King IV Report on Corporate Governance for South Africa 2016

High level overview

Dr Ronel Nienaber
## How remuneration has evolved through the King Codes

<table>
<thead>
<tr>
<th>King II 2002</th>
<th>King III 2009</th>
<th>King IV 2016</th>
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</thead>
<tbody>
<tr>
<td>Executive remuneration governance</td>
<td>2.25 Remunerate executives <em>fairly and responsibly</em> 2.26 <strong>Disclose</strong> remuneration of directors and senior executives 2.27 Shareholders should <strong>approve</strong> the remuneration policy</td>
<td>14: Governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term</td>
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<tr>
<td><strong>Comply OR explain</strong></td>
<td><strong>Apply OR Explain</strong></td>
<td><strong>Apply AND Explain</strong></td>
</tr>
<tr>
<td>Policy on executive rem decision making</td>
<td>• Remuneration policy  • Reporting of remuneration  • Non-binding Vote to shareholders on remuneration policy and its implementation</td>
<td>• Detailed Remuneration policy  • Detailed Reporting on outcomes  • Single, total figure  • Two Votes with consequences  • Fairness in the context of all employees  • Institutional investor inclusion</td>
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</tbody>
</table>
Structure of King IV

- King IV is more succinct than King III
- From 75 to 17 principles
- Against 16 principles there are 208 recommended practices
- For the 17th principle which applies to institutional investors, there are 6 recommended practices
- 5 Sector supplements:
  - Municipalities
  - Non-Profit Organisations
  - Retirement Funds
  - Small and Medium Enterprises
  - State-owned Enterprises
GOVERNING BODY

17 principles guide what organisations should strive to achieve by the application of governance practices.

EFFECTIVE CONTROL

- 6 Governing body as custodian of governance
- 7 Effective board compositions
- 8 Balancing power and responsibilities
- 9 Appointment of competent executive management
- 10 Performance evaluations for improved performance and effectiveness
- 11 Govern risk and opportunity to achieve strategic objectives
- 12 Manage technology and information to achieve strategic objectives
- 13 Legal compliance
- 14 Fair and transparent remuneration
- 15 Internal and external assurance

ETHICAL CULTURE

1 Ethical leadership
2 Effectively managed ethics
3 Responsible corporate citizenship

GOOD PERFORMANCE

4 Appreciation of the business’ inseparable elements
5 Enable stakeholders to make informed assessments

LEGITIMACY

16 Stakeholder inclusivity
17 Responsible institutional investors

Source: Werksmans King IV booklet (adj)
Fundamental concepts

Remuneration:

- Fosters enhanced accountability on remuneration through:
  - more definitive disclosure requirements
  - separate non-binding votes on the policy and the implementation report
  - stakeholder inclusion
  - use of performance measures that support positive outcomes to be disclosed
- Fair, transparent and responsible remuneration for executive management in the context of overall employee remuneration
- Acknowledges the need to address the gap between the remuneration of executives and lower paid workers
King IV™ recommends that the board oversees that the implementation of the remuneration policy results in all of the following:

- To attract, motivate, reward and retain human capital
- To promote the achievement of strategic objectives within the organisation’s risk appetite
- To promote positive outcomes
- To promote an ethical culture and responsible corporate citizenship
Principle 14

The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.
Definition of ‘Fairness’

Fairness relates to the equitable and reasonable treatment of sources of value creation, including relationship capital as portrayed by the legitimate and reasonable needs, interests and expectations of material stakeholders of the organisation.
Principle 3

…further states “that the governing body should oversee and monitor, on an ongoing basis… the management of an ethical workplace including employment equity; fair remuneration …etc.”

It is critical that the remuneration policy addresses how fair, responsible and transparent remuneration will be achieved in an organisation.

Remuneration should always be justified in terms of the remuneration policy – incentives, salaries or benefits awarded which cannot be justified or explained, run a very high risk of being considered unfair.
From ‘Apply or Explain’ to ‘Apply and Explain’

- Application of all 16 principles are required to substantiate a claim that good governance is being practised.
- Explanation is ‘outcomes-based’ – HOW was the principle applied and WHAT was the outcome.
- The explanation allows stakeholders to make an informed decision as to whether good governance outcomes have been achieved.

Governance outcome:
The positive effect or benefit of good corporate governance for the organisation.

These positive effects include: ethical culture, good performance, effective control, and legitimacy.
Compliance

• King IV is a set of voluntary principles regarding what is generally, globally considered as sound corporate governance practices
• Every organisation that adopts good corporate governance, contributes to sustainable value creation and inspires the confidence of its shareholders
• If King IV conflicts with any legislation, the legislation will prevail
• For entities with a primary listing on the JSE Limited Securities Exchange, certain aspects of King IV are included in the [draft] listings requirements and therefore binding on issuers, once finalised
• Practices implemented will likely become the criteria by which the standard of care of the governing body, is measured
• If a court considers the requirements under King IV when evaluating a particular situation, and the governing body has decided to not implement these governance practices, they may be found liable for such failure
Materiality

• ‘a measure of the estimated effect that the presence or absence of an item of information (or identified subject matter) may have on the accuracy or validity of a statement (or decision). Materiality is judged in terms of its inherent nature, impact (influence), value, use value and the circumstances (context) in which it occurs.

