

Executive Remuneration Regulatory update and best practice

Gerald Seegers / Val du Pre le Roux
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Unmasking Reward in a changing business landscape

Agenda

- Executive reward in today's market
- Best practice principles
- Executive compensation in FS Sector – G20 update
- Preparing for the challenge ahead
- Open discussion

Executive reward in today's market

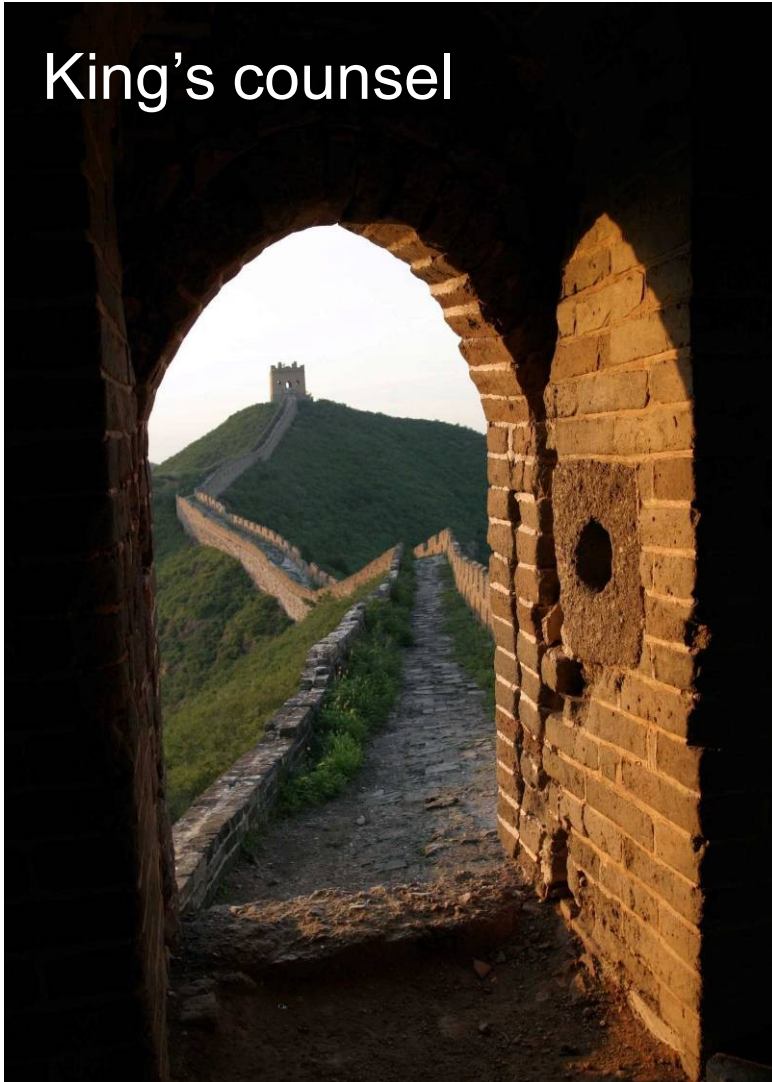
- Changed beyond recognition over the past decade
- Downturn has brought the subject firmly into the spotlight
- Provoked shareholder reaction, political pressure and public anger
- Is the current 'reward framework' fit for purpose?

Are executives being
paid too much?



Best practice principles

King's counsel



- The release of King III on 1 September 2009 represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for organisations that embrace its principles.
- King III became necessary because of the anticipated new Companies Act and changing trends in international governance.

Best practice principles

Globally, there is a focus on the need for robust governance processes around executive remuneration coupled with the requirement for transparency.

These themes are echoed in King III and three general principles in respect of the remuneration of directors and senior executives are set out:

1 Companies should remunerate directors and executives fairly and responsibly

2 Companies should disclose the remuneration of each individual director and certain senior executives

3 Shareholders should approve the company's remuneration policy



Best practice principles

2.25 Companies should remunerate directors and executives fairly and responsibly

Companies must adopt remuneration policies that create value for the company over the long term.

