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2020 AGM Season: In a year like no other, some things remain the same

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Summary of 2020 AGM outcomes (1/2)

The 2020 AGM season has been characterised by increased complexity for Boards and Remuneration Committees as they navigate the difficult economic environment, and the need to align executive pay outcomes to performance and the experience felt by all stakeholders (including employees, customers, and community, in addition to shareholders). Adding to this complexity is the acceleration of the need to consider discretion - as a result of both ASIC's guidance[1] on pay decisions in the context of COVID-19, and the requirement to balance different stakeholder views in a period of high volatility and uncertainty. And in particular, that financial outcomes may not reflect the level of effort of executive teams and the broader workforce during the period.

In considering what a fair outcome is that balances the needs and expectations of all stakeholders, Boards were required to grapple with issues that had previously not been a consideration. Particularly, the broader employee context (e.g. workforce hardship such as lack of job security and redundancies, fixed pay reductions, or zero bonus pools); government support (e.g. JobKeeper); and the weighting of non-financial metrics in a formulaic outcome where financial targets may not have been met.

Given the economic climate, some companies implemented measures to realign executive pay to take account of their business pressures - through temporary fixed pay reductions for both executives and Boards, fixed pay freezes, and either below target or no bonuses. This resulted in heightened scrutiny of those companies that did award fixed pay increases or bonuses. Concurrently, the increased use of discretion and subsequent uncertainty of reward outcomes for executives may have resulted in pressure on the perceived value of reward for executives and potentially reduces trust in the framework and Board.

Despite these complexities, the number of ASX200 companies receiving a strike has only marginally increased from 2019 with 1 more company receiving a strike. 92% of ASX200 remuneration reports avoided a strike (>75% of votes were cast in favour). However, both the average % vote against remuneration reports (8.7%) and the number of 'extreme' votes increased, with 5 companies receiving an 'against' vote of more than 50% (compared to only one in 2019).

In previous years, we had anticipated an increase in the use of discretion - both in how performance metrics are assessed, as well as factors that may not be articulated or determined within the incentive framework - and the impact of COVID-19 on businesses accelerated this trend[2]. For the most part, in instances where discretion was applied in favour of management (such as adjustment of the performance outcome upwards compared to formulaic outcomes, or adjustment of targets downwards) this was not always well received by shareholders. There was a tendency for these companies to receive a higher 'no' vote, and in some cases, was a contributing factor to a strike.

In most cases, companies that received a strike last year materially improved their voting outcome, most achieving an overall <5% 'no' vote. This resulted from a combination of enhanced disclosures, articulation of the link between business performance and pay outcomes, and some changes to discrete variable reward plan elements (e.g. introduction of deferral, extended vesting periods, revisit to metrics and weighting and 'tougher' performance thresholds).

The issue of performance against non-financial metrics resulting in bonus outcomes was further exacerbated with some companies experiencing materially better non-financial performance than financial performance. The divide between stakeholder perspectives on non-financial measures continues to be widespread, including within the proxy advisor and investor community, but also between financial services regulators and proxy advisors. We expect this to be amplified as we approach the implementation of APRA's revised Prudential Standard CPS 511[3].

Figure 1	2020	2019
ASX 100[4]		
% receiving a strike	7.32% (6 out of 82)	8.33% (7 out of 84)
Average % vote 'Against' Rem report (and minimum / maximum range)	9.29% (0.6% - 67.25%)	8.41% (0.3% to 47.58%)
ASX 200[4]		
% receiving a strike	8.18% (13 out of 159)	7.27% (12 out of 165)
Average % vote 'Against' Rem report (and minimum / maximum range)	8.70% (0.00% - 67.25%)	7.61% (0.01% to 53.00%)

1. Australian Securities and Investment Commission, Board oversight of executive variable pay decisions during COVID-19, https://asic.gov.au/regulatory-resources/corporate-governance/executive-remuneration/board-oversight-of-executive-variable-pay-decisions-during-the-covid-19-pandemic/
2. 10 minutes on: COVID-19: Managing remuneration during and post COVID-19: discretion is key, October 2020
3. See here for details on APRA's revised Prudential Standards on Remuneration: CPS511
4. Results of AGMs held in the calendar year to 18 December 2020. ASX positions based on 3-month average market capitalisation as at 30 September 2020 (excluding REITs and companies domiciled overseas).

