PRACTICE NOTES

A guide to the application of King III: Remuneration

King III Remuneration Practice Notes v2 October 2012

Relevant legislation and regulations *for example* Companies Act, JSE Listing Requirements, SEC requirements, SARB regulations, Labour legislation, accounting standards, memorandum of incorporation, employment contracts and international legislation for multinationals etc must be read in conjunction with these practice notes.

Intended primary audience: members of Remuneration Committees, Boards of directors of JSE listed companies and institutional investors (as a proxy for shareholders) and reward professionals.

Remuneration of directors and senior executives
Principle 2.25: Companies should remunerate directors and executives fairly and responsibly

King III Practice Recommendation (par 147)
Companies should adopt remuneration policies and practices for executives that create value for the company over the long term. The policies and practices should be aligned with the company's strategy, should be reviewed regularly and should be linked to the executive's contribution to company performance.

Practice Notes:

PN 147.1 Conceptually, a company's remuneration philosophy and intent should be captured in a remuneration strategy designed to support its business and human resource and people strategies, the salient features of which should be contained in the Remuneration Report.

[Refer to Annexure PN 147.1A for a framework of a remuneration strategy]

PN 147.2 Remuneration policies are designed to give effect to the remuneration strategy and should be designed to support the business objectives within the larger operating environment, and the Remuneration Committee should ensure that all relevant variables are addressed, and that a balanced remuneration mix is offered within the company's financial constraints.

PN 147.3 The remuneration strategy should be approved by the Remuneration Committee and confirmed by the Board. Remuneration policies should be reviewed annually to ensure their continued relevance.

Remuneration Committees should ensure that there is regular monitoring of the remuneration practices to ensure that they adhere to the remuneration policies.

PN 147.4 The company should indicate in the Remuneration Report the manner in which executive remuneration is related to the value-created for shareholders and other stakeholders.

King III Practice Recommendation (par 148)
Factors affecting company performance, but outside the control of senior executives, and to which they have made no contribution should only be considered to a limited extent. At lower levels in the company the effect of outside factors should be ignored.

Practice Notes:

PN 148.1 Remuneration policies, in particular, the structure of variable pay, should seek to moderate the impact of positive or negative factors, which are outside of their control, on executive remuneration, in addition to considering overall performance of the organization. Examples of such factors are the platinum price for platinum mining houses, the international crude oil price for energy companies, and the gold price for gold mining companies.

In such companies, overall sustainable performance should still be targeted, within a mix of other financial and non-financial targets, but the factors that lie outside of the control of the executives should impact less overall on any bonus calculation than the more directly controllable factors.

Although these factors should not play a direct role in the determination of bonus amounts for lower level employees, the role of affordability in the determination of bonuses cannot be ignored, and bonus policies will need to take into account a company's financial constraints or distress.

King III Practice Recommendation (par 149)
The board should promote a culture that supports enterprise and innovation with appropriate short- and long-term performance-related rewards that are fair and achievable.

Practice Notes:

PN 149.1 In profit generating companies, a culture of enterprise and innovation is a leading indicator of an ongoing ability to produce sustainable profits. The Board should set targets that correspond with the enterprise's risk tolerance. This could be high risk taking or low risk taking - depending on the context of the business operating environment and business life cycle.

PN 149.2 The board should require that short–term and long-term performance-related rewards meet criteria listed in practice notes PN 158.1; PN158.2; PN 160.1; PN 160.2.

PN 149.3 In certain circumstances, it is appropriate to set targets that are lower than previous / current levels; particularly when the board is aware of future adverse conditions that could influence the performance of the organisation. Conversely, where the Board anticipates good trading conditions, more stretching targets should be set.

King III Practice Recommendation (par 150)
The Remuneration Committee should assist the board in its responsibility for setting and administering remuneration policies in the company's long-term interests. The committee considers and recommends remuneration policies for all levels in the company, but should be especially concerned with the remuneration of senior executives, including executive directors, and should also advise on the remuneration of non-executive directors.

Practice Notes:

PN 150.1 The Remuneration Committee should consist mainly of independent directors with company executives attending by invitation, and should operate according to a terms of reference that mandates it to oversee the remuneration policies in the company.

The Committee should have a systematic agenda to review the remuneration strategy and determine the organisation's remuneration policy (including higher level strategic reward principles that would inform the detailed policy and implementation thereof), and the decisions to implement; and oversee the implementation of these policies over an annual cycle.

King III Practice Recommendation (par 151)
In proposing the remuneration policy, the Remuneration Committee should ensure that the mix of fixed and variable pay, in cash, shares and other elements, meets the company's needs and strategic objectives. Incentives should be based on targets that are stretching, verifiable and relevant. The Remuneration Committee should satisfy itself as to the accuracy of recorded performance measures that govern vesting of incentives. Risk-based monitoring of bonus pools and long-term incentives should be exercised to ensure that remuneration policies do not encourage behavior contrary to the company's risk management strategy.

Practice Notes:

PN 151.1 The Remuneration Committee should regularly review and objectively assess the appropriateness of the fixed to variable remuneration mix for the company, to ensure that it reflects the remuneration strategy, and

(i) serves the company's operational needs and objectives,

(ii) is competitive, and

(iii) serves the achievement of strategic objectives.

PN 151.2 The balance between short and long term incentives should ensure an appropriate focus on the shorter and longer term business objectives without introducing inappropriate risk to the company, and should be appropriate to the life cycle, industry and type of company.

PN151.3 In setting incentive targets, management submissions should be tabled for approval to the Remuneration Committee, addressing whether:

(i) they are stretching and present an adequate target given business and economic realities,

(ii) the measures and measurements are verifiable (if necessary by internal or external auditors), and

(iii) they are relevant given the business strategy, business plans and short and long term objectives.

PN 151.4 The Remuneration Committee should ensure that in the design of the short term and long term incentive plans the setting of associated targets does not encourage behavior contrary to the company's risk management strategy and does not unintentionally or intentionally drive excessively risky behavior in pursuit of incentive targets.

Methods to align short term incentives better with the long term objectives of the company should be encouraged. Risk taking that yields short term profits at the expense of long term potential losses should be discouraged and avoided. Bonus Deferral and claw back provisions (including bonus-malus schemes) should be adopted in the case of subsequent under-performance or misstatement (deliberate or not) of financial results.

King III Practice Recommendation (par 152)
The Remuneration Committee should scrutinise all benefits including pensions, benefits in kind and other financial arrangements to ensure they are justified, correctly valued and suitably disclosed.

Practice Notes:

PN 152.1 The Remuneration Committee should annually review the benefits offered by the company to determine:

(i) whether they are appropriate and competitive given the industry, the company's financial position, legislative requirements, and market benchmarks and trends;
(ii) if the costs relating to the administration of the benefits / schemes are justified. This may include an assessment of how the benefits are perceived and understood by participants;
(iii) if the schemes / trusts are well governed;
(iv) whether the benefits / schemes meet the needs of employees and are fair towards all employees.
(v) whether benefits that are offered to executives are similarly offered to employees and if not, what the justification is.

PN 152.2 As benefit funds are administered independently through boards of trustees, the Remuneration Committee (or other relevant board committee such as the Audit Committee) would not ordinarily be required to review the audited financial statements. If the Committee however is concerned about the protection and management of employees' interests, they may specifically request the Boards of Trustees of Benefit funds to present these statements.

King III Practice Recommendation (par 153)
Non-executive director fees, including committee fees, should recognise the responsibilities borne by directors throughout the year and not only during meetings. Fees should comprise a base fee which may vary according to factors including the level of expertise of each director, as well as an attendance fee per meeting.

Practice Notes:

PN 153.1 To avoid conflict of interest in determining their own fees and structure, the Remuneration Committee should request executive management (through independent advice if required) to recommend a fee structure.