• Materiality in relation to the inclusion of information in an integrated report refers to matters that ‘could substantially affect the organisation’s ability to create value over the short, medium and long term’

Source: King IV Code p14
Recommended practices (1)

- **Remuneration policy**
- The governing body should:
  - **Set direction** of how remuneration should be approached on an organisation-wide basis
  - **Approve the policy** that gives effect to its direction on fair, responsible and transparent remuneration
Recommended practices (2)

- The policy should address organisation-wide remuneration, and include provision for:
  - Remuneration to executive management that is *fair and responsible* in the context of overall employee remuneration
  - The use of *performance measures* that support positive outcomes across the economic, social and environmental context in which the organisation operates;
  - A vote on the policy and implementation report
  - *All elements of remuneration* and the *mix* of these
- The governing body should oversee the implementation and execution of the policy
Recommended practices (3)

- **Remuneration report**
- The governing body should ensure that remuneration is disclosed by means of a remuneration report in three parts:
  - A *background statement*
  - An overview of the main provisions of the policy
  - An implementation report containing details of remuneration awarded during the reporting period
Recommended practices (4)

- **Remuneration report | Background statement**
  - Provide the context for remuneration considerations and decisions, with reference to:
    - *Internal and external factors* that influenced remuneration
    - *Most recent results* of votes on policy & report
    - *Key areas of focus* and decisions taken including substantial changes to the policy
    - Whether *remuneration consultants* have been used and whether the committee is satisfied that they were independent and objective
    - The view of the remuneration committee on whether the policy *achieved its stated objectives*
    - *Future areas of focus*
Recommended practices (5)

- **Remuneration report | Remuneration policy**
- **Overview of main policy provisions and objectives:**
  - *Remuneration elements* and design principles for executive management and at a high level for other employees
  - Obligations under *executive contracts*
  - *Performance measures* used to assess the achievement of strategic objectives and positive outcomes including the weighting and period of time over which measured
  - An illustration of *potential consequences* on the total remuneration on a single, total figure basis – minimum, targets and maximum performance outcomes
  - An explanation of how the *policy addresses fair and responsible executive remuneration* in the context of overall employee rem
  - The use and justification of *benchmarks*
  - The basis of setting *NED fees*
Recommended practices (6)

- **Remuneration report | Implementation report**
- Includes remuneration disclosure into Companies Act:
  - Remuneration of each member of exec management, *in separate tables*:
    - A single, total figure of remuneration, received and receivable for the reporting period, all the remuneration elements, disclosed at fair value
    - Details of unvested variable remuneration awards in current and prior years including the number of awards, the values at date of grant, vesting and expiry dates and the fair value at the end of the reporting period
    - Cash value of all awards that were settled during the reporting period
  - *Performance measures*, weighting, results
  - Reasons for any payments made on *termination of office*
  - A statement regarding *compliance* with, and any *deviations* from, the remuneration policy
Recommended practices (7)

- **Voting on remuneration**
- NED fees by special resolution within the two years’ preceding payment
- Policy and implementation report every year for a separate non-binding vote at the AGM
- Policy should record measures that the board commits to take in the event that either the remuneration policy, or the implementation report, or both, have been voted against by 25% or more of votes exercised
  - An engagement process to ascertain reasons for dissenting votes
  - Appropriately address legitimate and reasonable objections and concerns raised which may include amending the policy, or clarifying or adjusting governance / processes
Voting on remuneration (cont)

If less than 75% votes are in favour, the following should be disclosed in the background statement of the following year’s report:

- *With whom the company engaged* and the manner and form of engagement to ascertain the reasons for dissenting votes
- The *nature of steps taken* to address legitimate and reasonable objections and concerns
Materiality

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Source: King IV Code p14
Implications for reward practices (1)

- Remuneration policy that articulates how fair, transparent and responsible remuneration will be achieved – with specific reference to executive management *in the context of overall employee remuneration*

- *King IV is not prescriptive regarding the wage gap*, but requires mindful application of a policy that address this issue

- Detailed Remuneration disclosure in three parts

- Outcomes-based disclosure that indicates robust setting of performance targets & single figure remuneration

- Performance measures that ensure sustainable value creation across the economic, social and environmental context
Implications for reward practices (2)

• The Remuneration Committee needs to have an overview of the implementation of the remuneration policy, and make a statement of compliance (and any deviations)

• Shareholder engagement ensuring alignment of the policy and outcomes with the expectations of all stakeholders

• Annual Shareholder voting on the remuneration policy and the implementation report

• Reporting on the voting results and any consequential actions
The overarching objective of King IV™ is to make corporate governance more accessible and relevant to a wider range of organisations, and to be the catalyst for a shift from a compliance-based mindset to one that sees corporate governance as a lever for value creation. Mindful application harnesses the benefits of corporate governance in the interests of the organisation and society at large.

Prof Mervyn King
Thank you

• Questions?