreover, whilst the US may face difficulties in implementing the advisory vote given the relatively dispersed ownership structures of listed companies there, Singapore's ownership structures mean that a company can communicate effectively with many of its large investors with relative ease.

In terms of implementation, it would simply require companies to place an additional item on the agenda for Annual General Meetings, along the lines of 'Resolution X: To approve the directors' remuneration report for the year ended Dec31, 2007', for example.

However, there are issues that would need to be addressed to ensure the effective implementation of an advisory vote on remuneration. For companies, there would need to be

guidance on what should be included in the remuneration report.

Companies should not blind investors with too much information; conversely, sufficient information should be provided so as to allow shareholders to make an intelligent voting decision.

Investors, for their part, would need to consider the nature of the advisory vote as either a comment on remuneration policy and implementation (i.e. forward-looking), or a vote on the level of remuneration paid (i.e. backward-looking). This is an important distinction.

The danger is that investors see this vote as being purely about the annual levels of remuneration that have been paid to executives - a situation that some countries now find themselves in.

The advisory vote should serve as an opportunity to comment on the overall structure of the total remuneration package (salary, annual bonus, long-term incentive, pension, perks, contract provisions, etc) and how it was implemented in the year.

Shareholders would be encouraged to not vote against stock-option schemes, for example, that had already been approved at previous meetings.

Moreover, investors should be reminded that the advisory vote on executive remuneration is solely focused on remuneration, and the overarching policy of compensating executives.

If this important distinction is not made, there is a risk that investors (consciously or subconsciously) perceive the vote as an opportunity to air concerns over unrelated issues. Undoubtedly, there will come a time when investors ask for an advisory vote on pay in Singapore. Global trends point towards this.

As discussed, there are issues to be mindful of. Companies need guidance on what should be included in a remuneration report. Investors need guidance on what the advisory vote involves.

Nonetheless, the dilemma facing Singapore and its companies is whether the advisory vote is implemented before shareholders ask for it.

By doing so Singapore and its companies would be well placed to take the lead in corporate governance in Asia, and attract the attention of global investors.

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