PN 153.2 The following aspects should be considered when determining the fee structure of non-executive directors:

- An annual base fee in respect of the Board appointment that reflects the expertise and contribution of the directors;
- Committee fees where for example, the specialist technical expertise required for the Audit Committee and the Remuneration Committee usually merits a premium fee;
- Fee per meeting (for preparation and attendance);
- Supplementary fees for additional projects;
- Reimbursement of direct expenses;
- It is common practice to differentiate fees based on the home jurisdiction of the director, and market practice in the home jurisdiction is used as a basis to determine these fees; and
- As covered in later sections, performance based share or share option schemes is not favoured for non-executive remuneration (and will impact the independence of directors in listed organisations); as opposed to full value share grants that are not geared instruments and with no performance criteria influencing vesting and therefore viewed in a different light.

PN 153.3 The components of remuneration are normally a matter of negotiated commercial contracts and therefore should be sufficiently flexible to suit each individual circumstance. Factors that influence the **individual base fees** of non-executive directors include time commitment, level of responsibility, level of competence as well as the contribution and profile of the director.

PN 153.4 Companies should consider an **attendance or meeting fee** for all non-executive directors. In determining an appropriate and fair attendance fee structure, the following could be considered:

- The general level of hourly or daily rates of fees earned by directors in their professional capacities (for instance, as lawyers, accountants, executives, partners in audit or legal firms or management consultants);
- The hours spent in travel and preparation for meetings, as well as actual attendance;
- The number of meetings held (as this is an indication of the workload);
- Attendance only should not be a qualification for meeting fees. Directors carry responsibilities whether they attend meetings or not and could for example still qualify for the meeting fee if they provide detailed input and feedback on board submissions prior to the meeting. Disqualification of attendance fees should be based on the holistic performance of the director as determined by the chairman from time to time;
- For multi-national companies that require non-executive directors to travel abroad for purposes of attending Board and Committee meetings, an additional allowance may be considered; and
- In the case of companies of similar size or complexity, a comparison may be made on typical fees. Company performance (profit, dividend and share price) is not considered to be of special significance for the purpose of setting an attendance fee.

PN153.5 **Supplementary fees**, for additional workloads assigned to a non-executive director is acceptable subject to required approval being obtained. If supplementary fees are paid separately, they may be calculated as an hourly or daily rate.

PN 153.6 Directors should be reimbursed for all **direct and indirect expenses** reasonably and properly incurred in the performance of their duties (such as office, secretarial, accommodation or travelling expenses) as would ordinarily be the case for employees of the company.

PN 153.7 Different remuneration levels may be set for chairmen and deputy chairmen of committees, senior directors, and lead independent directors.

PN 153.8 Fees could be substituted with full value shares that are not restricted (either in terms of time or performance).

King III Practice Recommendation (par 154)
Although permitted by the Act, the chairman and other non-executive directors should not receive share options or other incentive awards geared to share price or corporate performance, as such incentives align their interests too closely with executives and may be seen to impair their objectivity.

Practice Notes

PN 154.1 Granting share options or similar highly geared share-incentives that are typically related to the achievement of performance conditions to non-executive directors should be avoided because of the potential impact of such grants on their independent decision making and conflict of interest (real or perceived). It is however acceptable to award full value shares that are not geared and which vest immediately.

PN 154.2 Non-executive directors should not participate in any performance bonus schemes.

PN 154.3 Shares granted under approved black economic empowerment schemes may be allowed subject to shareholder approval.

King III Practice Recommendation (par 155)
Non-executive directors' fees should be approved by shareholders in advance. The Act requires a special resolution at intervals of not more than two years for this purpose.

Practice Notes

PN 155.1 Non-executive directors' fees should be approved by special resolution, (requiring at least 75% votes (or another percentage as indicated in the Memorandum of Incorporation of the company) in favour of the resolution by the shareholders present) during an Annual or Special General Meeting, not more than two years prior to the implementation of the fees. Approval should be obtained prior to payment of the fees.

King III Practice Recommendation (par 156)
The proceedings of the Remuneration Committee should be governed by a terms of reference approved by the board.

Practice Notes

PN 156.1 The terms of reference of the Remuneration Committee is also referred to as a Charter. The terms of reference provides a mandate on the scope of activities of the Committee, and is approved by the Board and should be made available to stakeholders (e.g. on the company's website).

See Annexure PN 150.1A for a framework of a Remuneration Committee Terms of Reference.

Base pay and bonuses

King III Practice Recommendation (par 157)
In setting remuneration policies, the Remuneration Committee should ensure that remuneration levels reflect the contribution of senior executives and executive directors and should be rigorous in selecting an appropriate comparative group when comparing remuneration levels. There should be a balance between the fixed components and the bonus component of total remuneration of executives so as to allow for a fully flexible bonus scheme.

Practice Notes

PN 157.1 A Remuneration policy is defined as the policy document(s) that provides guidelines for the implementation of the reward strategy and the design and management of reward processes.
Remuneration/reward policies should consider the following components:

(i) Fixed pay: Guaranteed Package (Salary and benefits) – the cost to company of all fixed guaranteed elements of remuneration, including the cost of all benefits, such as company contributions to pension and medical aid, leave entitlements, flexible work conditions, but excluding the cost of short and long term incentives.

(ii) Variable pay: Short Term Incentives - Annual Bonus and (generally) cash performance-based payments. Thresholds should be set for minimum acceptable performance. Consideration should be given to ensure fairness between threshold, target and stretch incentives that relate to appropriate levels of organisational performance. It is becoming more common to defer a portion of the cash based incentive into a long term incentive arrangement (deferred bonus).

(iii) Variable pay: Long Term Incentives – longer term (usually) share-based awards which are retention and performance based. Retention schemes typically fall under this category.

The value of total rewards (aggregate of the three components stated above) and the percentage contribution of each reward component within the total reward structure, should be set and reviewed regularly. The total reward package should be considered in determining competitiveness thereof, and the percentage composition of the three components within the total reward package should reflect the orientation on individual performance as well as organisational short and long term goals.

PN 157.2 Market practice in selecting an appropriate peer group for benchmarking is to select comparable companies e.g. size, geographic location, business life cycle and sector. Factors such as revenue, profits, market capital and number of employees are often used as size metrics. Further factors such as the international scope of the business (local, international operator or global player) also influence the selection of comparators. Comparators are usually drawn from the same jurisdiction as the Company, but international comparators may be used for global Companies, especially when sector analyses are being done. Care should be taken to compare the correct values by for example adjusting for cost of living and exchange rate differentials.

PN 157.3 When benchmarking the guaranteed package (basic salary plus employer contributions towards benefits, allowances and other guaranteed earnings), comparison should be made with comparable roles within the comparator group. When international comparators are utilised consideration should also be given to cost of living adjustments for the component of the package that relates to local living costs.

PN 157.4 When benchmarking, the nature and quantum of annual bonuses, the following factors should be considered for the Company and the comparator group:

- The actual payments made for the financial year
- The level(s) of “on-target” payments
- The level(s) of “maximum” or “stretch” payments

These values should be reviewed in absolute terms as well as a percentage of guaranteed package / basic salary.

PN 157.5 A fully flexible bonus scheme is one in which, when performance is below acceptable levels (threshold), no bonus amount will be paid out.
In practice, employees should not have a high dependence on incentive pay-outs to cover the daily living expenses, as the fixed component of guaranteed remuneration should provide this.

It should generally be recognised that incentives are payable for incremental performance above a minimum expectation. This excludes employees employed on sales commission plans or the like where the ratio of guaranteed: variable remuneration will be designed to encourage specific behaviours.

