ICGN Remuneration Guidelines

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Executive Summary

Institutional investors have both a fiduciary responsibility and an economic interest in ensuring that executive remuneration or compensation is well aligned with their interests. The ICGN maintains current and relevant guidelines regarding the process of awarding remuneration and key plan design features to help communicate investors’ perspectives on this critical issue. These guidelines update existing ICGN policy and provide further detail in line with recent events.

Three principles underpin these updated guidelines: transparency, so investors can clearly understand the program and see total pay; accountability, to ensure boards maintain the proper alignment in representing owners in part by obtaining shareowner approval of a remuneration report; and performance-based, so the programs are linked to relevant measures of company performance over an appropriate timescale. This should also reflect due regard for the reputational aspects of remuneration.

The ICGN believes boards and their mechanisms for deciding upon executive pay play a critical role in representing owners in the process of remuneration design and oversight. It is therefore critical that they adhere to best practices in regard to their process, and that they ensure the relevance and independence and pertinence of all supporting advisors and material used in setting remuneration programs.

The board is responsible for providing full and complete disclosure of the company’s program, with particular emphasis on providing the rationale behind the plan design and how the components of the plan are integrated into an overall remuneration philosophy. The ICGN believes companies should provide a full explanation of the relationship of the plan to performance measures, and should include specific performance targets or hurdles. Boards will adopt different decision making processes for agreeing executive remuneration, be this through remuneration committees, the supervisory board, or sub-groups. The key point is that the mechanism is fully accountable to the governing body and its operation is, and is seen to be, independent and fair.

The ICGN believes plan design should carefully consider the major elements of compensation (cash and short-term incentives, equity and long-term incentives, and post-employment and other benefits), and carefully construct the program to fit the individual circumstances of each company. Accordingly, the ICGN believes the influence of benchmarking or peer relative analysis in establishing compensation levels should be kept to a minimum. The ICGN believes employment contracts, severance, and change in control agreements should be strictly limited, and any use of these tools should be justified within the context of the remuneration philosophy and overall plan design.

Remuneration has an important role in a company’s ability to recruit and retain the executive talent it needs to ensure success. It also has the potential to damage reputation, affect employee morale and affect behaviour. Getting the balance on time scale and appropriate performance measures is critical. These updated guidelines on remuneration

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are intended to provide a global benchmark to help shareholders and boards achieve this balance.
1.0 Introduction and Purpose

The traditional view of executive remuneration or compensation is to attract and retain qualified personnel. While true in simple terms, this definition fails to consider the significance of compensation programs in the overall governance of organizations. For long-term investors, a much broader view of remuneration is required that encompasses proper alignment, incentives to pursue optimal capital allocation and good corporate governance.

Investors have taken an increased interest and more active role in remuneration in recent years for several reasons. First and foremost, institutional investors have a fiduciary responsibility to act in the best interest of their beneficiaries, and executive remuneration is an important cornerstone.

Secondly, because remuneration programs have such a significant impact on the alignment and incentives of management, they are inexorably linked to the long-term viability of the company. Well designed remuneration programs have a demonstrable positive impact on the long-term performance of the company. Conversely, poorly designed or poorly executed compensation plans can have a serious negative impact on shareowner value. In this regard, the opportunity for a significant principal/agent problem arises. Thus, investors have a clear economic interest in addition to a fiduciary interest in the design and implementation of remuneration plans. The combination of these drivers give owners, particularly long-term owners, a role in setting broad policies and guidelines related to executive remuneration and in overseeing the practices of companies in this area through such means as proxy voting and direct engagement.

These guidelines are primarily addressed to companies and their non-executive or supervisory board members, and set out key remuneration principles which should be applied by companies regardless of their domicile. They cannot address every issue related to remuneration. Rather, they reflect the overall policy and philosophical approach to remuneration that leading institutional investors and their associations expect from companies. In this regard, the guidelines set out general principles that reflect best international practice. They should be applied pragmatically, taking into account the specific circumstances of each company and the economic and legal environment in which it operates.

