SINGAPORE INSTITUTE OF DIRECTORS

STATEMENT OF GOOD PRACTICE

GUIDING THE REMUNERATION COMMITTEE

This Statement has been superseded by the Remuneration Committee Guide.

With all the intense shareholder scrutiny, media attention and the ever increasing complexity of business management and executive compensation plans, it seems that chairing and serving on the Remuneration Committee ("RC") is becoming one of the most difficult jobs in corporate boards these days. Shareholders will increasingly demand RCs to take a higher level of active oversight in how directors and senior executives are being paid and scrutinize the business rationale behind every single compensation component.

RCs would do well to adopt practices that fulfill the letter and the spirit of the principles laid out in the Code of Corporate Governance ("Code"). RCs should have an enhanced role in providing oversight in the area of executive compensation in order to create shareholder value while motivating directors and senior executives.

I. Principle 7 of the Code recommends that "there should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his own remuneration."

To avoid potential conflicts of interest (or the perception of such conflicts), Guideline 7.1 of the Code prescribes that the RC should be staffed entirely with non-executive directors, a majority of whom, including the Chairman, should be independent directors. It is, however, best practice for the RC to consist entirely of independent, non-executive directors.

Before a formal and transparent procedure can be installed, it is important to establish a charter or terms of reference for the RC for fulfilling the following roles and responsibilities:

- ➢ Development of a compensation philosophy for the directors and executive management, which serves as a basis for and cascades down to the rest of the organization.

- ➢ Identification of the company's key strategic, financial and operating objectives which can be used as a basis to incentivize the directors and executive management.

- ➢ Development of compensation practices, which utilize the different compensation components of base salary, annual and long-term incentives, perks and benefits, to meet the following objectives:

    - Attraction and retention of executives,
    - Alignment with shareholders' interests;
    - Maintenance of internal equities;
    - Appropriate mix between fixed pay versus variable pay based on the desired risk to reward ratio;

- Balanced focus on annual business performance and long-term sustainability;
- Reinforcement of the company's desired culture;
- Avoidance of shareholder and media criticism;
- Efficiency and compliance with all relevant tax, accounting and other legal rules; and
- Protection of executives in corporate development events (for example, change-in-control, retention or severance provisions), yet not setting barriers to value-enhancing corporate transactions.

➢ Initiation of regular compensation program reviews, and making recommendations to the board on changes.

➢ Review and approval of CEO pay increases and variable incentive awards.

➢ Review of compensation decisions for the other executives.

➢ Administer all aspects of incentive pay programs (or delegate such administrative duties).

➢ Hiring and contracting with key executives, and protecting proprietary information while guarding against future competition through employment agreements, confidentiality undertakings and non-competition covenants.

➢ Making decisions regarding severance pay of top executives when needed.

➢ Review of director compensation.

➢ Approval of the write-up on the RC to be inserted in the corporate governance report within the annual report.

To manage the above roles and responsibilities properly requires good process management. To be formal and transparent, the RC should have a pre-determined year-round agenda. Some useful practices to adopt are:

➢ RC to take the initiative to drive the agenda, with management providing supporting information, as required.

➢ RC to meet on a pre-planned, regular and scheduled basis, and meet more often when there is corporate restructuring, legislative changes, significant executive or market movement or changes. An annual cycle may encompass the following activities:

- Establish performance and incentive targets at the beginning of the year.
- Review competitive compensation trends and actual performance during the year as well as address any off-cycle events or issues.
- Make end–of–year compensation decisions, based on competitive market and performance reviews.
- Disclose compensation philosophy and compensation payments in annual report.
- Seek shareholder approval for director fees, where appropriate, at the AGM.

- Chairman of RC to be thoroughly briefed by internal/external experts during finalisation of agenda papers.

- Send RC papers sufficiently in advance of the meeting to allow for a thorough preview.

- Allow sufficient time at each meeting to address critical issues properly.

- Allow for private sessions, when necessary, during which management is not present, to allow for impartial and unencumbered discussion.

When external expertise is needed, it is important to find an executive compensation consultant who is not only technically competent but who is able to exercise independence and objectivity with the interest of the company in mind. While the consultant needs to work with management to understand the business issues and perspectives, the RC should take responsibility and charge over the process and outcome of an executive compensation review, including the hiring and firing of the consultant.