King III Practice Recommendation (par 158)
Yearly bonuses should clearly relate to performance against yearly objectives consistent with long-term value for shareholders. Individual and corporate performance targets, both financial and sustainability related,

should be tailored to the needs of the business and reviewed regularly to ensure they remain appropriate.

Practice Notes

A checklist for the review of incentive schemes is enclosed as Annexure PN 166.1A.

PN 158.1 Annual incentive designs are many and varied but best practice dictates that they should reward a combination of both business and individual performance:

- Business performance is usually assessed in terms of a limited number of performance indicators, most likely to be financial in nature, but increasingly with non-financial elements being factored in.
- Individual performance is usually assessed from a weighted ("balanced") scorecard of key performance areas or value drivers. The selection of these is usually informed by the performance management framework.

PN 158.2 Annual incentive design architecture is most often placed along a continuum between "highly structured" and "fully formulaic":

- In the highly structured type, a single business performance indicator is used to set a performance funding curve that defines the relationship between business performance and an incentive pool that is formed as a result of this performance. The incentive pool is then allocated / distributed to participants according to role and performance contribution.
- At the other extreme of fully formulaic, overall business performance plays a lesser role in influencing incentive bonuses, and then only as one element of a scorecard. It is the individual's/team's performance in terms of a defined (balanced) scorecard that determines the level of incentive pay.
- Consideration needs to be given to the balance required between the performance of the subsidiary company alone, and the combined performance of the group.
- In finalising bonus pay-outs, consideration should be given to including an element of discretion to mitigate unintended consequences.

PN 158.3 Performance targets for annual bonuses, both corporate and individual, should be reviewed annually in advance, and should include financial and non-financial targets which include measures of a shorter term nature as well as leading indicators of longer term sustainability.

PN 158.4 The practice of introducing personal or non-financial performance measures that may determine a portion of the bonus, independently of the organisation's annual financial performance is gaining traction, and is supported by international remuneration guidelines e.g. European Commission guidelines.

King III Practice Recommendation (par 159)
Depending on the nature of the business it may be appropriate to have overriding conditions for the award of bonuses (often termed 'gatekeepers'), such as achieving safety goals or minimum levels of financial performance.
Targets for threshold, expected and stretch targets of performance should be robustly set and monitored and the main performance parameters should be disclosed.

Practice Notes

PN 159.1 It is important to differentiate between a gatekeeper and a modifier where the gatekeeper typically only acts as a penalty, with a modifier enhancing or decreasing incentives for performance relative to targets.

The gatekeepers (e.g. safety) should be designed to ensure that fundamental principles governing the operation of the business are not violated in the pursuit of profitability. The application and quantum of a penalty (as a result of violation of the gatekeeper) applied to the bonus is normally left to the discretion of the Remuneration Committee.

PN 159.2 For each performance measure or scorecard element, a weighting should be set reflecting its overall importance for that year, as well as levels for “Threshold”, “Target” and “Stretch” performance. Threshold performance relates to the minimum levels required for the payment of any Bonus, such as the budget. Target performance relates to good performance incorporating some stretch, and “Stretch” performance relates to truly exceptional performance in the context of the prevailing business environment.

PN 159.3 Best practice is to disclose the nature of each metrics and their weighting in each executive / prescribed officer’s incentive, but the actual values for performance levels are not usually disclosed in advance, as they may damage competitiveness. Disclosure of these targets should be done in arrears after incentives have been approved for payment.

King III Practice Recommendation (par 160)
Incentives may be given for both long-term and short-term goals. However, the performance drivers should not be duplicated, and a balance should be struck with the need to reward success over the long term. Multiple performance measures should be used to avoid manipulation of results or poor business decisions. Targets may be linked to bonuses.

Practice Notes

PN 160.1 Short term targets usually relate to financial and operational targets that have a direct bearing on the performance for the year. Profitability measures such as earnings, production and unit costs are common short term measures. Targets should be balanced between financial and non-financial targets. Longer term targets are more outcome based and measures such as Total Shareholder Return relative to a peer group, Return on Capital and real growth in headline earnings per share (HEPS) over the vesting period, as well as sustainability measures are common measures.

PN 160.2 The use of multiple performance measures based on business outcomes reduces the risk of unintended outcomes impacting the entire award. For example, measures of performance based on accounting, shareholder, absolute and relative aspects of performance are used together to provide a holistic view of business performance. Different targets can also be used in different types of long-term incentive schemes which are used simultaneously (e.g. a combination of option and full value share based plan/scheme). However, each scheme with related targets should have a particular objective.

Financial modeling or stress testing of likely payouts should be conducted regularly.

PN 160.3 The weighting attached to different targets may differ at each level of the company in line with the accountability of employees and the behavior that needs to be encouraged.

Employment contracts, severance and retirement benefits

King III Practice Recommendation (par 161)
Contracts should not commit companies to pay on termination arising from the executive’s failure.

Practice Notes

PN 161.1 Employment contracts should be so worded that companies are not obliged to pay special severance or compensation on termination of employment contracts arising out of failure or incapacity to perform, or underperformance against contracted objectives. There should be clear disclosure on the basis for any termination payment to senior executives including the rules relating to unvested portions of long term incentive grants as well as the application of CPTs in this arrangement.

King III Practice Recommendation (par 162)
Balloon payments on termination do not generally meet the requirements of a balanced and fair remuneration policy.

Practice Notes

PN 162.1 Employment contracts should be so worded that companies are not obliged to pay special (balloon) payments on termination of employment.

PN 162.2 Balloon payments are typically cash payments made in recognition of service with no performance criteria attached, agreed to in cases of termination (also termed a "golden parachute").

PN 162.3 Balloon payments to end employment contracts, should be avoided and where they occur, should be disclosed in detail (i.e. the total amount as well as the rationale for payment) in the annual report.

King III Practice Recommendation (par 163)
For bonuses, there should be a contractual link between variable pay and performance. In the event of early termination there should be no automatic entitlement to bonuses or share-based payments.

Practice Notes

PN 163.1 Bonus plans should create a contractual link between variable pay and the performance criteria. The performance criteria should define:

(i) the conditions under which payments will be made,

(ii) the assessment of the performance conditions and

(iii) the approval process under which payments may be made

PN 163.2 Bonus plans should be so worded that companies are not obliged to pay any bonuses or share-based payments in the event of early termination of employment due to resignation or dismissal for good cause.

King III Practice Recommendation (par 164)
Contracts should make it clear that if a director is dismissed because of a disciplinary procedure, a shorter notice period than that given in the contract would apply without entitlement for compensation for the shorter notice period.

Practice Notes

PN 164.1 Employment contracts should provide differentiated notice periods for different reasons for termination for example, incapacity, dismissal, resignation, retirement, retrenchment or redundancy and link appropriate notice periods to the different reasons for termination of service.

PN 164.2 Where standard employment contracts commit companies to extended notice periods in the event of termination through disciplinary action, consideration should be given to amending the templates for new contracts / appointments. Existing contracts can be renegotiated at an opportune time to address these requirements, subject to agreement by the Board and the Executive.

King III Practice Recommendation (par 165)
Contracts should not compensate executives for severance because of change of control; however this does not preclude payments for retaining key executives during a period of uncertainty.

Practice Notes

PN 165.1 Employment contracts or incentive scheme rules should not be worded to automatically sever employment contracts with executives because of a change in control. The contracts and schemes should also not allow the early vesting of long-term incentives or entitle executives to automatic bonus payments when there is a change in control. In the case of JSE listed companies, the rules of the long-term incentive schemes as approved by the JSE and shareholders will apply. If the rules are insufficiently clear, approval for the course of action proposed should be sought from the JSE and shareholders.