The ICGN believes that best practice in remuneration begins with the formation of an independent and effective process for deciding upon executive remuneration. In many jurisdiction companies have established remuneration committees, comprising independent non-executive or supervisory board members, who can take responsibility for proposing remuneration for approval by the whole board. The purpose of such a committee is to ensure independence and focus in the process. The overall concepts in these guidelines apply regardless of the particular mechanism which is chosen. The important point is that the company establish a formal, independent process for setting remuneration, which is wholly transparent and accountable to shareowners. Any such remuneration committee is considered complementary to the board, and does not remove
ultimate responsibility for the full board regarding proper remuneration. For convenience, we term this decision making body a ‘remuneration committee’, although terms may differ across markets.

The ICGN’s guidelines are intended to serve as a communication tool from investors to companies in any domicile and any industry. The ICGN believes remuneration programs should be carefully designed and implemented with the unique situation of each company in mind. However, we believe certain broad principles and guidelines are universal. Within this framework, we recognize the need for flexibility to tailor remuneration programs to meet the challenges and opportunities that each company faces. With this flexibility, it is incumbent upon the company to properly structure a remuneration committee, develop and implement processes for setting remuneration programs, and provide full disclosure of remuneration programs, including all aspects ranging from the philosophy to details of individual executive pay elements.

2.0 Role of the Remuneration Committee

2.1 The remuneration committee is responsible for all aspects of the remuneration program. The committee should take ownership of devising, drafting and implementing the remuneration program.

2.2 The committee should be sufficiently independent in its makeup and process to completely fulfill its role in administering a remuneration program in the best long-term interests of shareowners. Ideally, the committee should comprise entirely independent non-executive directors or supervisory board members. However, depending on best practice in the relevant market, a clear majority of its members should be independent. Special care should be taken to ensure that the committee as a whole has adequate experience and background as well as diverse perspectives. The committee should consist of at least three members. The ICGN is aware that current CEOs of other companies may have a potential conflict or bias in setting their peers’ remuneration, yet can also have valuable insights into remuneration issues. The ICGN believes committees should carefully consider the role of other CEOs in the remuneration setting process and should limit the number of CEOs on the committee to ensure independent thinking prevails.

2.3 The committee should have available the necessary resources to fulfill its duties and obligations. This includes controlling all aspects of the engagement of specialist remuneration consultants, including their selection, engagement, and release. Special care should be taken to avoid conflicts of interest that would impair the independence of the consultants. For example, the committee’s consultant would not be considered independent if they are also currently engaged by the company’s management.

2.4 The committee has the responsibility to integrate all components of remuneration into a cohesive program that supports and is tied to the
objectives of the company, which may be both short-term and long-term in nature. Performance measures should include appropriate financial targets, but non-financial targets may also be highly relevant to long term sustainable commercial success.

2.5 In establishing the remuneration program and evaluating appropriate forms as well as levels of remuneration, the committee should take into account all relevant information. This may include the use of peer relative analysis and benchmarking to peer and market examples. However, care should be taken not to over emphasize the influence of peer group benchmarking on the ultimate design of the program. Peer group averages alone are not adequate justification for the design of a remuneration program or the levels of pay. Rather, each company’s remuneration program should be carefully designed to fit its unique situation.

2.6 It is the committee’s responsibility to maintain appropriate communication with shareholders, either directly or via the board. This includes a responsibility to provide full disclosure regarding the remuneration program, as well as maintain a dialogue and seek input from shareowners as appropriate.

3.0 Remuneration Plan Design

3.1 The ICGN believes remuneration plans should be structured with an appropriate balance of short-term and long-term incentives. This ratio may vary based on market conditions and the specific circumstances of the company. It is incumbent upon the committee to carefully evaluate all relevant information in establishing the desired mix of short-term and long-term remuneration elements, and update this evaluation over time to ensure that the plan evolves to meet the company’s changing situation.

