SAY ON PAY FOR SINGAPORE COMPANIES

Should Shareholders Have Voting Rights on Executive Remuneration?

By
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In the corporate setting, the CEO and senior executive remuneration is typically determined by the Board of Directors. In many countries, corporate governance codes have been developed to provide guidance on such remuneration practices. However, there has been a recent trend of countries adopting regulation which allows shareholders some form of voting rights on executive remuneration. Such voting rights are commonly referred to as Say on Pay (SoP) votes.

While certain aspects of individual SoP regulations may differ – for example, votes can be binding or non-binding – they are generally instituted with the aim of incentivising boards to act in the interests of shareholders and to avoid awarding executives excessive pay packages.

SoP first appeared in the UK in 2002, when the Directors' Remuneration Report Regulations required all UK companies listed on major exchanges to hold non-binding SoP votes on executive compensation annually. In 2013, regulations were updated to give shareholders a binding vote.

In the US, SoP was introduced as part of the Troubled Asset Relief Program (TARP) in 2009 when companies with outstanding financial assistance loans were required to hold SoP votes. With the enactment of the Dodd-Frank Act in 2011, all public companies are now also required to hold non-binding SoP votes.

Evidently, SoP is becoming increasingly commonplace. According to a 2013 report by the Hay Group, 12 of 16 major jurisdictions studied – including Australia, the UK and US – had some form of SoP legislation in place.

SoP IN SINGAPORE

In Singapore, there have been calls to introduce SoP. During the Singapore Corporate Awards Seminar in May 2014, Lee Suet Fern, Managing Partner of Stamford Law Corporation, called for Singapore to consider adopting SoP. She noted that Singapore would have to decide whether to take up SoP practices that are being adopted internationally, or "be Robinson Crusoe and ride far out there and be different from everybody else". She further added that SoP will ensure that management is directly accountable to shareholders, and could also help companies reduce their reliance on a "hero CEO".

However, others have cautioned against the idea. At the same event, Singapore Exchange (SGX) Chairman Chew Choon Seng suggested that SoP "may have the perverse effect that shareholders, for whatever reason,

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refuse to compensate executives fairly, damaging the prospects of the company and deterring much-needed talent from joining the company, particularly one that is troubled".

Gerard Ee, President, ISCA, also observed that many companies here are comparatively small, and would "find it a great burden to follow compliance rules".

Given these diverse views on implementing SoP in Singapore, it might be useful to highlight some considerations for and against its adoption.

CONSIDERATIONS FOR ADOPTING SoP

SoP represents a direct way of enhancing board and management accountability to shareholders. Without SoP, shareholders can only voice their disapproval of executive remuneration by voting against the re-election of board members involved in the setting of executive pay. Such votes are non-specific and do not clearly signal shareholder unhappiness about excessive executive pay.

In contrast, SoP votes establish a mechanism for shareholders to directly express their displeasure over executive remuneration matters.

Consequently, SoP can potentially be effective in preventing inappropriate executive pay. In Canada, where the introduction of mandatory SoP is being debated, proponents say that it can increase the accountability, transparency, and performance linkage of executive pay in the country.

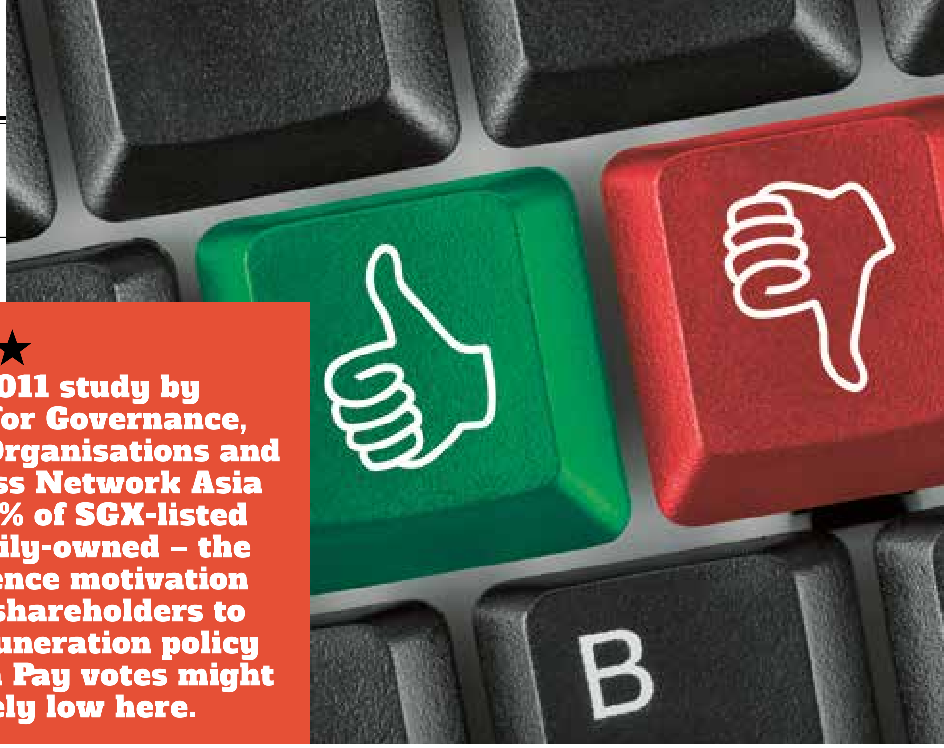
Consistent with this, a 2012 report by Sodali[1], which surveyed 35 institutional investors from 10 countries, showed that four out of five institutional investors support the SoP voting process. The report also noted that "the survey results and comments from respondents make clear investors view the say-on-pay vote as a highly successful corporate governance tool that provides insight into board independence and a means to promote dialogue on both governance and strategic issues".