Summary of 2020 AGM outcomes (2/2)

Notwithstanding the different economic backdrop to pay decisions this year, shareholder and proxy advisor concerns continued to be consistent with themes in prior years:

- awards despite poor company (financial) performance
- inappropriate use of discretion
- misalignment of bonus outcomes to employee experience
- perception of excessive quantum, where pay is above market or includes one-off payments
- lack of detail / transparency to variable remuneration outcomes, particularly on non-financial metrics and contribution to performance, or performance targets (even where a company deems the target not to have been met)
- targets not seen to be rigorous.

Similar to previous years, companies with high 'no' votes were typically also experiencing other non-remuneration related challenges including financial hardship, compliance and environmental issues, transaction activity and public scrutiny over broader governance issues.

However, distinct to 2020 was the view by shareholders and proxy advisors that companies should not be issuing executive bonuses whilst receiving JobKeeper wage subsidy payments - often irrespective of whether companies saw JobKeeper having an influence on financial performance. This was a contributing issue to multiple strikes - including Premier Investments, notwithstanding delivery of an increased profit outcome for shareholders - as well as a number of 'near strikes'. However, not all companies that received JobKeeper and awarded bonuses received material challenge to their remuneration reports - indicating differences on a case by case basis.

We have seen heightened intensity on transparent disclosures of rationale for bonuses, performance targets, and performance outcomes. Yet, where transparency may have been provided, disagreement with the ultimate reward outcome can still occur - such as where Boards have exercised discretion that has resulted in an outcome that is perceived to be inappropriately favourable for management. In relation to one of the higher 'no' votes - Bapcor (57%) - this was a contributing issue.

There has been no reprieve from proxy advisors or shareholders on the use of non-financial measures particularly when used in LTI. This was a contributing reason to AGL's strike (47% 'no'), which sought to introduce a carbon emissions reduction measure to LTI. A large weighting to non-financial metrics, and a lack of transparency about those metrics, was a factor in multiple of the larger 'no' votes. The negative reaction to non-financial measures in LTI plans persists despite clear regulatory expectations for non-financial measures from APRA in CPS511, albeit in a financial services context.

The 'two strikes rule' - and a first board spill motion
During the year only one company - Cromwell Property Group - received a second strike, and saw the first board spill motion being passed following successive strikes since the introduction of the 'two-strikes' rule in 2011. A spill meeting must be held within 90 days of their AGM.

Figure 2

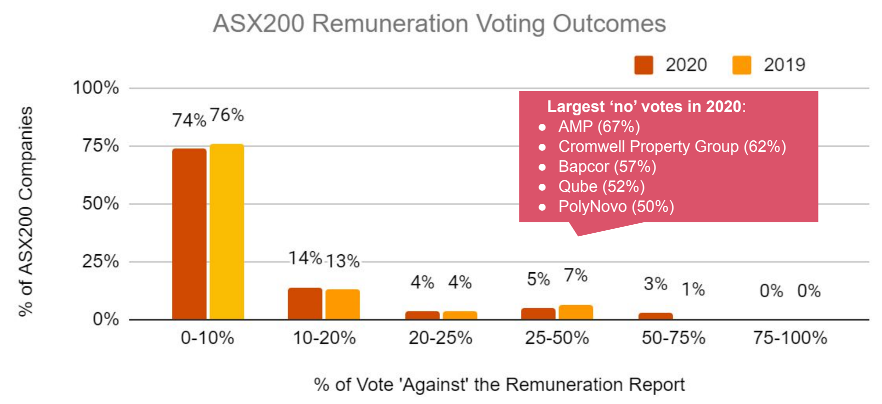
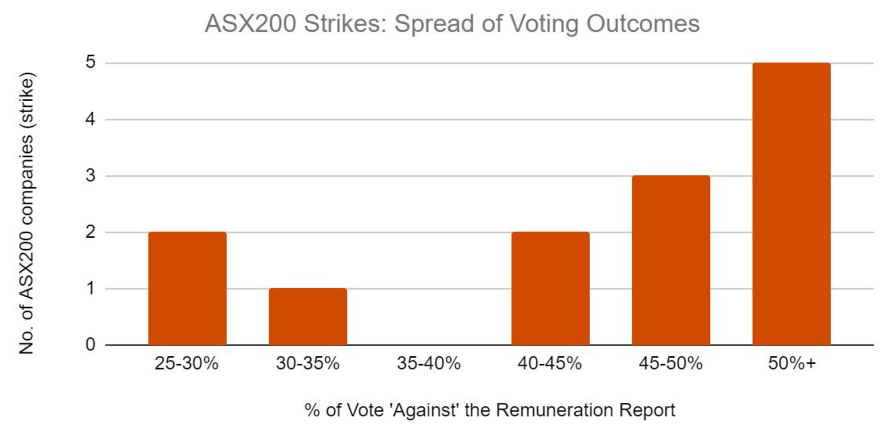