3.2 The ICGN believes remuneration plans should be strongly linked to the company’s performance that reflects and is consistent with value to long-term shareowners. It is acceptable to provide incentives to achieve both long-term and short-term goals, however, the performance drivers should not be duplicative, and a balance needs to be struck with the need to reward success over the long-term.

3.3 The remuneration 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, and committees may use tools such as tally sheets to gain a compete perspective of the remuneration program. This will help the committee evaluate the overall mix of remuneration and determine how to integrate the elements. 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. Too
much reliance on peer relative analysis leads to unjustified escalation in executive pay that gives rise to concern. 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 and expertise of the individual.

3.4 Compensation plans generally consist of four primary categories: cash and short-term incentives; equity and long-term incentives; retirement and post-employment benefits and “other” compensation, such as perquisites.

3.4.1 *Cash and Short-Term Incentives.*

The cash component and short-term incentives should generally be tied to annual performance measures. Objectives should be set and recorded at the beginning of the performance period. Companies should disclose the circumstances in which short-term performance measures may be adjusted, including the process and timing of disclosure of these actions. The ICGN believes short-term performance measures should not be adjusted after a brief period of the performance horizon has passed, such as the first quarter for example, regardless of the circumstances. Companies should avoid performance periods shorter than 1 year (such as quarterly bonus programs).

3.4.2 *Equity and Long-Term Incentive Tools.*

The equity and long-term incentive component should consist of an appropriate mix of equity and equity-like tools, which may include options, restricted shares, stock appreciation rights, and other equity-like incentive structures for example. The ICGN believes companies should provide clear justification for the types of equity tools employed and the relative mix of these tools.

Companies should provide a clear plan (contained within the remuneration report or other disclosures) that details how these tools will be used including the target dilution levels, cumulative dilution to date, and projected run rates over a multi-year period and actual run rates over previous years. This justification should include the methodology by which companies will determine the appropriate dilution and run rate, and evaluate the effectiveness of the plan over time, including its impact on long-term value creation. The equity plan should also include a maximum annual limit on individual participation and the planned distribution of equity tools (in other words, distribution between the executive ranks and employee base including the rough percentage of the overall plan that will go to each group).

Any potential dilution of shareholders should require prior approval through votes to protect pre-emption rights.
The ICGN believes equity ownership guidelines and holding requirements should be an integral component of company’s equity plan and overall compensation philosophy. Equity ownership guidelines are generally expressed as a multiple of salary and bonus opportunity, and serve to align the interests of the management team with the long-term owners. Accordingly, the guidelines should require significant ownership levels over an appropriate period of time. Holding requirements generally require that executives shall hold significant portions of equity grants for extended periods, which should include requirements to hold some portion of grants for a fixed period of time after separation (such as retirement or other event in which employment is ceased).

The ICGN believes the following equity plan characteristics are inappropriate: discount options; re-load provisions; gross-up provisions; accelerated vesting upon change in control; and, repricing without shareholder approval. Companies should also provide clear guidance regarding the circumstances under which key plan criteria may be amended, including performance targets, including notification to shareowners (disclosure).

Equity (and equity-like) remuneration should have vesting terms that are clearly consistent with the company’s capital allocation and investment horizon. The ICGN believes that, as a general rule, vesting of long-term incentives should be a minimum of three years.

The ICGN is opposed to share repurchase plans that are strictly designed to offset equity plan dilution. Share repurchase plans should be an integral component of the company’s capital allocation decision, not its remuneration program. Share repurchase plans designed to offset equity plan dilution may lead to poor capital allocation decisions or poor timing of repurchase activity.

Equity grants should be scheduled at regular annual intervals. Companies should adopt and disclose a formal pricing methodology for establishing the strike price of grants where applicable. For example, this may entail a policy of establishing the strike price at the average closing price of the company’s common shares over the previous 2 to 4 week period. In no circumstances should boards or management be allowed to back date grants to achieve a more favorable strike price (in the case of options).