PN 165.2 Long term incentive schemes are typically designed to retain employees and to align employee value creation with that of shareholders. Practice is however that in times where long term incentive schemes are under-water (option based plans), or where it is likely that corporate performance targets will not be met on share based plans, or where the company is facing a corporate take-over or having to enter into a process of retrenchments, companies design retention plans to lock in high potential / high flyer employees (either in terms of skills, influence, contribution, marketability, succession plans etc). These schemes should be ring-fenced from other schemes and separately disclosed in the Annual Remuneration Report. The value of retention schemes should also be considered when reviewing the total remuneration of employees.

Share-based and other long-term incentive schemes

King III Practice Recommendation (par 166)
The Remuneration Committee should regularly review incentive schemes to ensure their continued contribution to shareholder value. The committee should guard against unjustified windfalls and inappropriate gains from the operation of share-based incentives.

Practice Notes

PN 166.1 A checklist for the review of incentive schemes is enclosed as Annexure PN 166.1A.
Examples of situations where unjustified windfalls could occur and should thus be guarded against, include:

- runaway inflation
- the announcement of the commencement of merger negotiations, and
- the announcement of government subsidies

PN 166.2 The following practices mitigate against the risk of unjustified rewards:

- the use of regular annual awards, as opposed to larger once-off grants;
- the use of appropriate, multiple performance measures;
- the application of gatekeepers and modifiers; and
- the introduction of share awards such as restricted shares and performance shares, which are less leveraged than share options and share appreciation rights.

King III Practice Recommendation (par 167)
Participation in share incentive schemes should be restricted to employees and executive directors, and should be within appropriate limits for individual participation, which should be disclosed.

Practice Notes

PN 167.1 The value of long term (share based) incentives forms part of the overall pay mix included in the remuneration policy and is typically set by level within the company hierarchy.

PN 167.2 [Typically] the maximum number of units that may be granted under, or underlie, long term (share based) incentive plans, or the number of units that may be awarded on an individual level, should be included in the scheme rules. The salient features of these scheme rules should be disclosed in the Remuneration Report.

PN 167.3 Market benchmarks should be reviewed to assess the reasonability of annual grants and overall holdings of unvested share awards.

King III Practice Recommendation (par 168)
All share-based incentives, including options and restricted or conditional shares, whether settled in cash or in shares, should align the interests of executives with those of shareholders and should link reward to performance over the longer term. Vesting of rights should therefore be based on performance conditions measured over a period appropriate to the strategic objectives of the company.

Practice Notes

PN 168.1 The nature of the metrics selected, which should be aligned with shareholder interests, the degree of stretch and challenge in the performance targets and the vesting term of the awards (ranging from three to five years) align with longer term shareholder interests and the strategic objectives of the Company.

PN 168.2 The extent of forfeiture or vesting of share based awards, at different levels of performance, should be clearly articulated in the Remuneration Report.

PN 168.3 The treatment of dividends on share based incentives should be clearly disclosed in the Remuneration Report.

King III Practice Recommendation (par 169)
Highly leveraged incentive schemes should be used with care as they may result in excessive cost or risk for the company.

Practice Notes

PN 169.1 Highly leveraged plans are those where a relatively small change in the share price yields a much higher benefit to plan participants. For example, pure share option or share appreciation right plans require the grant of approximately three times as many units to provide the same expected value as a restricted share award, and are thus more highly leveraged. Similarly Out-performance plans that have a low chance of vesting, but deliver large values in the case of exceptional performance can be considered as highly leveraged. (PN 169.2 A combination of restricted or conditional share plans and share option or share appreciation right plans provide a more balanced portfolio approach and reduce the highly leveraged nature of pure option/appreciation schemes. Balance versus the complexity of a combined approach, needs to be carefully considered.

King III Practice Recommendation (par 170)
The regular and consistent granting of share incentive awards and options, generally yearly, is desirable as it reduces the risk of unanticipated outcomes that arise out of share price volatility and cyclical factors, allows for the adoption of a single performance measurement period and lessens the possibility and impact of 'underwater' options or excessive windfall gains.

Practice Notes

PN 170.1 The policy of consistent annual grants has generally found favour in South Africa, compared to the practice of awarding large amounts on grant or promotion with no subsequent annual / 'top up' awards.

PN170.2 Despite this policy, companies may still need to award larger than normal awards as sign-on incentives either in recognition of internal promotions, or as a motivation to join the company. The details of the policy, how regular share incentive grants are made and the frequency thereof, should be disclosed in the Remuneration Report.

King III Practice Recommendation (par 171)
The price at which shares are issued under a scheme should not be less than the midmarket price or volume-weighted average price (VWAP) (or similar formula) immediately preceding the grant of the shares under the scheme. There should be no re-pricing or surrender and re-grant of awards on 'underwater' share options.

Practice Notes

PN 171.1 This practice guards against the fixing of an issue price prior to the date of grant as well as against share-based units granted at a discount to the prevailing market price. Reference to 'immediately preceding the grant of the shares' refers to one day prior to the date of grant.

PN 171.2 Trailing VWAPs (over a period of up to five days) can be used with due consideration to the liquidity of the share (and subject to the proviso that the issue price not being lower than the VWAP or midmarket price on the day before the grant date).

PN 171.3 Where share incentive plans are underwater (option plans), the fair value of these incentives should still be taken into consideration in the overall calculation of total rewards.

PN 171.4 Under-water options should not be replaced by a new grant that is substantially higher than the standard annual allocation.

King III Practice Recommendation (par 172)
The rules of a scheme should provide that share or option awards should not be granted within a closed period. No backdating of awards should be allowed.

Practice Notes

PN 172.1 Closed periods include standard periods as laid down by the JSE as well as ad hoc closed periods.

PN 172.2 Even if a closed period is not announced, share grants should not be made to employees in a period where they have access to price sensitive information which is not in the public domain. Companies should also not allow these employees to trade in company shares during this period where they could be in a position of information that puts them in a more advantageous position compared to shareholders.

PN 172.3 Subject to the company being in an open period, share grants should be made as soon as possible after approval has been obtained from the Remuneration Committee. A practice of granting at more or less the same time every year, immediately after the announcement of financial results, is good practice.

PN 172.4 The term "backdating" refers to the practice of setting the grant price of an option or share appreciation right to a prior date, which may represent a more favourable price for executives than that of the actual grant date. This is viewed as "cherry-picking" by investors and should not be allowed.

PN 172.5 The grant price of shares or options for long-term incentives should not be based on the company's share price during the closed period.

King III Practice Recommendation (par 173)
Options or other conditional share awards are normally granted for the year in question and in expectation of service over a performance measurement period of not less than three years. Accordingly, shares and options should not vest or be exercisable within three years from the date of grant. In addition, options should not be exercisable more than 10 years from the date of grant. For new schemes it is best practice to restrict the exercise period to less than seven years.

Practice Notes

PN 173.1 Vesting periods of 100% after three years, or 33% per annum in year 3, 4 and 5 are common practices.

PN 173.2 Grants made under existing schemes with different vesting periods should remain unchanged. It is however advisable to review schemes that are not compliant with the practice and to amend for future grants, subject to shareholder approval (and JSE approval where appropriate).

King III Practice Recommendation (par 174)
To align shareholders' and executives' interests, vesting of share incentive awards should be conditional on achieving performance conditions. Such performance measures and the reasons for selecting them should be fully disclosed. They should be linked to factors enhancing shareholder value, and require strong levels of overall corporate performance, measured against an appropriately defined peer group or other relevant benchmark where yearly awards are made. If performance conditions for share-based incentive schemes are not met, they should not be re-tested in subsequent periods. Where performance measures are based on a comparative group of companies, there should be disclosure of the names of the companies chosen

Practice Notes

PN 174.1 The most commonly used performance vesting conditions for share plans are (absolute) real growth in HEPS, Return on Capital, relative total shareholder return (measured against that of a peer group) and specific strategic objectives .