II. Principle 8 of the Code focuses on the level and mix of remuneration. It states: "The level of remuneration should be appropriate to attract, retain and motivate the directors needed to run the company successfully...[and] a significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance."

The challenge in executive compensation is to balance talent objectives with performance objectives. An over-emphasis on pegging compensation to the market in order to attract and retain executive talent may come at the expense of a strong linkage between compensation and performance. An over-emphasis on the latter may hamper the company's ability to attract and retain executive talent.

The RC should ensure the establishment of a compensation framework that is market competitive and a compensation strategy that helps to support the company's objectives (e.g., talent attraction, performance, etc.).

The total compensation package typically is comprised of fixed and variable components. Fixed components include:

- Base salaries;
- Benefit programs;
- Benefit programs;

Incentives, in both annual and long-term forms, make up the variable portion. When setting forth compensation policy, the RC should determine the appropriate balance between the fixed and variable components (and within that, short- vs. long-term incentives). A number of factors, including economic factors, competitive and industry practices, business cycles and priorities, company culture and management philosophy, affect this decision.

The RC should be well aware of not only the competitive positioning but the magnitude of the total potential compensation costs (including the perks and benefits) to the company, particularly for the CEO's package. It should not be constrained by industry averages or past practices but exercise independent judgment in determining the appropriate level of compensation considering a multitude of factors as well as business conditions. The RC should also be aware of the differences in compensation levels throughout the company and be comfortable with the relative differences.

Performance measurement is frequently a key challenge. There is a growing tendency to include in the compensation arrangements not only financial but non-financial metrics (e.g., compliance standards, customer/quality data, employee and organization capability development, etc.) in a more explicit and well-defined manner, especially in annual executive appraisal. This inclusion has the advantage of basing incentives not just on achieving financial results alone, but indicating the quality and sustainability of the results.

Some financial and non-financial measures used to incentivize executives are illustrated below.

Measures used to incentivize senior executives
Market-oriented, e.g., Total Shareholders's Return, Wealth Added
Value-oriented, e.g., Economic Value Added, Cash Value Added, Economic Profit, Cash Flow Return on Investment
Yield-oriented, e.g., Return on Capital Employed, Return on Assets, Return on Equity
Operating result-oriented, e.g., Revenue Growth, Margins, Costs, Productivity
Customer-oriented, e.g., Customer Satisfaction, Retention, Brand Perception
Employee-oriented, e.g., Employee Engagement, Capability Development

In structuring long-term incentive awards (whether stock or cash-based) for executives, the RC should take into account the company's performance over the years, relative shareholder returns, the value of similar awards to executives at comparable companies, and what has been given in the past years to the executives. Other than devising vesting schedules to reward and/or retain executives through performance and/or tenure conditions, the RC should consider ways to encourage executive stock ownership in order for them to have a stake in the company and to align their interests with that of the shareholders.;

III. Principle 9 of the Code indicates that "each company should provide clear disclosure of its remuneration policy, level and mix of remuneration and the procedures for setting remuneration in the company's annual report...to enable investors to understand the link between remuneration paid to directors and key executives, and performance."

The RC should ask itself the following questions when approving and disclosing any executive compensation program:

- Are we clear about the components in the program and their respective objectives?
- Have we satisfied ourselves that the program is, and understand how it is, aligned to stakeholders' interests and good business practices?
- What are the weaknesses, if any, in this program?

- Is the program structured to match pay vs. market measures with expected performance vs. market measures?

- Are we basing incentive awards on absolute performance and how is that performance relative to industry peers? Are we paying for something unnecessary?

- Is the program helping to focus executive attention on short- and long-term performance, growth and returns?

- Are stock-based incentive run-rates within industry norms?

- Will executives be motivated by the program? Will they feel that there is internal fairness and market parity?

- How will the program be viewed by the media, shareholders and investment analysts?

- Will the program stand the test of time; during good performance and bad, and through bull and bear markets? Is there anything in this program that will set a bad precedent?

- How will we know if this program is a success?

After approval of the program, proper documentation of the context, design considerations and details of the program are necessary for future reference. The company's auditors should also be invited to review the incentive plan calculations.

Proper and effective communication to the executives is frequently a determinant of the success of even a well-designed program. Effective communication needs to take into account what the key messages of the program are and how best should the messages be communicated to all parties.

Lastly, there should be in place a review process within a fixed timeframe, such that it becomes a natural part of the RC's agenda in the future.