3.4.3 Performance-Based Methodologies.

The ICGN strongly supports the use of performance measures tied to the vesting of equity and equity-like instruments. This may include
indexing or premium pricing methodologies\(^2\) and other performance criteria such as key operational metrics. The ICGN does not support time accelerated vesting\(^3\) as a legitimate or desirable performance vesting methodology.

Performance targets associated with equity components should be consistent with long-term sustained superior performance. This means that performance goals should be constructed to measure sustained performance over long periods (including multiple accounting periods). Care should be taken to mitigate potential unintended negative incentives that may be associated with performance measures. For example, poorly constructed performance programs could provide an opportunity to manipulate short-term accounting measures to meet performance goals.

The ICGN believes plans should be designed to minimize or eliminate potential adverse incentives in the following ways (at a minimum): a) Utilize multiple performance metrics with some offsetting drivers that would mitigate the ability to manipulate accounting measures or drive poor business decisions to reach goals (for example, if revenue growth is a desired performance target, it should be accompanied by a profitability or margin measure to ensure that the “incentive” is not to increase revenue at any cost); b) Utilize performance methodologies that encompass multiple periods, such that no opportunity to manipulate one accounting period over another exists (channel stuffing or expense shifting for example); c) Utilize varied performance metrics over time (perhaps with each year’s grant) in an effort to evolve the program with the company’s situation and provide diversified performance drivers; and d) companies should adopt a “clawback” policy that provides for the recapture of performance related pay in cases of restatement or fraudulent reporting if either resulted in an award of performance-based remuneration.

In change in control or other corporate events the ICGN believes 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 equity instruments based on corporate events. The remaining equity instruments and performance awards should be tied to

\(^2\) Indexing and premium pricing methodologies are forms of performance-based vesting. Indexed stock options have a strike price set relative to a peer group index such that the strike price is adjusted to reflect the performance of the index. Premium priced options have a strike price set at a premium to the current market at the time they are granted.

\(^3\) Time accelerate vesting is a methodology that accelerates the vesting of an equity award based upon meeting some pre-determined criteria or performance hurdle. Under time accelerated vesting, the equity awards will vest eventually vest even if the performance criteria for acceleration are not met, the performance criteria is tied only to the acceleration of vesting.
the long-term success of the new entity, not the execution of the transaction.

The ICGN does not favor “retesting” or granting of additional time to meet performance goals except in very exceptional circumstances. The company should have a clearly articulated policy on how these considerations will be made and how the company will disclose any material changes to terms of the remuneration plan.

3.4.4 Post Employment and Other Benefits

Post employment and other benefits include retirement arrangements (both defined benefit and defined contribution plans), health care, and other benefits such as perquisites (both during and after employment). Should companies utilize any of these forms of remuneration, care should be taken to integrate these structures within the overall philosophy and structure of the total plan. Post employment and other benefits can entail significant liability for the company and may represent significant portions of the total value of the remuneration program. As such, the alignment and incentive characteristics of these elements of the remuneration plan can have a material impact on its overall effectiveness. As a general rule, the ICGN believes post employment benefits and perquisites may significantly detract from the performance and alignment qualities of remuneration plans, while arguably having some value to attract and retain key employees. These competing interests must be balanced strictly in the best long-term interests of the shareholders.

As noted under Section 3.1 and 3.2, the company should disclose all material aspects of the remuneration plan, which includes post employment and other benefits. The ICGN believes companies should disclose the existence of all retirement programs for executives, clearly noting any supplemental benefits or sweeteners provided (such as above market earnings on account balances or additional years of service credit for example). Disclosures related to defined benefit programs 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, health, perquisites) is unfunded, the company should provide adequate detail as to the potential liability to the company under these programs.
4.0 Employment Contracts, Severance, and Change in Control Agreements

4.1 The ICGN believes contracts, employment agreements, severance, and change in control arrangements should be strictly limited. As a rule, these arrangements should not adversely affect the executive’s alignment of interest with shareowners or their incentive to pursue superior long-term value.