PN 174.2 Vesting conditions for options and share appreciation rights are generally less stretching than those of performance shares, because options and share appreciation rights have a strike price payable whereas performance shares are full free (restricted) shares.

PN 174.3 Common practice for Threshold Performance regarding TSR is to use either the lower quartile or the median of the Peer Group, whereas Stretch performance at the upper quartile of the peer group is generally used.

PN 174.4 Re-testing refers to the practice of re-testing performance conditions after they have failed to meet the conditions in the first test. Although normally not desirable, re-testing may be necessary in cyclical industries. Where re-testing is required and implemented, there should be full disclosure to shareholders with a full motivation for the practice. A prerequisite of vesting post the retesting of these targets, should however still be cumulative performance in line with the original performance conditions (e.g. extrapolated over the original target for the additional periods).

King III Practice Recommendation (par 175)
Vesting of awards should be made on a sliding scale to avoid an 'all or nothing' vesting profile and should start at a level that is not significant in comparison with base pay. Awards with high potential value should be linked to commensurately high levels of performance. Full vesting should require significant value creation.

Practice Notes

PN 175.1 The practice of using a "sliding scale" is implemented by setting a Threshold and a Stretch level for each performance measure. Modest vesting is permitted at Threshold performance, and maximum vesting at or above Stretch performance. Linear vesting is applied between these levels.

King III Practice Recommendation (par 176)
When companies face the risk of losing key employees, remuneration policies to retain them may be adopted. Incentive schemes to encourage retention should be established separately, or should be clearly distinguished, from those relating to reward performance and should be disclosed in the annual Remuneration Report voted on by shareholders.

Practice Notes

PN 176.1 Pure retention schemes where there are no specific performance criteria, should be ring-fenced and appropriately disclosed.

PN 176.2 The retention element of any long term incentive plan (i.e. the portion that does not vest subject to the achievement of corporate performance targets), should be distinguished from the rest of the award that is linked to the achievement of corporate performance targets and thus separately reported on. The weighting between performance and retention, should be more heavily weighted towards performance at senior levels.

PN 176.3 The salient features of the retention schemes should be included in the Remuneration Report, for example the nature of the plan (cash or shares), the basis of the awards, the number of recipients, the lock in period and the terms relating to termination of employment before the end of the retention period.

PN 176.4 Retention schemes should be viewed as additional remuneration, and should not replace existing long term incentive plans, especially where these are underwater or where a reasonable level of certainty exists that corporate performance targets will not vest.

King III Practice Recommendation (par 177)

There should be no automatic waiving of performance conditions in any of these situations:

177.1.1 a change of control;

177.1.2 a 'roll over' of options and awards for a capital reconstruction; and

177.1.3 early termination of the participant's employment.

Depending on the circumstances, it may be appropriate to pro rate the benefit both on time and performance, or to create new instruments to preserve the value of the outstanding awards. In the case of change of control, it may be appropriate to allow pro rata early vesting, to the extent that performance conditions have been satisfied, and the time for vesting periods has been served.

Practice Notes

PN 177.1 "Pro-rata vesting related to time" means that the period of time that has actually been served as a portion of the original vesting period should be applied. For example, if early termination is permitted after 2 years have elapsed of a three year vesting condition, 2/3^{rds} of the award should vest by application of this principle. In addition, the portion vesting due to performance is applied to this portion. <u>In the case of JSE listed companies, the rules of the scheme as approved by the JSE and shareholders will apply. If the rules are insufficiently clear, approval for the course of action proposed should be sought from the JSE and shareholders.</u>

PN 177.2 "Pro-rata vesting with regard to the extent that the performance vesting condition has been satisfied" can be calculated based on:

a) actual period to date performance; or

b) an assumption of targeted performance; or

c) estimated full period performance (e.g. by using a valuation model). <u>In the case of JSE listed companies, the rules of the scheme as approved by the JSE and shareholders will apply. If the rules are insufficiently clear, approval for the course of action proposed should be sought from the JSE and shareholders.</u>

King III Practice Recommendation (par 178)

Where individuals leave voluntarily before the end of the service period, or are dismissed for good cause, any unvested share-based awards should lapse.

Practice Notes

PN 178 In the case of JSE listed companies, the rules of the scheme as approved by the JSE and shareholders will apply. If the rules are insufficiently clear, approval for the course of action proposed should be sought from the JSE and shareholders.

King III Practice Recommendation (par 179)
In other cases of the end of employment, where the Remuneration Committee decides that early vesting is appropriate, the extent of vesting should depend on performance criteria over the period to date as well as the time served of vesting periods.

Practice Notes

PN 179.1 Refer to PN 177.1 and PN 177.2 regarding the application of pro-rating relative to time served over vesting periods and performance criteria.

PN 179.2 It has become practice for employees retiring to retain their rights in share based awards, after retirement.

Principle 2.26: Companies should disclose the remuneration of each individual director and certain senior executives

King III Practice Recommendation (par 180)
Companies should provide full disclosure of each individual executive and non-executive directors' remuneration, giving details as required in the Act of base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits (including present values of existing future awards).

Practice Notes

PN 180.1 The disclosure of remuneration should be done in a clear and concise manner in the Remuneration Report (Refer PN 181.1). Plain language should be used and industry jargon prevented as far as possible. Where technical or legal terms or references to schemes are used, the meaning of these terms and/or schemes should be explained.

PN 180.2 Disclosure should be made of the remuneration (paid and accrued as at the company's financial year-end) of individual executives (executive directors appointed on the main board of the company), the non-executive directors and prescribed officers. Disclosure should include total remuneration granted or paid for the year under review (including the fair value of long term incentives as well as short term incentives declared and/or paid for the year under reviewed).

PN 180.3 It is recommended that disclosure should be done by name and not on an anonymous basis. If this is not done, a reason for such decision should be included in the Remuneration Report.

PN 180.4 The value of long term incentives including share-incentive grants, options, rights and/or restraint payments should be computed based on the expected net present value of all such instruments. This may be done using an appropriate pricing model (such as the Black and Scholes or Binary Tree Option Pricing Models, or Monte Carlo Models for Performance Shares) or a simpler model based on a projection of expected performance.

The basis of future awards is normally disclosed by stating the annualised expected value of regular awards as a percentage of guaranteed package / basic salary in the policy section of the Remuneration Report.

PN 180.5 Best practice would be to disclose the following in relation to long-term incentives per director or prescribed officer:

- Value at grant per grant (cf PN 180.4);
- The value of all unvested / unexercised historical awards at current expected value;

- The value realized from all options exercised / share based awards settled in the period under review.

King III Practice Recommendation (par 181)
In its annual Remuneration Report, to be included in the integrated report, the company should explain the remuneration policies followed throughout the company with a special focus on executive management, and the strategic objectives that it seeks to achieve, and should provide clear disclosure of the implementation of those policies.

Practice Notes

PN 181.1 The annual Remuneration Report should consist of the following sections:

(i) The objectives the business seeks to achieve through its remuneration strategy. Although the emphasis in the Remuneration Report is on directors and senior executives, this would typically include a broader perspective on the remuneration philosophy and strategy as it applies to all employees.

(ii) A synopsis of the terms of reference that governs the Remuneration Committee (i.e. the detailed Terms of Reference could appear on the website).

(iii) The Remuneration Committee members and the number of times the committee met in the period of review.

(iv) Key decisions taken by the committee during the year under review.

(v) Synopses of the remuneration policies on guaranteed package (salaries, benefits), short term incentives, long term incentives, any retention schemes).

(vi) The salient features of all incentive schemes in place or to be implemented .

(vii) Disclosure of the executive remuneration as contemplated in PN 180.1 and PN180.2.