Annual bonuses should clearly relate to performance against annual objectives consistent with long-term value for shareholders.

Share-based and other long-term incentive schemes should be based on performance conditions measured over a period appropriate to the strategic objectives of the company. This should be not less than three years.

Where performance conditions are not met, they should not be re-tested in subsequent periods.

Regular annual grants of awards is desirable. There should be no re-pricing or surrender and re-grant of share options which are “underwater”.

There should be no automatic waiving of performance conditions on a change of control, a capital reconstruction or termination of employment.

It may be appropriate to pro-rate the benefit both for time and performance.

Best practice principles

2.26 Companies should disclose the remuneration of each individual director and certain senior executives

Full disclosure of remuneration paid to each executive and non-executive director should be provided viz base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits.

Disclosure of the maximum and expected potential dilution that may result from incentive awards granted in the current year is also required.

In addition, the same must be disclosed for the three most highly-paid employees who are not directors in the company.

The company's annual remuneration report must explain the remuneration policies followed.

It must also explain the company's policy on base pay and the use of appropriate benchmarks

Best practice principles

2.27 Shareholders should approve the company's remuneration policy

On an annual basis, the company's remuneration policy should be tabled to shareholders for a non-binding advisory vote at the annual general meeting.

This vote enables shareholders to express their views on the remuneration policies adopted and on their implementation.

Best practice principles

Application of the Code

- In contrast to the King I and King II codes, King III applies to all entities regardless of the manner and form of incorporation or establishment. Principles are drafted on the basis that, if they are adhered to, any entity would have practiced good governance.
- It is recommended that all entities disclose which principles and/or practices they have decided not to apply or explain. This level of disclosure will allow stakeholders to comment on and challenge the board to improve the level of governance within an organisation.

Best practice principles

Implications of the Code

- It will increase the burden on companies in so far as disclosure is concerned.
- Companies are advised to review their policies in light of King III to assess the extent of their compliance.
- So far as companies in the financial services sector are concerned, King III does not go far enough in terms of representing best practice.
- In response to shortcomings identified as a result of the financial crisis, regulators across the world have been issuing codes of practice and best practice principles in this area. On 25 September 2009, the Financial Stability Board issued Implementation Standards and at the same time the G20 issued their communique on compensation reform.
- We believe that it is only a matter of time until a similar code is published in South Africa.

Best practice principles

Financial Services Sector – G20 & FSB

Key developments in the two documents include:

- Appropriate deferral of variable pay is 40%-60% for senior executives. Those with material impact on firm's risk profile, rising to over 60%.
- A facility for total compensation to be restricted to a certain (undefined) percentage of net revenues where the firm needs to rebuild its capital base.
- Guaranteed bonuses to be limited to recruitment of new staff and limited to a year.
- Extensive banded disclosure requirements relating to quantum, mix and structure of compensation for senior executives.
- Immediate prospective compliance required.

Best practice principles

Key questions directors should be asking

- Does our remuneration policy comply with the principles of King III and reflect current international best practice?
- Are our long-term incentive plan rules consistent with the principles of King III in terms of the use and application of performance conditions?
- Do our non-executive directors receive share options and/or other share incentive awards?
- Does our annual bonus plan link performance to clearly set objectives that create long-term value for shareholders?
- Do we fully disclose remuneration paid to executive directors, non-executive directors and certain senior employees in our annual remuneration report?
- Can we explain how our remuneration policy links into our strategic objectives?

Preparing for the challenge ahead

Nine PwC principles

- 1 Change is coming and trust needs to be rebuilt
- 2 A new executive reward model is needed
- 3 Pay for performance must become a reality for all
- 4 The upward ratchet in executive pay should cease
- 5 The reward package should be considered in its totality
- 6 Remuneration Committees must stop over relying on data
- 7 Governance must have substance as well as form
- 8 Advisers need to up their game
- 9 The case for executive pay needs to be made

Open discussion

“Regulators are not intending to cap nor setting precise prescriptions for how companies should set compensation, which can be counterproductive. Instead, they want to develop standards that reward innovation and prudent risk-taking, without creating misaligned incentives”.

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