Further, concerns that shareholders could potentially use SoP votes to wilfully reject executive pay packages may be unfounded. Analysis of SoP voting trends in the US by Semler Brossy[2] reveals that in the first half of 2013, 1,759 out of 1,800 firms obtained shareholder support in their SoP votes, with 72% of companies receiving at least 90% shareholder approval.

Overall, only the most flagrant pay practices tend to be voted down by shareholders. These negative examples which are rejected by shareholders often also play a useful role in subsequently serving as benchmarks for firms keen to avoid controversial pay practices.

[1] Sodali is a global leader in corporate governance consulting, shareholder transactions and institutional investor relations.

[2] Semler Brossy is an established, independent executive compensation consulting firm.



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In these respects, SoP could play a meaningful part in reducing inappropriate executive compensation.

CONSIDERATIONS AGAINST ADOPTING SoP

However, another school of thought is that shareholders may not be able to make better or more informed decisions than the Boards of Directors when voting on executive remuneration. A 2009 article from the University of California, Los Angeles (UCLA), opines that "shareholders have neither the information nor the incentives necessary to make sound decisions on either operational or policy questions".

Given the length and complexity of disclosure documents, and that most shareholders' holdings are likely to be too small to significantly influence SoP voting outcomes, it is probable that the average shareholder could decide that "the necessary investment of time and effort in making informed voting decisions simply is not worthwhile". Correspondingly, leaving decisions on executive pay in the hands of shareholders may not lead to optimal outcomes for the firm.

Additionally, SoP regulation can impose a significant compliance and administrative burden on firms. A Tower Watson[3] survey of US firms in 2011 found that for 40% of respondents, the "desire to minimise administrative burden" influenced how often they intended to hold SoP votes. The survey further noted that in addition to resources allocated to holding SoP votes, companies also had to devote significant resources to other associated activities such as:

- Analysis and communication of voting results;
- Development of outreach programmes to address shareholder concerns and to lay groundwork for future votes;
- Development of new compensation packages (if required).

In Singapore, the Code of Corporate Governance currently only requires firms to disclose the various components of a CEO's remuneration to the nearest thousand dollars, and those of the top five key management personnel in bands of $250,000. SoP may require excessive disclosures that inadvertently harm a firm's competitive interests.

COST-BENEFIT ANALYSIS

Caution should be exercised in determining whether or not to move ahead with SoP in Singapore. In this regard, a thorough cost-benefit analysis of the relevant issues would provide a useful context for furthering the discussion on SoP here.

In gauging the potential benefits that SoP could bring, the extent and severity of the existing executive pay problem in Singapore should be assessed to determine the degree to which shareholders stand to gain from any new regulation.

Any Singapore-specific factors which could limit the knowledge or incentives of investors to cast informed votes should also be identified because they may reduce any potential benefits to be gained from mandating SoP votes.

For instance, given that the majority of SGX-listed firms are family-owned – a joint 2011 study by NUS' Centre for Governance, Institutions & Organisations (CGIO) and Family Business Network (FBN) Asia found that 52% of SGX-listed firms are family-owned – the ability and hence motivation for minority shareholders to influence remuneration policy through SoP votes might be relatively low here. Additionally, the overall benefits of SoP should be measured against the significant costs associated with additional compliance, administration, and disclosure that local firms would have to shoulder should SoP become mandatory.

Given the comparatively small sizes of Singapore firms, administrative loads are likely to represent a significant burden. The introduction of SoP requirements will also certainly require more extensive disclosures of executive remuneration than is currently required, and could compromise any competitive strength which firms may hold in this area. ISCA

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[3] Tower Watson is a leading global professional services company that helps organisations improve performance through effective people, risk and financial management.