(viii) Employment policies related to executive contracts and severance (See PN 183.1; PN 184.1).

(ix) Details of actual payments made to executive directors and prescribed officers, including salaries, benefits, annual incentives, deferred incentives, and, for long term (share based) incentives disclosure as indicated in PN 180.5.

(x) Policy on and detail of non-executive directors fees (paid and proposed) and fee structure.

Refer to Annexure PN 180.2A for a framework of an annual Remuneration Report.

King III Practice Recommendation (par 182)
The Remuneration Report should explain the policy on base pay, including the use of appropriate benchmarks. A policy to pay salaries on average at above median requires special justification. It should also explain and justify any material payments that may be viewed as being ex-gratia in nature.

Practice Notes

PN 182.1 The Remuneration Report [see PN151.1; PN 151.2 and PN 181.1(ii)] should explain the benchmarks used in setting pay levels through for example disclosure of the sources of benchmark data, the industries or companies that are used in comparing data ('comparator group') and the level of benchmarking for example lower quartile, median or upper quartile.

PN 182.2 Companies that benchmark remuneration in excess of the median, or the 50th percentile, should explain the reasons for their policies. Reasons for such a policy could include highly specialised skills, incentives that are lower than market, unique industry that makes benchmarking difficult, maturity of the organisation, operating in a global environment which affects the ability to attract and retain highly skilled employees etc.

PN 182.3 Ex gratia payments could include relocation allowances, retention payments, sign on bonuses, termination payments and all other payments that are not made in the normal course of business as part of the annual remuneration package.

Contracts and severance

King III Practice Recommendation (par 183)
Policies regarding executive employment should be set out in the annual Remuneration Report.

Practice Notes

PN 183.1 The executive employment policies should be disclosed in the Remuneration Report as envisaged in PN 181.1.

King III Practice Recommendation (par 184)
These policies normally include at least the following:
184.1.1 the period of the contract and the period of notice of termination (after the initial period, contracts should normally be renewable yearly); and
184.1.2 the nature and period of any restraint.

Practice Notes

PN 184.1 The disclosure of executive employment contracts should include:

(i) The contract term;

(ii) The period of notice after the initial period;

(iii) The period after which the contract should be renewed; and

(iv) The period and nature of restraints on executives (detailed per executive).

King III Practice Recommendation (par 185)
The annual Remuneration Report should disclose the maximum and the expected potential dilution that may result from the incentive awards granted in the current year.

Practice Notes

Disclosure of the executive employment contracts should be done in terms of PN 181.1.

Principle 2.27: Shareholders should approve the company' Remuneration Policy

King III Practice Recommendation (par 186)
Every year, the company's remuneration policy should be tabled to shareholders for a non-binding advisory vote at the annual general meeting. This vote enables shareholders to express their views on the remuneration policies adopted and on their implementation.

Practice Notes

PN 186.1 A resolution for the approval of the Remuneration Policy (as contained in the Remuneration Report) (refer PN 180.2A) should be tabled at the Annual General Meeting (requiring 50% votes from the shareholders attending). The resolution requires a non-binding advisory vote in which the shareholders express their views on the adoption of the remuneration policies and on their implementation.

PN 186.2 The "non-binding advisory" nature of the vote is generally for all policy related sections of the Remuneration Report, with the exception of:-

- "Proposed remuneration for non-executive directors", for which there is a special resolution and a binding vote.

Refer to Annexure PN 180.2A for the framework of the annual Remuneration Report.

PN186.3 A non-binding advisory vote is aimed at providing an opportunity for shareholders to influence the board's perspective on remuneration matters, specifically as it concerns the structure of total remuneration in terms of policy (i.e. salary, benefits, perks, short term and long term incentives) and how schemes are being implemented. The nature of the advisory vote is therefore feedback on the remuneration policy and implementation thereof (forward looking) as opposed to a vote on the level of remuneration paid (i.e. backward looking).

PN 186.4 Shareholders will be able to vote in favour of or against the resolution or to abstain. If less than 50% of the votes are in favour of the resolution, the board is not compelled to change the remuneration strategy and policies but is strongly advised to engage with shareholders and investors, to understand the reasons for their concerns expressed through the voting pattern. A pro-active discussion around intended changes to the remuneration policy with investors, is encouraged.

King III Practice Recommendation (par 187)
The board should be responsible for determining the remuneration of executive directors in accordance with the remuneration policy put to shareholders' vote

Practice Notes

PN 187.1 The Board determines the remuneration of the executive directors in accordance with the approved remuneration policy and remains responsible for setting remuneration levels of executives. The board also approves the employment conditions and gives instructions to the company to implement these decisions. The role of the Remuneration Committee is therefore an advisory one and final approval is the prerogative of the board.

PN 187.2 The Committee Chairman should provide regular feedback to the Board on the decisions taken at the Remuneration Committee. Management should in turn provide regular feedback to the Committee regarding the implementation of decisions.

Annexure PN 147.1 A

Remuneration Strategy Framework

Annexure PN 147.1 A

Objectives of a Remuneration strategy

(a) To provide an integrated approach for remuneration management that effectively attracts, motivates, engages and retains the talent required to achieve the desired business results.

(b) To align remuneration practices with business strategy through a process of analysis and thereby ensure that the remuneration practices serve the business objectives. It provides guidelines and direction for the remuneration choices that will be made because it interprets the remuneration strategy and practices in terms of the business needs.

(c) To adhere to legal, ethical and best practice standards and to reflect corporate governance and citizenship by complying with the customary norms and industry and statutory minimum standards.

Points to analyse/investigate	Outcomes
Analyse the business environment and understand the external factors The business environment should be scanned for economic and legislative factors, among others, that could influence the reward positioning of the company. Specific analysis that should be performed includes the following: A thorough understanding of the company, its business drivers and the internal culture to ensure that the reward strategy supports business objectives and aligns with the desired culture. Identifying key stakeholders involved in the company and conducting a needs analysis to understand their priorities, preferences and needs. Understanding the quantitative and qualitative skill requirements of the company to fulfil its business objectives and the demand and supply factors that play a role in attracting and retaining these skills.	**1 Draft a remuneration strategy document** The remuneration strategy should contain a summary of the factors (assumptions) that were taken into account when the strategy was developed. This must assist the approvers of the strategy to place it into context. This information should inform the remuneration policies: **1.1 Remuneration strategy objectives**: It must articulate the strategic intent of the remuneration strategy. These objectives should be defined in such a way that success can be measured (They should be SMART objectives – specific, measurable, achievable, relevant and time-framed). Reward objectives normally relate to the attraction, retention, motivation and engagement of employees. The remuneration objectives also form part of the Employee Value Proposition that defines what the company offers as an employer. **1.2 The remuneration philosophy**: It must articulate the remuneration principles that underpin the remuneration framework and guide the development of the various reward practices and reward decisions (King III). Stakeholders will look to this philosophy to set guiding principles on how reward will be handled in the business. **1.3 The optimal mix of total remuneration elements (the reward framework or model)**: This framework could be a simple mix of remuneration elements (remuneration mix) for the whole company or it could be customised for the various categories of employees in the company, as they are driven and motivated by different factors. The framework should be designed to excite a keen interest in the success of the company, to link performance with rewards and to acknowledge individual reward preferences. All elements of the total rewards model must be considered: **1.3.1 Remuneration** Remuneration consists of both fixed and variable remuneration. The mix of these two kinds of remuneration should promote the ideals of fair and equitable remuneration as contained in King III: - Attracting and retaining talent without promoting undesirable remuneration gaps. - Promote performance that sustains the company's operation, customer service and meets legal and ethical standards. - Corporate governance and citizenship should be reflected in the company's remuneration through compliance with the customary norms as well as industry and statutory minimum standards. This should be done without supporting irresponsible corporate behaviour.

