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CORPORATE & COMMERCIAL **ALERT**

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Companies Amendment Bill 2021: Drawing attention to the remuneration gap

The Department of Trade, Industry and Competition (DTIC) published the Companies Amendment Bill, 2021 (Bill) for public comment on 1 October 2021. The Bill is the second draft of the Companies Amendment Bill which was published in September 2018 (2018 Draft) which, if passed, will represent the first set of substantive amendments to the Companies Act 71 2008 (Act) since it came into effect on 1 May 2011.

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Companies Amendment Bill 2021: Drawing attention to the remuneration gap

The DTIC has requested that interested parties submit comments on the Bill by 31 October 2021.

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The DTIC has requested that interested parties submit comments on the Bill by 31 October 2021.

The background note and explanatory memorandum to the Bill, published in the Government Gazette No. 45250, provide an overview of the proposed amendments, which include:

- changing the definition of "*securities*";
- providing for the definition of "*true owner*";
- providing for the preparation, presentation and voting on companies' remuneration policies and directors' remuneration implementation reports;
- providing for the filing of annual financial statements and copies of companies' securities registers and registers of disclosure of beneficial ownership with the Companies and Intellectual Property Commission;
- differentiating where the right to gain access to companies' records may be limited;
- clarifying when a notice of amendment of a memorandum of incorporation takes effect;
- empowering the court to validate the irregular creation, allotment or issue of shares;
- clarifying certain aspects relating to partly paid shares;
- excluding subsidiary companies from certain of the requirements relating to inter-group financial assistance;
- providing for instances where a special resolution is required for the acquisition of shares by a company;
- extending the definition of an employee share scheme to include situations where there are purchases of shares of a company;
- providing for the circumstances under which a private company will be a regulated company in the context of affected transactions;
- providing for circumstances where a company is unable to identify the persons who hold a beneficial interest in its securities;
- dealing with the composition of the social and ethics committee and the publication of the application for exemption from the requirement to appoint a social and ethics committee;
- providing for the presentation and approval of the social and ethics committee report at the annual general meeting or other meetings of shareholders; and
- ensuring the differentiation of duties between the chairperson of the Companies Tribunal and its chief operation officer.

Companies Amendment Bill 2021: Drawing attention to the remuneration gap*...continued*

Section 30A requires public and state-owned companies to publish, in their annual financial statements and reports, details about director and prescribed officer remuneration as well as the gap between their highest paid and lowest paid employees.

By and large – save for section 30A (discussed in more detail below) and sections 56 (beneficial interest in securities), 72 (board committees), 118 (application of Part C and Takeover Regulations), and 135 (post-commencement finance) – the majority of the amendments proposed to the Act under the Bill do not differ significantly from those proposed under the 2018 Draft. The Bill appears to take cognisance of input provided by interested parties and commentators by clarifying ambiguous verbiage and certain functions of the Companies Tribunal and providing certainty with more concise drafting and the adoption of clearly defined terms. It should further be noted that the Bill does not contain any provisions in relation to employee representation on the boards of companies (as proposed by the DTIC earlier this year).

Disclosure of remuneration

However, we wish to highlight one area where the Bill does contemplate a significant departure from the provisions of the 2018 Draft, which is in relation to executive remuneration, as detailed below. Another significant development is the disclosure of beneficial ownership, which will be addressed in a separate Corporate Investigations alert.

The Bill proposes a number of additional significant amendments to the new section 30A of the Act, originally proposed under the 2018 Draft. Section 30A requires public and state-owned companies to publish, in their annual financial statements and reports, details about director and prescribed officer remuneration as well as the gap between their highest paid and lowest paid employees.

The DTIC asserts that the rationale for section 30A is predicated on the significant levels of inequality in South Africa and the need to address this by augmenting the extent of disclosure of executive remuneration to provide for:

- additional shareholder control over excessive remuneration and the perceived injustices associated with that;
- curtailing a board's desire to award excessive remuneration for fear of reputational harm; and
- more generally, entrenching good governance principles as contemplated under the King IV Report on Corporate Governance (King IV) and international best practice.

The construction of section 30A is somewhat convoluted and provides for a remuneration policy, an implementation report and a remuneration report. The remuneration policy sets out the policy applicable to the remuneration of directors and prescribed officers. The implementation report contains details of the remuneration and benefits received by each director and prescribed officer as contemplated in sections 30(4), (5) and (6) of the Act. The remuneration report consolidates the remuneration policy and implementation report into a single document and, in addition, includes:

- a background statement;
- total remuneration (including salary, benefits and other incentives), in the applicable year, that has been "*settled*" in favour of the highest paid employee and the total remuneration of the lowest paid employee as recorded on the company's payroll;

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A number of unintended consequences may occur if section 30A, in particular the straight comparison between the highest and the lowest paid employee, as well as the ratio between the 5% highest paid and the 5% lowest paid employees (remuneration gap), is passed into law.

- the average and median remuneration of all employees; and
- the gap, expressed as a ratio, between the remuneration of the top 5% highest paid employees and the bottom 5% lowest employees.

