A framework for reporting of CEO remuneration in New Zealand companies

Report prepared for the New Zealand Shareholders Association

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Contents

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Introduction

The purpose of this report is to introduce a template for reporting total remuneration received by CEOs of New Zealand listed companies.

Many other jurisdictions have already developed clear and prescriptive regulations for the detailed reporting of executive remuneration. New Zealand it seems has failed to keep pace with international standards. The template is intended to provide investors with a baseline understanding into what our CEOs are being paid and how this figure is arrived at.

A key concern is to avoid the lengthy and often complicated disclosures that sometimes result from legal compliance with reporting requirements. As such, it is proposed that the reporting template will operate as a self-regulatory tool on a comply-or-explain basis. The objective is to assist an informed, but not expert, investor to understand in comprehensive terms just how remuneration is aligned with value creation at shareholder level.

It is not a purpose of this report to provide guidance on the amount or composition of CEO remuneration which is a matter for the boards of each company to decide. The focus is on transparency of the terms negotiated and appropriate disclosure of information so that shareholders are informed and directors can be made accountable for the remuneration decisions they make.

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Remuneration template

Total remuneration for 2015

Single figure CEO remuneration (2015)

2015 $000	Salary and fees	Taxable benefits[1]	Subtotal	Pay for performance STI	Pay for performance LTI	Pay for performance Subtotal	Total remuneration
CEO 2	xxx	xx	x,xxx	xx	xxx	x,xxx	x,xxx

Single figure CEO remuneration (2014)

2014[2] $000	Salary and fees	Taxable benefits	Subtotal	Pay for performance STI	Pay for performance LTI	Pay for performance Subtotal	Total remuneration
CEO 2	xxx	xx	x,xxx	xx	xxx	x,xxx	x,xxx
CEO 1	xxx	xxx	x,xxx	xxx	xxx	x,xxx	x,xxx

Five year summary – CEO remuneration

		Single figure remuneration $000	Percentage STI against maximum	Percentage vested LTIs against maximum	Span of LTI performance period
2015	CEO 2	x,xxx	xx%	xx%	2012 – 2015
2014	CEO 2	x,xxx	xx%	xx%	2011 – 2014
	CEO 1	x,xxx	xx%	xx%	…
2013	CEO 1	x,xxx	xx%	xx%	…
2012	CEO 1	x,xxx	xx%	xx%	…
2011	CEO 1	x,xxx	xx%	xx%	…

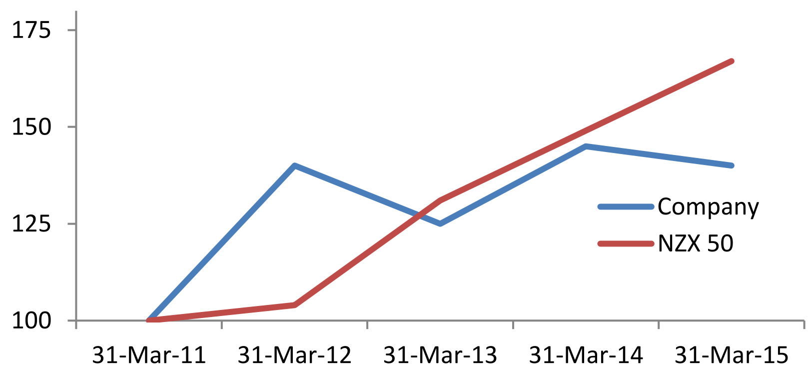
Explanation of the above items

Note	Explanation
1	Taxable benefits include the use of a company car and provision of a low interest loan. During the year ended 31 March 2014 the Company made a loan with a face value of $3.28m to CEO 1
2	On 18 October 2014 the Company appointed CEO 2 to take over the running of …
3	…
4	…
5	…

Breakdown of pay for performance (2015)

	Description	Performance measures	Percentage achieved
STI	Set at 30% of at-risk pay. Based on a combination of financial and non-financial performance measures.	75% weighting operating profit before tax. Threshold for vesting (25%) at 5% increase from FY14 and maximum vesting at 50% increase from FY14; pro-rata vesting in between.	xx%
		25% weighting increase in market share. Maximum vesting at 25% increase in market share, no vesting for decrease in market share and pro-rata vesting in between.	xx%
LTI	Conditional awards of shares under the long-term incentive scheme	50% weighting relative TSR performance against NZX 50 (fixed at date of grant) with 25% vesting at median and 100% at upper quartile; pro-rata vesting in between.	xx%
		50% weighting EPS growth 3% per annum over RPI for threshold vesting (25%) and 8% per annum for maximum vesting – pro rata vesting in between.	xx%