	The company should draft a specific statement setting out its position with regard to these criteria, so that it can be used as a guideline against which to test policy decisions, positioning and actions. **1.3.2 Benefits** Benefits should be cost effective and cost efficient, have controllable cost escalation rates and be appropriate to the company's life cycle. The selection of benefits must be sustainable: - Enhance the standard of living of the recipients, - Benefits must be administered efficiently. The company should draft a specific statement setting out its position with regard to benefits, so that it can be used as a guideline against which to test policy decisions and product development. **1.3.3 Work-life balance** Although it is important to promote a work-life balance, work-life programmes should not disrupt operations or hamper production. The company should draft a specific statement setting out its position with regard to work-life balance and the working environment, so that it can be used as a guideline for business involvement and standards in this regard. **1.3.4 Performance and recognition** Performance and recognition programmes can be both monetary and non-monetary and should be cost-effective. They should drive company, team and individual performance to sustain the company. These programmes should be designed, documented and administered according to the principles contained in King III. **1.3.5 Development and career development** If the company decides on career and development initiatives as part of the Employee Value Proposition (EVP**),** measures of value-add should be developed and approved up front. This statement must address the needs of all stakeholders and be clear, without ambiguity.
	2. Communication plan The behaviours of employees are influenced by their level of understanding and by their perceptions of the remuneration and benefits system. Inadequate knowledge or incorrect perceptions of the remuneration system or of elements of the remuneration system can impact negatively on the effectiveness of the remuneration programmes and can lead to costly and the unnecessary loss of skills and demands. The communication plan should outline the way in which the remuneration system will be promoted internally and externally – what target audiences will receive communication, what channels will be used, how frequently communication will take place, how coverage in the various channels will be achieved and the underlying message to be conveyed.

Application of the remuneration strategy

(i) The remuneration strategy should be approved by the Remuneration Committee as the result of the analysis to align the company's objectives with remuneration. Once the Remuneration Committee accepted the remuneration strategy, all remuneration policies will be evaluated against it.

(ii) The remuneration strategy should form the introduction to the Remuneration Policy that will be submitted to shareholders for an advisory vote and disclosed in the annual report (we need to discuss what goes into the integrated report)

(iii) The remuneration strategy should also highlight priority areas and inform the Remuneration Committee agenda.

Annexure PN 166.1A

Short Term Incentives Design Standards

Short Term Incentives (STIs) should encourage appropriate behaviour, should not create risks or be vulnerable to undeserving windfalls. In order to meet the above criteria, all Short term Incentive designs and implementations should meet the following criteria.

1. Guidelines to reduce design and operational risks

Target setting

(i) A combination of achievement of financial and non-financial targets should be used in the determination of the bonus amount. The use of multiple performance measures based on business outcomes reduces the risk of unintended outcomes impacting the entire award.

(ii) For each performance measure, a weighting should be set reflecting its overall importance for that year, as well as levels for "Threshold", "Target" and "Stretch" performance.[1]

(iii) Profitability measures such as earnings, production and unit costs are common measures. In the case of financial performance, factors based on accounting, shareholder, absolute and relative aspects of performance are used together to provide a holistic view of business performance.

(iv) Short term targets usually relate to financial and operational targets that have a direct bearing on the performance for the year. Longer term targets are more outcome based and measures such as Total Shareholder Return, relative to a peer group, and three-year real growth in HEPS.

(v) The inclusion of personal targets for individual employees should be encouraged.

(vi) Factors that lie outside of the control of the executives should form a lower portion of the overall bonus calculation than more directly controllable factors.

(vii) Factors that play no direct role in the determination of bonus amounts or if employees have no influence over should be avoided.

(viii) Rules of STIs should be written that if a Company cannot afford bonuses as in the case of poor financial performance leading to financial constraints or distress, the bonus will not pay out, even if it is due to uncontrollable factors. The rules should provide for discretion to the Remuneration Committee in the final analysis.

(ix) Where uncontrollable factors are used in bonus schemes, bonus amounts should be capped to avoid unintended consequences.

(x) Where performance is below acceptable levels (threshold) no bonus amount will be paid out.

(xi) When reviewing the nature of targets the following factors should be considered for the Company and the comparator group:
   (a) The actual payments made for the financial year – see earlier comment
   (b) On "on-target" payments
   (c) The "maximum" or "stretch" payments

(xii) These values should be reviewed in absolute terms as well as a percentage of guaranteed package.

[1] Threshold performance relates to the minimum levels required for the payment of any Bonus. This could be the annual budget for instance. Target performance relates to good performance incorporating some stretch, and "Stretch" performance relates to truly exceptional performance in the context of the prevailing business environment.

Size of bonus

(xiii) Affordability: Payments from the plan should not expose the organisation to undue market and liquidity risk.

(xiv) Employees should not become dependent on their bonus pay-out to cover their daily living expenses and the guaranteed remuneration should be sufficient to cover these expenses without a high dependence on the incentive pay-outs. This excludes employees employed on commission plans where the ratio of guaranteed: variable remuneration will be differently designed to encourage specific behaviours.

Risk management

(xv) The design of the STIs and the setting of associated targets, that the schemes should not encourage behavior contrary to the company's risk management strategy and that the schemes do not unintentionally or intentionally drive excessive risk behavior in an endeavour to meet certain targets that would influence incentive pay outs.

(xvi) The gatekeepers (e.g. safety) should be designed to ensure that fundamental principles governing the operation of the business are not violated in the pursuit of profitability. The quantum of penalty (as a result of violation of the gatekeeper) should be flexible and left to the discretion of the Remuneration Committee.

(xvii) Bonus Deferral, with claw back provisions (also referred to as bonus-malus schemes) in the case of subsequent under-performance or misstatement of reported results, the use of Economic profit measures based on Economic Capital, which reflects the market, credit, operational and insurance are recommended risk management performance measures.

Regular reviewing of targets

(xviii) Performance targets for annual bonuses should be reviewed annually in advance.

Non-Executive directors

(xix) Non-executive directors should not be allowed to participate in bonus schemes that are directly linked to the performance of the organisation.

2. Guidelines to encourage appropriate behaviour

(i) **Alignment:** Payments under the plan should reinforce the tactical and strategic objectives of the organisation.

(a) The plan should firstly be aligned internally, with the daily activities of the participants as reflected in performance management practice.

(b) Secondly, it should be aligned externally, with the expectations of stakeholders and with the environment.

(c) Thirdly, it should be aligned with efficacy, or the ability of the person being offered the incentive to influence the outcome and the difficulty of the goal.

(ii) **Communication:** Participants should understand the workings of the plan, what they need to do to optimise their payments, and have access to regular reports which give feedback on the metrics that drive payment.

(iii) **Good governance:** Targets and parameters should be set in advance of the applicable financial year. Disclosure of targets, achievements against those targets and payments should be disclosed to the appropriate governance bodies – management, executive committees, the Remuneration Committee, the board or shareholder or stakeholders as determined by disclosure best practice.

(iv) **Instrumentality:** Participants must believe that if they perform as agreed, they will be accordingly rewarded.

(v) **Participants** in the STI should be able to influence the business process. The scale of eligibility should be set carefully to avoid excluding employees that may influence the business results or include employees that may dilute the earnings. Some jobs just don't allow it to be incentivised, while affordability determines how much incremental money will be available to pay as an incentive.

(vi) **Simplicity**: Schemes should avoid complexity where possible. A set of guiding principles for the STI should be approved by the remuneration committee and be available for inspection by all participants. The rules should be clear, unambiguous and provide for every event where rules about the scheme, the payment and participation are involved.

