

Legislative Council Panel on Transport
Special Meeting on 5 May 2007

KCRC Variable Pay Scheme

PURPOSE

This paper informs the Panel on the application of the KCRC's variable pay scheme for 2006.

BACKGROUND

2. On 21 March 2006, the Panel was briefed on the variable pay scheme and the results for 2005 via LC Paper No. CB(1)1131/05-06(03). To recap, the scheme was introduced by the KCRC on a full-year basis from 1 January 2005 in response to the recommendations made in the Hay Report to the Government following a study on the remuneration packages of the top three management tiers of statutory bodies in Hong Kong.

3. The variable pay scheme is not a simple bonus scheme where an additional lump sum is paid to those eligible on top of their basic annual remuneration having regard to the profit that the organisation concerned has earned in that year. Under the scheme a corporate pool is established into which members of the KCRC Management Committee (MCOM) must contribute a percentage of their total annual remuneration, this being 30% for the CEO, 20% for Directors and 15% for General Managers. Payment from this corporate pool is based on the overall performance of the Corporation under four strategic areas, namely, Finance, Customer Service, Operations and Capital Projects.

4. Under each of the strategic areas, performance measures with defined targets are established by the KCRC Managing Board at the beginning of the year. These targets are set with regard to performance in the previous years and the forecast for the coming year so as to be realistically achievable but their achievement would slightly stretch KCRC Management. Achieving the various targets depends on the continuous collective management efforts of MCOM members over the year. Should the actual performance for the year

exceed the pre-determined targets, the Corporation will contribute a top-up to the pool commensurate with the extent to which the targets are exceeded. However, should MCOM collectively perform below the targets, participants in the scheme stand to lose up to the whole of their contributions to the corporate pool.

2005 VARIABLE PAY SCHEME

5. In 2005, performance exceeded the targets and the Corporation contributed about \$1 million as the top-up to the corporate pool. As the Panel was informed in March 2006, the Managing Board carefully considered whether payment of variable pay for 2005 should be influenced by the East Rail incident in December 2005, when cracks were first found in the mountings of underframe equipment. The Board decided that the cracks incident should be delinked from the variable pay scheme on grounds that the Corporation was contractually bound to accept the results of the variable pay assessment process, and that depending on the findings of an enquiry panel, other means existed to take appropriate action against individuals if found necessary.

6. Notwithstanding the Board's decision, MCOM members, as a token of appreciation for the staff, decided on their own initiative to retain only that portion of the variable pay representing their individual contributions and the additional sum of \$1 million topped up by the Corporation was distributed to all staff.

2006 VARIABLE PAY SCHEME

7. In June 2006, the Managing Board approved the implementation of the variable pay scheme and the performance targets for 2006. Details of the performance measures for 2006 as compared to those for 2005 are shown in the following table.

KCRC Corporate Scorecard

2006 Targets	2005 Targets
<p>Finance</p> <p>1. EBITDA⁽¹⁾</p> <p>Customer Service</p> <p>2. Service attitude of staff</p> <p>3. General service standards</p> <p>4. Perception on value for money</p> <p>5. Perception of train service reliability</p> <p>Operations</p> <p>6. Train service performance</p> <p>7. Delays of 8 min. or more</p> <p>8. Delays per million passenger trips</p> <p>9. Passenger safety</p> <p>Capital Projects</p> <p>10. Project completion (LMC Spur Line)⁽²⁾</p> <p>11. Project completion (KSL)⁽³⁾</p> <p>12. Accident rate (per 100,000 man hours)</p>	<p>Finance</p> <p>1. Transport revenue</p> <p>2. Commercial revenue</p> <p>3. Cash operating costs</p> <p>Customer Service</p> <p>4. Service attitude of staff</p> <p>5. General service standards</p> <p>6. Perception on value for money</p> <p>Operations</p> <p>7. Train service performance</p> <p>8. Delays of 8 min. or more</p> <p>9. Delays per million passenger trips</p> <p>10. Passenger safety</p> <p>Capital Projects</p> <p>11. Project completion (LMC Spur Line)</p> <p>12. Accident rate (per 100,000 man hours)</p> <p>13. 1st yr. service performance of MOS Rail⁽⁴⁾</p> <p>14. 1st yr. delays of 8 min. or more of MOS Rail</p> <p>15. 1st yr delays per million passenger trips of MOS Rail</p>

(1) Earnings before interest, tax, depreciation and amortisation.

(2) Lok Ma Chau Spur Line

(3) Kowloon Southern Link

(4) Ma On Shan Rail

8. In 2006, the contribution from the remuneration of the MCOM participants to the pool was \$5.02 million. In January 2007, the Managing Board considered and accepted the 2006 variable pay assessment results, calculated according to a pre-determined formula and reviewed by the KCRC's external auditor. The assessment showed that the 2006 corporate scorecard targets were exceeded overall by 12.24%. This resulted in the Corporation having to top up the variable pay pool by \$614,000, bringing the total to \$5.63 million. Table (p.112) at note 5(c) of the KCRC Annual Report 2006 shows

that the resulting variable remunerations included in the emoluments to the CEO and Directors amounted to \$5.13 million, with the balance going to the substantive General Manager members of MCOM. This illustrates the non-bonus nature of the scheme, since it can be seen that apart from the \$614,000, all of the money distributed under the scheme had first been taken from the participants.

9. As in the previous year, the Managing Board considered carefully whether there were any factors that should be taken into account in determining the amount of the variable pay. The Board again concluded that the Corporation having decided to introduce the variable pay scheme was contractually bound to accept the results of the variable pay assessment process. The Board also noted that appropriate disciplinary action had already been taken against those individuals identified in the investigation report into the cracks incident and against those senior KCRC staff who had expressed publicly their views on matters concerning the Corporation's corporate governance in a manner contrary to established procedure. The Board, however, left entirely to MCOM members to decide whether or not to accede to the request of some Board Members that they consider voluntarily giving up the top-up sum of \$614,000 as had been done in 2006.

10. After due deliberation at MCOM on 27 February 2007, MCOM members decided to decline the request on the grounds that this would have been contrary to the basic principle on which the scheme had been first established, which was to encourage teamwork by the Corporation's management to strive for continuously improved year-by-year performance by the Corporation, not merely in financial terms to satisfy the Government as the sole shareholder, but more importantly, as regards passenger service and safety. Regard was also paid to the fact that it was the longer-term ambition of the Managing Board to gradually extend the scheme to lower levels of management and that one purpose of the MCOM scheme was to demonstrate to these staff that above average effort on their part would be objectively recognised and underperformance would work against them.

Kowloon-Canton Railway Corporation
5 May 2007