Five-year summary – TSR performance



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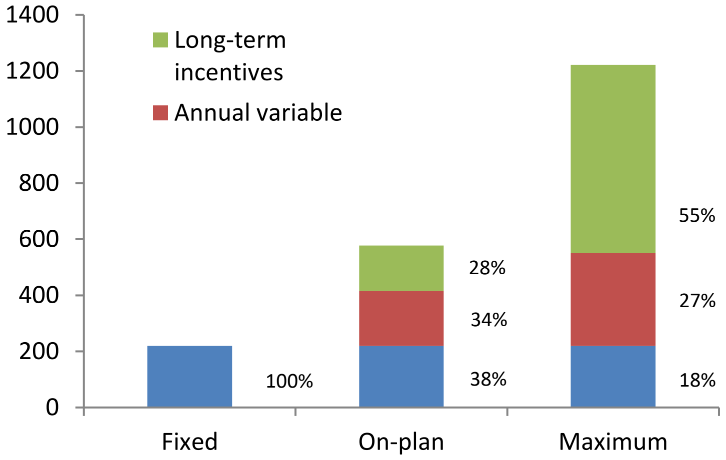
Remuneration policy and disclosures

Scenario charts – CEO remuneration performance pay



Explanation of remuneration policy and items in scenario charts

Fixed remuneration comprises of salary and taxable benefits and is based on amounts reported in the single figure remuneration breakdown as there are no anticipated changes. Base salary is set at $220,000 per annum. The annual variable element pays out at 90% of base salary for on-plan performance or …

Scheme interests awarded to CEO in 2015

Type of scheme interest	Basis of award	Face value of award and % of award vesting at threshold	Length of vesting period	Summary of performance measures and targets
e.g. shares, options	X times base salary, x number of shares at market price on date	$x,xxx face value, 20% vesting at threshold performance	Date performance period ends e.g. 31 March 2017	Short narrative of performance criteria ▪ criteria one ▪ criteria two

Required disclosures per guidelines

…
…
…

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The elements of total CEO remuneration

This section of the report provides guidelines as to the measurement and reporting of items included in the remuneration template. The guidelines are in place to promote comparability as they ensure consistency between companies using the remuneration template as a reporting tool.

Single figure for CEO remuneration

An investor's key interest is not in knowing the single total figure remuneration but in understanding what this figure is comprised of and how it was arrived at. It is important that the single total figure remuneration include all types of reward that accrue to the CEO and that these are broken down into their various components.

Salary and fees

Salary and fees will include all cash paid to or receivable by the CEO in respect of the financial period in relation to periodic remuneration.

Taxable benefits

Taxable benefits will apply to most other elements of compensation that are not at risk and not included within salary and fees above. It will include:

- The taxable value of attributed fringe benefits provided to the CEO in relation to which the Company is liable to pay Fringe Benefit Tax (FBT);
- The settlement of tax liabilities on behalf of the CEO that may arise in relation to any other component of remuneration (for example on share options);
- Cash value of any employer contributions to KiwiSaver or other superannuation contributions made before any employer superannuation contribution tax (ESCT) or PAYE has been withheld;
- Any cash payments made directly to the CEO in lieu of retirement benefits;
- Any other taxable benefit within the charge to income tax not dealt with under the foregoing categories (for example recruitment payments or compensation for loss of office).

Where a taxable benefit has been received but the CEO is not yet economically entitled to that benefit because it is connected to performance measures or targets then it will be appropriate to exclude this item until such time as those performance measures or targets

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have been met. This may for example be the case with certain dividends connected to LTI arrangements.

Short-term incentives (STIs)

STIs in the reporting period will reflect the cash value or cash equivalent of amounts or other assets receivable where entitlement is determined by the achievement of performance measures or targets that relate only to the current period and is not the result of an award made in a previous period. This will include amounts that are deferred provided that deferral is not subject to the achievement of further performance measures or targets in a future period. In borderline cases, companies may wish to explain in the notes their classification of deferred amounts as either a deferred short-term incentive or an unvested long-term incentive in the breakdown of the single figure for remuneration.

Long-term incentives (LTIs)

LTIs will include the cash value or cash equivalent of amounts or other assets received where entitlement is determined by the achievement of performance measure or targets across more than one period. The notes should also disclose whether any LTI awards settled in equity have been met via the issue of new shares or with equity bought on market.

These items will be reported in the period where final vesting is determined i.e. as a result of the achievement of performance measures or targets within the current period and not contingent on the satisfaction of performance measures or targets in a future period. It is the value of shares or share options at vesting that is important for reporting purposes. Any gain or loss on the value of shares that have vested and any increase or decrease on the subsequent exercise of a share option after vesting is not recorded in the single figure of remuneration.