Figure 3



What this means for the year ahead

The key issues from the 2020 AGM season remain similar to prior years, albeit against a very different environment. The consistency of those themes allows organisations to proactively and preemptively prepare for the 2021 AGM season.

	Preemptive actions to be considered by companies
Application and disclosure of discretion and adjustments	Establish a set of guiding principles on discretion, which can be communicated to the market, and consider ASIC's guidance on discretion. Proactively determine and document the scenarios and circumstances in which discretion and adjustment may be applied, and how. Enhance disclosures in remuneration reports - including if and how discretion and adjustment are applied, and the rationale for each.
Engaging with stakeholders, particularly around remuneration framework changes	Develop / revisit stakeholder engagement strategy and engage with shareholders early to disclose the rationale for changes to the remuneration framework - particularly if introducing 'non-traditional' plans - with specific focus on alignment to strategy and appropriateness to your unique circumstances, while remaining cognisant of proxy advisors advice to shareholders. Where changes to the remuneration framework are not being proposed, articulate the rationale for how the framework continues to be relevant, particularly as the business evolves. If you have a 'non-traditional' plan in place, you may wish to continue to remind shareholders of the purpose of the plan, the rationale for its use, and the benefits to shareholders.
Introduction or expansion of non-financial measures (where applicable)	For new or expanded non-financial metrics (e.g. ESG and other Organisational Health metrics), articulate the rationale and collect data that illustrates the linkage to creating shareholder value, and the validity of target setting, noting proxy advisor skepticism of reward against these types of metrics. Consider testing the approach in the year prior to introduction into the remuneration framework.
Target setting and performance assessment	Consider how performance metrics and targets support the management of non-financial risks and are differentiated from performance deemed as part of the 'day job'. Recognise that accurate target setting in an uncertain environment may be challenging and proactively disclose if alternate mechanisms are used (e.g. broader target ranges, delayed target setting, alternate performance periods, signal the increase likelihood of using Board discretion). Consider implications of broader concerns likely to impact reception of pay decisions (e.g. 2020's JobKeeper impact), and stress test from multiple stakeholder perspectives (e.g. management, community, regulatory, proxy advisor, customers, employees).
Better alignment of pay and performance	Enhance transparency by including retrospective disclosures of performance metrics and targets, the specific performance level achieved by metric, and associated reward outcome (collectively or individually as appropriate). Provide further detail to realised pay to demonstrate ROI for shareholders including performance outcome achieved, value derived through share price appreciation, and how this aligns to the shareholder experience.
Managing remuneration quantum and approach to benchmarking	Articulate benchmarking approach and appropriateness to the organisation (e.g. use of global benchmarks to attract global talent, adaptation of market data for bespoke reward frameworks) particularly where peer groups may differ from the criteria more commonly used by external observers (e.g. market capitalisation). If adopting atypical reward approaches, consider whether the existing benchmarking approach needs to evolve.

How can PwC help?

To have a deeper discussion about these issues, please contact:

Sydney

Emma Grogan
Ph: (02) 8266 2420
Email: emma.grogan@pwc.com

Cassandra Fung
Ph: (02) 8266 2183
Email: cassandra.fung@pwc.com

Marc Bosotti
Ph: (02) 8266 7855
Email: marc.bosotti@pwc.com

Melbourne

Andrew Curcio
Ph: (03) 8603 1685
Email: andrew.curcio@pwc.com

Michelle Kassis
Ph: (03) 8603 5676
Email: michelle.kassis@pwc.com

Daryl O'Callaghan
Ph: (03) 8603 2841
Email: daryl.ocallaghan@pwc.com

Michael Bierwirth
Ph: (03) 8603 4835
Email: michael.bierwirth@pwc.com

Daniela Del Rossi
Ph: (03) 8603 4168
Email: daniela.del.rossi@pwc.com

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