4.2 Employment contracts should not extend longer than 1 to 3 year periods, and should not be open-ended or renewed on an “automatic” basis. Contracts that run for a multi-year period for the purpose of recruitment should revert to a 1 year contract after the initial contract period. Within this, boards should pursue a policy of mitigation to minimize post-employment expenses to executives.

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

4.4 Severance payments should be limited to situations of wrongful termination, death, or disability.

4.5 The ICGN believes companies should not utilize change in control agreements or make special arrangements in the event of an equivalent corporate event. Change in control agreements can have a significant detrimental impact on the alignment and incentives of the management team. These arrangements typically tie significant remuneration to the transaction in the form of cash payouts, accelerated vesting of equity, and other benefits that are not well aligned with the long-term interests of the owners or with the success of the new entity.

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

4.7 Companies should provide full disclosure of the existence of all employment agreements, severance arrangements, change in control agreements, or any other contractual agreements with key executives. Disclosure should include a description of the agreements with sufficient detail of all material factors such that shareowners have a complete understanding of their terms. Companies should provide estimated payments under specific scenarios such that shareowners can determine the potential payouts under each agreement.
5.0 Disclosure

5.1 The committee is responsible for providing full disclosure to shareowners and the market of all aspects of the committee’s structure, decision making process, and the remuneration program.

5.2 The committee should provide disclosure on at least an annual basis that provides a detailed explanation of the remuneration program. This report should include the company’s rationale for the program, including the company’s overall remuneration philosophy and how the program is designed to support the company’s business objectives. The report should also provide detailed disclosures of the remuneration of each key executive.

Each component of the remuneration program should be identified and its role in the overall compensation program should be justified and explained. This disclosure should include the relative mix of compensation (cash, equity, retirement benefits, perquisites, and other forms of reward) as well as an explanation of how each fits into the performance objectives of the plan. The disclosures should also provide detail on any tax related payments, and favorable treatment provided to executives (such as low rate loans, forgivable loans, or preferential earnings rates).

The report should be detailed enough to allow shareholders to evaluate the minimum and maximum value of remuneration packages in total under different performance scenarios. This should include disclosure of the potential maximum and expected value of performance related remuneration components, and an explanation of the methodology for estimating the expected value.

If the company utilizes any form of employment agreements, change in control agreements, or other contractual arrangements, these should be fully disclosed. The disclosures should include the key terms of these arrangements and the rationale for their use. Care should be taken to articulate how these arrangements are in the best interest of the owners and tied to the long-term performance of the company, if at all.

5.3 Special care should be taken in the remuneration report to provide a full explanation of the relationship of the plan to performance measures. It is the committee’s responsibility to integrate all the components of the plan and ensure that the plan as a whole is sufficiently tied to long-term sustained superior performance. The remuneration report should include evidence of the committee’s actions in this regard. Any benchmarks or other hurdles contained in the plan or utilized to establish plan design should be disclosed. As a general rule, the ICGN believes companies should disclose performance targets and hurdles at the time they are established, such as when annual cash incentive plans are implemented or when equity grants are made.
5.4 In cases where disclosure of performance hurdles at grant date would divulge commercially competitive information, the company should provide full disclosure of the targets upon measurement or realization of the performance period instead of at grant date.

5.5 The company should obtain shareholder approval of the remuneration report, a remuneration policy, or similar comprehensive disclosure as may be appropriate in the applicable jurisdiction. The purpose of obtaining shareholder approval is to provide owners with an opportunity to formally express their opinion regarding the performance of the company in regards to designing and implementing a remuneration program that is in shareholders’ interests. In some cases, approval of a remuneration report is required by regulation or advised by market codes of best practice.

5.6 Disclosures should be presented in a single location and in a clear and understandable format. To the degree possible, tabular disclosures supported by narrative descriptions should be used to organize information.

5.7 The committee or if appropriate in the relevant market, the board, should seek and maintain a constructive dialogue with shareholders and should seek input regarding key elements of remuneration philosophy or plan design.

**Sources**

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