Measurement will depend on the type of interest that has vested:

- Any monetary award will be reported at cash value;
- The value of shares or options will be reported by first multiplying the original number of shares or options awarded by the actual number that vest (or is estimated to vest if the amount is not yet known). The result then will be multiplied by the market value of the interest on the date of vesting.

The value of vested shares determined above must include any accumulated dividends rolled up into the shares and the value of vested options will be less any exercise price the CEO is required to pay. Where the value returned is negative then the value is deemed to be nil. Investors will expect an explanation of the methodology used to determine market value on the date of vesting to be disclosed in the notes. If estimates are needed to support the

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valuation then this should also be disclosed and the figures adjusted in future periods when full information relating to the attainment of performance conditions is available.

Five year summary – CEO remuneration

The five year summary is a table that will present in simple terms historic levels of CEO pay alongside an indication of the relative attainment of performance pay against maximum opportunity over a five year period. The five year period will assist investors in understanding the relationship between performance and pay over a longer term and will make use of information reported elsewhere in the template. This may need to be calculated retrospectively for previous years at least initially until prior period figures are available to draw upon.

The amount reported in the single figure remuneration column should be consistent with the guidelines and totals disclosed in the single figure remuneration breakdown discussed above. A percentage total of the annual variable element achieved against maximum opportunity will need to be reported for each of the at-risk components:

- The STI achieved for each period will be expressed as a percentage of the maximum bonus that could have been earned in respect of that period;
- The vesting of LTIs in each period will be expressed as a percentage of the maximum number of shares that could have vested in that period or as a percentage of the maximum amount that could have been paid in that period where settlement takes place in cash or other assets.

In relation to LTIs that have vested in the period an additional column has been added to provide investors with information on the relative span of the performance period across which vesting has been determined.

Breakdown of pay for performance

The breakdown of pay for performance will provide further information on performance related pay in the most recent period. The total percentage award achieved should match amounts reported in the five year summary. A description and breakdown of the relative performance measures related to the STI and LTI components of remuneration should be included with sufficient detail to allow an investor to understand the process of how at-risk pay has been calculated. A key reason for including this breakdown is transparency regarding the company's remuneration policy. It will allow the investor to form an assessment of whether the setting of remuneration is appropriately aligned with performance.

If full information is not available and estimates are required then this should be disclosed in the notes. Where the performance measures selected are commercially sensitive then

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omission is acceptable provided the company makes a commitment to disclose these measures when it is no longer the case that they are commercially sensitive and the company explains its reasons for omitting this information. Performance measures that are based on publicly available information are preferred and these will not normally be accepted as being commercially sensitive.

Five year summary – TSR performance

The aim of the five-year total shareholder return (TSR) performance graph is to aid comparability between company performance and the remuneration information presented elsewhere in the template. It is expected to complement the five year summary of CEO remuneration and provide useful insight into the past remuneration decisions of the company.

A line graph will depict the TSR for a holding of the company's shares for the previous five years alongside the TSR of an appropriate comparator group of shares of the same kind and number belonging to a specified broad equity market index. The graph is expected to represent the greatest benefit for retail shareholders who will not always have access to market data to readily assess company performance. These guidelines do not seek to prescribe a particular TSR methodology although it is preferable that this be consistent with performance measures that make use of TSR to assess performance as far as possible. Key elements such as assumptions regarding the reinvestment of income and whether averaging is used in calculating TSR will need to be explained in the required disclosures. The company's reasons for selecting a particular index or comparator group will also need to be disclosed.

If a company's shares have only recently been publicly traded then it may not be possible to ascertain share price information. In these circumstances it would be reasonable to plot the graph from the earliest point where this information is available provided that disclosure is made.

Remuneration setting and policy framework

This section of the report deals with the forward-looking element of the remuneration template and has been included to provide details of the company's remuneration policy and how the components of the remuneration package for the CEO have been set for the upcoming period.

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Scenario charts – CEO remuneration performance pay

The scenario charts are essentially a visual representation in the form of a bar graph of a company's policy for CEO remuneration. This format is expected to provide some indication of the expectations of the remuneration committee when setting CEO remuneration although is not intended to be a prediction of future remuneration. The bar graph will present three alternative scenarios illustrating remuneration payable where performance meets, exceeds or falls short of target performance. The graph should state in percentage terms what proportion of total remuneration is comprised of fixed, annual variable and LTI components in each of the three scenarios described in further detail below.

STIs will be measured at face value of the cash value or cash equivalent of amounts or other assets receivable. Long-term incentives will be measured at face value at the time the award is made with no allowance for share price appreciation or dividends prior to vesting. Where options are granted these should be measured at the time of the award using an appropriate valuation methodology with a sufficient explanation of the valuation method provided in the notes. An explanation of the remuneration policy should also state as a percentage of salary the amount of STIs that will be paid or the proportion of long-term incentives awarded that will vest in each of the three scenarios.