(vii) **Certainty about the rules:** A letter should be issued in advance of each year to each participant setting the targets and paraeters for their participation in the scheme that year. The letter should state:

(a) the amount of payment for performance against set targets – would take this out;
(b) the measures used to assess performance;
(c) the targets appropriate to the scheme, including gatekeepers, thresholds, targets and stretch targets;
(d) caps, where appropriate;
(e) deferral or banking requirements, where appropriate; and
(f) conditions in which the remuneration may exercise its discretion.

(viii) **A performance culture**: Payments under the plan should be significantly geared to individual, team and organisational performance, with no payments made for unacceptable levels of performance, and exceptional payments made only in the case of genuinely stretching achievements. STIs should promote high performance with high integrity.

Annexure PN 180.2A

Remuneration Report Template

This Remuneration Report template is provided for information purposes only, and does not constitute the provision of professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional advisers. Before making any decision or taking any action, Companies should consult a professional adviser who has been provided with all the pertinent facts relevant to the company's particular situation.

1. Introduction

The following points should be covered in this section:

- A summary of what issues will be covered by the Remuneration Report; and
- General comments on the application of King III in the context of the Remuneration Report – "applies or explain".[2]

2. Remuneration philosophy, strategy and policy

The following points should be covered in this section:

- A summary of the company's remuneration strategy and policies[3] as applied throughout the company. This should cover all aspects of remuneration – base pay, benefits, short-term incentives, long-term incentives and non-financial benefits;
- In respect of each element, an explanation of how the remuneration policies link into the company's business strategy. For example, if the company's strategy is for executives to deliver stretching goals, there may be an emphasis on variable pay; and
- A description of how the policies have been implemented to support the business strategy.

3. Remuneration Committee and its role

The following points should be covered in this section:

- Confirmation of the members of the Remuneration Committee;
- A summary of the purpose of the Remuneration Committee and its roles and responsibilities; and
- A note of the Remuneration Committee meetings held and attendance by its members.

4. Key remuneration decisions taken during the period under review

Summarise the key remuneration decisions taken in the year under review to demonstrate how the remuneration policy has been implemented in practice. For example, were base salaries frozen, was a new annual bonus plan introduced, were performance vesting conditions introduced for long-term incentive plans etc.

5. Overview of remuneration

The following points should be covered in this section (which is likely to be the longest section in the Remuneration Report):

- An overview of the typical executive remuneration package by reference to fixed remuneration and variable remuneration. [Note: this could be done by way of a chart which shows the breakdown between the various elements]*;
- The following elements should be covered:
  - Base pay
  - Benefits (including pension/provident fund)
  - Short-term incentives

[2] This is not a specific requirement under King III. However, its inclusion would represent best practice.

[3] Also known as the remuneration mix and included in the company's overall employee value proposition.

  - Long-term incentives
- For each element describe:
  - The general policy and its application (including use of benchmarking, peer group used, level of benchmarking – lower quartile, median or upper quartile - where relevant)
  - The main features of the benefit/incentive. For example, a general description of how the short-term incentive or long-term incentive plan operates and the benefits provided under it
  - Limits on payments that can be made. For example, is there a limit on short-term incentive payments as a percentage of base salary and what is it?
  - The role of performance targets and their application (both financial and personal). For example, what are the performance targets and how does their satisfaction translate into vesting/payment? Why have these performance targets been chosen?
  - Application of the policy to payments due to be paid, or awards to be granted, during the next financial year and those made during the financial year in question. For example, in respect of short-term incentives paid in the financial year in question, how was the payment calculated and to what extent were performance targets achieved?
- In respect of base pay, where the policy is to pay at above the median level, this should be disclosed and an explanation provided as to why this is appropriate. For example, the need to attract particular individuals in an industry where there is a skills shortage or the fact that the company operates in a global environment which means that benchmarking has its limitations; and
- In respect of long-term incentive awards to be granted during the financial year, disclose the annualised expected value of the awards as a percentage of guaranteed pay.

6. Executive contracts and policies

The following points should be covered in this section:

- Provide a summary of the main terms and conditions of employment of each executive director and prescribed officer:
  - The contract term
  - The notice period after the initial term has been served
  - The period after which the contract should be renewed
  - Contractual payments due on termination of employment
  - Contractual payments due on a change of control of the company
  - Restraint of trade provisions and payments due in respect of such provisions
- Where any ex gratia payments have been made to those individuals during the year, such payments should be disclosed and the reason for their payment explained. For example, relocation allowances, retention payments, sign on bonuses, termination payments.

7. Non-executive directors' terms of appointment

The following points should be covered in this section:

- A summary of the main terms of appointment
  - Term of appointment
    - Rotation/re-election requirements
    - Fee structure i.e. fee rather than salary and not eligible to participate in employee incentive plans
  - Overview of fee structure
    - Base fee
    - Committee fee
    - Supplementary fees
    - Meeting attendance fee
    - Travel allowances and reimbursements
    - Benefits

- Description of how fees are set e.g. benchmarking and process followed; and
- Confirmation of the body responsible for setting fees e.g. board of directors.

8. Payments made to executive directors and other specified individuals

The following information should be disclosed in this section:

- Details of the cash based payments made to (i.e. received by the) executive directors and the prescribed officers during the financial year in question should be disclosed in this section.

This could be presented in tabular format, as follows:

Name	Basic salary	Benefit 1	Benefit 2	Pension/provident fund	Short-term incentives	Long-Term incentives (PV)	Total [current year]	Total [previous year]

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- A comparison may be drawn between the payments made during the current financial year and the previous financial year by reference to each constituent; and
- Details of the long-term incentive incentives held by executive directors and the prescribed officers should be disclosed in this section. The disclosure should cover:
    - Long-term incentive awards which have been granted during the financial year in question;
    - Long-term incentive awards which have vested/been exercised during the financial year in question; and
    - All other unvested long-term incentive awards held by the individual.

This could be detailed further in tabular format, as follows:

Name	Plan	Award date/ price	PV of the Award made	Vesting date	N Start of year	N Awards vested	N Awards lapsed	N End of year	N Awards exercised	Share price on exercise	Date of vesting/ exercise

9. Payments made to non-executive directors

Details of the payments made to non-executive directors during the financial year in question should be disclosed in this section. This could be presented in tabular format, as follows:

Name	Board fee	Other/meeting attendance fee	Committee 1	Committee 2	Committee 3	Committee 4	Total [current year]	Total [previous year]

10. Shareholding

In this section, disclose the number of shares in the company held by each director and the prescribed officers. This could be presented in tabular format, as follows:

Name	Shares held at [start of year]	Shares held at [end of year]	Total

11. Funding of share plans and dilution

The following points should be covered in this section:

- Confirmation of the number of newly issued shares which can be used in satisfaction of the long-term incentive plans as approved by shareholders;
- Details of the number of new shares issued in satisfaction of awards granted under the long-term incentive plans as at the end of the current financial year, including those issued during the current financial year; and
- Disclosure of the headroom available to the company in terms of issuing new shares to satisfy awards granted under the long-term incentive plans in the future, including the number expected to be issued in respect of awards granted during the current financial year.

On behalf of the South African Reward Association (SARA):
Contributors:

- Mr Nick Icely
- Mr Martin Hopkins
- Mr Ray Harraway
- Mr Jerry Botha
- Mr Brendan Olivier
- Mr Deon Thompson
- Dr Mark Bussin
- Dr Ronél Nienaber (Convenor)

On behalf of the Institute of Directors in Southern Africa (IoDSA):

- Mr Tom Wixley
- Ms Ansie Ramalho (IoDSA)

For a proposed terms of reference that could serve as a guideline for consideration by remuneration committees visit the IoDSA's website at www.iodsa.co.za- *King III & CRISA- King III Practice Notes.*