

# GRG Remuneration Insight 149

## Boards Must Receive Fee Recommendations

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### Introduction

Boards are always in a conflicted position when setting remuneration levels and elements for non-executive directors (NEDs). This conflict arises because NEDs are the decision makers and the beneficiaries of those decisions. Yet they need to make decisions in the context of what constitutes good governance and legal obligations. In GRG's experience most Company Secretaries and Legal Counsels, when asked, advise Boards to engage an independent remuneration consultant to provide recommendations on NED remuneration and for the Board to then make decisions consistent with those recommendations.

This GRG Remuneration Insight discusses why Boards must receive fee recommendations.

### AFL

ASX Listing Rule 10.17A states that the total amount of directors' fees paid to NEDs of a company must not exceed the total amount of directors' fees approved by ordinary shareholders.

This rule applies to ASX listed companies but not to other public companies. It limits the total amount of fees that may be paid to NEDs (known as fees cap or aggregate fees limit or AFL). It includes superannuation contributions and retirement benefits paid by the company but does not include equity grants that have been approved by shareholders.

Approval of the AFL does not constitute approval of remuneration for Corporations Act purposes as it does not relate to specific NEDs.

### The Law

Section 208 of the Corporations Act broadly provides that for public companies to provide remuneration to a NED (related party) either:

- a) the company must obtain the approval of shareholders for the remuneration, or
- b) the remuneration must be "reasonable".

Section 211 of the Corporations Act provides that for remuneration to be reasonable it must be aligned with:

- a) the circumstances of the company, and
- b) the NED's circumstances (including the responsibilities involved in the office).

Remuneration includes superannuation contributions and retirement benefits paid by the company.

Thus, unless a company has obtained shareholder approval a company may not remunerate its NEDs unless the remuneration is reasonable.

Another way of expressing the reasonableness test is that the remuneration paid to NEDs must be justifiable.

### Assessing Company and NED Circumstances

When assessing circumstances to assess whether remuneration is reasonable it is GRG's view that in relation to NEDs their personal financial circumstances are irrelevant to assessing reasonableness – why should a rich or poor person be paid more or less than another person for performing the same role? It is the responsibilities, accountabilities, know-how and experience that are required to fulfil the role, that are more important factors. Unlike executive roles where there are many nuances between roles, the role of a NED tends to be fairly generic in comparable companies, with the obvious exception between Board Chair and other NED roles. Thus, the quantum

of remuneration for a NED role that is reasonable in the NED's circumstance is guided by what other comparable NEDs are paid in the relevant market.

Company circumstances are a more complex amalgam of factors such as company size as measured by market capitalisation, revenue, assets, profit and employee numbers, industry sector, operational challenges and business plans. Provided the companies are comparable to the company being assessed it would be reasonable to say that the quantum of remuneration for a NED role that is reasonable in a company's circumstance is guided by what other comparable companies pay in the relevant market.

## Market Practices

Market practice can be determined by using NED remuneration data from comparable companies. The challenging aspect here is to select the companies that are considered comparable. NEDs could choose the companies themselves but would face the risk of criticism for cherry-picking those companies that have adopted remuneration practices the NEDs favour rather than selecting those companies that are best comparators to the company of which they are NEDs. An alternative approach would be for an executive in the company to be tasked with the job of selecting companies for a comparator group. However, such an approach will not avoid criticism because the executive would ultimately report to the Board and therefore would be seen as likely to select a group of companies that they felt would find favour with the Board.

## NED Remuneration Policy

An important aspect of deciding upon the rate of fees to be paid to NEDs is the policy the company has adopted in regard to market positioning. Such a policy would cover several aspects including:

- what indexation factors will be applied to market data, which is always historical, to make the outcomes relevant to the period when the fees will be paid,
- does the fee include company superannuation contributions,
- are committee fees to be paid in addition to Board fees,
- is equity to be provided as part of fees on either an elective or compulsory basis,
- is equity to be provided in addition to Board and committee fees,
- where in the market are Board fees (excludes committee fees) to be positioned,
- where in the market are total remuneration packages (Board fees, committee fees, super, and equity) to be positioned.

When these aspects and others are covered in a formal NED Remuneration Policy, the Remuneration Committee and external remuneration consultants (ERCs) can prepare appropriate recommendations for Board consideration.

## External Remuneration Consultant

Even with market practice data and a NED Remuneration Policy there remain various aspects on which NEDs need to make decisions which means that NEDs remain conflicted when making those decisions. Clearly the best approach is for the Board to appoint an ERC. In addition to being trustworthy and ethical the ERC should be truly independent and not work for an organisation that provides non-remuneration services to the Board or to management of the company. Of course, the ERC should maintain a high-quality database of NED remuneration practices.

The ERC should then be asked to:

1. select the comparator group to be used to assess competitive NED remuneration practices,
2. consider the company's NED Remuneration Policy,
3. consider emerging market practices, regulatory changes and legal requirements as well as accounting and taxation consequences for the company and the NEDs, and
4. formulate specific recommendations in relation to each element of NED remuneration.

Once the recommendations are received the Remuneration Committee should consider them and formulate its recommendations to the Board. The Board should consider both the ERC's and the Remuneration Committee's recommendations and make decisions on these recommendations. The fees on which the Board decides should not be more than the ERC's recommendations unless there are very strong reasons for doing so e.g., perhaps when the Board did not disclose sensitive information to the ERC.

In the company's Remuneration Report it will be important to communicate that the fees being paid are in line with both the company's NED Remuneration Policy which should be summarised as part of the Remuneration Report and the recommendations received from the ERC. Applying this approach should ensure that the Board is above reproach in relation to matters concerning NED remuneration.