Fixed

Fixed components of CEO remuneration such as salary and benefits will represent the minimum remuneration receivable in a given period. Because the scenario charts are an indication of future remuneration the amounts may differ from those reported in the single figure for CEO remuneration. For example, the amounts may be adjusted to reflect a confirmed change to salary entitlement or to exclude non-recurring items reported under the taxable benefits column. Where there are no expected changes to amounts reported in the prior period it will be appropriate to use prior period amounts as the last known figures.

On-plan

On-plan remuneration reported in the bar graph should be a reflection of remuneration receivable by the CEO at target performance. This is an important signal to investors regarding what percentage of at-risk pay is expected to accrue to the CEO if the company performs in line with expectations and may align with vesting at threshold performance.

Maximum

Maximum reported CEO remuneration should reflect the maximum level of remuneration that may be payable to the CEO if all set performance hurdles were exceeded. This will come down to the particulars of each remuneration policy although amounts reported should

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assume that the CEO makes all the decisions or elections available to him/her to increase the size of the award.

Table of scheme interests awarded to CEO

A table has been included in the remuneration template to provide details of scheme interests that have been awarded to the CEO in the current period but where vesting has yet to occur. The level of detail included should be sufficient enough to help investors understand the nature of the scheme interest as well as the criteria by which vesting will be determined. This will depend on the particulars of each scheme but may include:

- Type of scheme interest e.g. performance shares, market value options;
- An indication of the basis of the award or policy by which the award is set;
- An indication of the face value of the award and amount that will vest at threshold performance (if applicable). Companies should consider disclosing further information where appropriate. Examples include the maximum award that may vest if greater than face value and fair value of the award in circumstances where face value is not a reasonable indication of value (e.g. discounted options are used);
- Length of the performance period or a vesting schedule where an award has multiple performance periods that need to be explained;
- An indication of the performance measures and targets that need to be satisfied for vesting to occur including the relative weightings of each measure.

Required disclosures

In addition to the above information these guidelines prescribe a number of additional disclosure items to be reported in the template. Companies are expected to respond to any of the following items that are applicable to their remuneration practices and provide an appropriate level of disclosure or explanation to investors:

1. Disclosure of the pay gap between CEOs and employees expressed as a multiple of the single figure for CEO remuneration over the median pay of all the company's employees. CEO remuneration should be consistent with the remuneration report however sampling will be permitted to estimate the median pay of workers if it is expected this information may be difficult to ascertain;
2. Explanation of the key elements of the TSR methodology adopted in the five year summary performance graph and reasons for selecting a particular index or comparator group to indicate relative performance;
3. Details of any discretion that has been exercised by the Board or the remuneration committee in respect of any award and what result this has had on the level of award that has been determined;

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4. Explanation of any information that has been omitted on the basis that it is commercially sensitive including reasons for the omission and an indication of when the company expects this information can be made known;
5. Any items in the nature of remuneration or indirect benefits that are not included in any category of the single figure for total remuneration. This may include items where no taxable benefit arises due to an available exemption or items that cannot be attributed directly to the CEO because the benefit accrues to a wider group of employees (such as company contributions to certain defined benefit schemes);
6. Key terms of any benefit that accrues to the CEO because of a loan made, guaranteed or secured by the Company or any related party;
7. An explanation of amounts withheld, recovered or clawed back in relation to items of remuneration paid or awarded that have been reported in previous periods and how these have been recognised in the remuneration report;
8. A brief summary of any estimates used in the remuneration report and disclosure of any amounts that have changed from prior periods when actual figures are known;
9. Details of any remuneration arrangement that involves the use of related parties or subsidiary entities making awards available to the CEO or involves awards made to a close family member of the CEO or entity over which the CEO has control or influence. This should include an explanation of how this has been reflected in the remuneration report;
10. Details of any payments made to past CEOs, payments for loss of office or termination payments that are not already included and separately disclosed in the reported single figure for CEO remuneration. This should extend to all amounts that would be included in the remuneration report were the person still the current CEO of the company. It is expected that these will already have be reported under the "taxable benefits" component of CEO remuneration if they are received by the CEO in the year of exit and therefore only residual disclosure of items is needed where there has been some deferral of payment;
11. Disclosure of where measures based on fair value are used in the determination of scheme interests awarded to the CEO in the current year. Where this is the case, a separate disclosure should also be made that indicates the value of the award in terms of current market value (this disclosure can be made either in the table of scheme interests awarded to CEO under 'basis of award' or in the notes).

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