The remuneration report must be approved by the board, presented to the shareholders at the annual general meeting (AGM) and approved by ordinary resolution of the shareholders. Under section 30A, voting on the remuneration report constitutes voting on the remuneration policy and the implementation report, although each has slightly different requirements and consequences:

- The remuneration policy must be approved by ordinary resolution of the shareholders at the AGM and, once approved, does not require further approval until either three years pass from the date of the previous approval or a material change to the remuneration policy is made. If the remuneration policy is not approved by the shareholders, it must not be implemented and must be presented at the next AGM or shareholders' meeting called for such purpose until finally approved.
- Similarly, the implementation report must be approved by ordinary resolution of the shareholders and if not approved:
    - at the next AGM, the board committee responsible for remuneration matters must present an explanation on the way in which the concerns raised by shareholders when previously voting against the implementation report have been addressed; and
    - the non-executive directors that serve on such committee must stand down for re-election each year that the implementation report is voted down by the shareholders.

Addressing inequality

King IV states that remuneration is a tool that is used to ensure the economic, social and environmental sustainability of a business in its pursuit of creating value for its stakeholders. King IV also acknowledges that a remuneration policy should be fair and responsible against the backdrop of employee remuneration generally and accepts that a remuneration policy has a bearing on the ability of a company to attract and retain scarce skills, and achieve its strategic objectives.

It is arguable that section 30A of the Act seeks to address not only the stated objectives of the DTIC but also those contemplated under King IV, and the unquestionable issue of inequality in South African society. This being said, a number of unintended consequences may occur if section 30A, in particular the straight comparison between the highest and the lowest paid employee, as well as the ratio between the 5% highest paid and the 5% lowest paid employees (remuneration gap), is passed into law.

It is common knowledge that South Africa is a victim of the so-called "*brain drain*" that sees numerous skilled people leaving the country in pursuit of perceived better opportunities in foreign jurisdictions. To this end, it must be acknowledged that both public and state-owned companies compete with not only private companies but also foreign jurisdictions for the services of well-qualified and experienced

Companies Amendment Bill 2021: Drawing attention to the remuneration gap*...continued*

It is noted that reporting on the remuneration gap is not intended to be target-based and is rather intended to strengthen accountability and transparency in relation to how remuneration is justified.

executives whose expertise are becoming increasing scarce, homogenous and transferrable. If such executives are unable to derive appropriate value for their services in South Africa as a consequence of the pressure brought to bear by section 30A of the Act, they may be incentivised to consider offshore opportunities.

The relative complexity applicable to the calculation of executive remuneration as compared to entry-level employees may make reporting on the gap between the highest paid employees and lowest paid employees difficult, especially when considering that executive incentives are often risk-based and contingent on a company achieving strategic goals or financial milestones over a period which may exceed a year. It is also unclear if the remuneration gap will be stated on a pre- or post-tax basis, which will impact the value of the remuneration ratio.

It is noted that reporting on the remuneration gap is not intended to be target-based and is rather intended to strengthen accountability and transparency in relation to how remuneration is justified. However, the practical consequence of a large remuneration gap, especially if this is coupled with an unapproved implementation report, may simply "*embarrass*" a company, regardless of the nuances at play, and the requirements and responsibilities of the particular roles that form part of the remuneration gap calculation.

Balancing act

Further, reporting on the remuneration gap may incentivise companies to limit the number of entry-level employees that it employs and instead opt to outsource such functions in an effort to improve its remuneration gap/ratios (the commentary to the Bill suggests that one option to address this risk, is that the salaries of sub-contracted employees are disclosed, but the Bill does not include this proposal). The Bill also fails to balance the complexities of paying fair and market-related remuneration against the financial sustainability of a company. In a country that has one of the highest unemployment rates in the world, reporting on the remuneration of the highest paid employee against other metrics may be more appropriate, such as the total employees of the company, the total tax paid to the South African Revenue Service, or the total remuneration paid to all employees of the company (or some mechanism to take into account other contributions made by the company to the local or national economy in areas such as enterprise development or corporate social responsibility, or in the case of state-owned companies, success in providing improved services and infrastructure to the public at large).

While not clear from the Bill, it is assumed that when the implementation report is voted down by shareholders, the non-executive directors that serve on the committee responsible for remuneration

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Given the unique socio-economic position that South Africa is in, we expect that more nuanced thought and robust discussion about the unintended consequences of some of the detailed requirements of section 30A are warranted.

must not stand for re-election as directors and not merely to the committee itself. In such circumstance, voting down an implementation report would be akin to the removal of a director under section 71 of the Act and may be self-defeating insofar as it results in a high turnover of non-executive directors or reduces the number of suitably qualified non-executive directors that are willing to serve on a company's remuneration committee.

On balance, the proposed inclusion of the majority of section 30A is a positive development for corporate governance that would align South African company law more closely with international best practice. This being said, and given the unique socio-economic position that South Africa is in, we expect that more nuanced thought and robust discussion about the unintended consequences of some of the detailed requirements of section 30A are warranted, so as not to disincentivise suitably qualified people from serving as directors or prescribed officers of public or state-owned companies. This, in turn, may prejudice these companies and accordingly the shareholders, entry-level employees and prospective employees that section 30A seeks to protect.

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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