www.pwc.com.au

10 minutes on...

2021 AGM Season: The more things change, the more they stay the same

January 2022

pwc

Summary of 2021 AGM outcomes

The 2021 AGM season occurred during a year where many organisations rebounded with improved financial performance, following a year of volatility and uncertainty, and significant changes to the way we work. While economic conditions improved, familiar challenges remained for Boards in relation to executive pay including applying appropriate discretion and balancing executive pay outcomes with all stakeholder experiences (including employees, customers, and community, in addition to shareholders).

We saw a slight uptick in organisations within the ASX 200 receiving a strike against their remuneration report, with an increase of 4 companies on last year (see Figure 1 right). However, the vast majority (89%) of ASX 200 remuneration reports avoided a strike (>75% of votes were cast in favour), see Figure 2 page over. While the average % vote against remuneration reports marginally decreased to 8.63% this year, the number of 'extreme' votes increased, with 7 companies (2 more than last year) receiving an 'against' vote of more than 50% (see Figure 3 page over).

Companies that received a strike last year improved their voting outcomes during this AGM season, with most achieving an overall 'no' vote of <10%. Where companies received a strike in 2020 and made improvements to their executive remuneration framework, the main enhancements included stronger disclosures, and increased clarity on the link between business performance and pay outcomes. Only one organisation in the ASX 200 (Crown Resorts) received a second strike, however a spill motion was avoided.

At the start of the pandemic, we anticipated the use of discretion to increase to reflect the experiences felt by all stakeholders[1] during a period of high volatility and uncertainty. ASIC provided guidance[2] relating to the considerations for using discretion as part of pay decisions, and specifically the impact of COVID-19 during this period to assist Boards in their decision-making. Overall, companies that applied discretion in favour of management (such as adjustment of performance outcome upwards compared to formulaic outcomes, or adjustment of targets downwards) were not well supported by shareholders and was a contributing factor to a strike in some cases.

A common reason for companies receiving strikes this year was remuneration outcomes and policies not reflecting the extent of operating and financial issues. For example:

- Rio Tinto voting outcomes were in response to remuneration consequence not being commensurate to the gravity of events at Juukan Gorge. Proxy advisers noted there was a case for a more robust application of the malus provisions and potential for malus to be applied to additional LTI grants.
- Westpac faced its second strike in four years with criticism off the back of excessive write-downs, a string of regulatory lawsuits and fraud allegations. The strike reflected shareholder sentiment that downward adjustments to STI outcomes were insufficient in light of the bank's challenges.
- While no STI and LTI were paid to Crown Resorts Executives, reasons for the second strike included paying substantial termination benefits, the incoming CEO's sign-on bonus being contingent on tenure only, excessive CEO fixed remuneration and Board fees compared to peers, and no minimum shareholding requirements.

Figure 1	**2021**	**2020**
ASX 100[3]		
% receiving a strike	11.11% (9 out of 81)	7.32% (6 out of 82)
Average % vote 'Against' Rem report (and minimum / maximum range)	8.50% (0.50% - 65.77%)	9.29% (0.60% - 67.25%)
ASX 200[3]		
% receiving a strike	10.63% (17 out of 160)	8.18% (13 out of 159)
Average % vote 'Against' Rem report (and minimum / maximum range)	8.63% (0.01% - 65.77%)	8.70% (0.00% - 67.25%)

1. 10 minutes on: COVID-19: Managing remuneration during and post COVID-19: discretion is key, October 2020
2. 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/
3. Results of AGMs held in the calendar year to 31 December 2021. ASX positions based on 3-month average market capitalisation as at 30 September 2021 (excluding REITs and companies domiciled overseas).

Summary of 2021 AGM outcomes (cont'd)

Shareholder and proxy advisor concerns continued to be consistent with themes observed in prior years, including:

- performance measures deemed 'business as usual' and targets not sufficiently challenging to warrant an incentive award.
- inadequate STI target disclosures and lack of detail / transparency around-variable remuneration outcomes, including financial metrics and contributions to performance.
- insufficient or inappropriate use of Board discretion.
- misalignment to good governance and best practice.
- individual outcomes misaligned to overall company performance.
- perception of excess quantum, where pay is above market or includes one-off payments or retention payments.
- insufficient executive and non-executive director shareholdings, and/or an absence of mandatory shareholding requirements.

Similar to previous years, companies with high 'no' votes were often also experiencing broader challenges including financial hardship, compliance and environmental issues, transaction activity and public scrutiny over broader governance issues. The most common reason for high 'no' votes was a perceived misalignment between executive pay outcomes and company performance, and the lack of downward discretion by Boards in such circumstances.

The longstanding view remains by shareholders and proxy advisors, that fixed remuneration increases should not be excessive, and that they should be in line with the broader workforce. In addition, an emerging view this year and last is that companies should not be issuing executive bonuses whilst receiving JobKeeper wage subsidy payments. This was a contributing factor to the strike received by IDP Education Limited, in which there was a substantial increase in the CEO's STI bonus despite significant weaker financial performance and an increase in the amount of JobKeeper subsidies received.

We have witnessed a heightened scrutiny over excessive incentive payouts in light of company performance, with this playing a contributing factor in strikes for a number of companies. In addition, a number of companies provided retention awards which were deemed inappropriate, contributing to company strikes (Dexus, Link Administration, Scentre).

While not (yet) directly contributing to a 'strike', Boards continue to be on notice in respect of climate and ESG related disclosures, particularly in the Resources industry, and in the larger FS banking sector where there is pressure for these companies to reduce exposure and stop financing fossil fuels. We saw pressure on Resources companies in 2021, in relation to including a non-binding vote on climate policies. We expect to see increased pressure for such votes in the future and an expectation in relation to transparent disclosure of the link between executive pay and the achievement of climate and ESG focused targets.

The 'two strikes rule' : During the year, one company (Crown Resorts Limited) received a second strike. Despite receiving a second strike, the subsequent motion to spill the Board did not pass as the majority of the Board had already resigned since the prior years AGM.

Figure 2

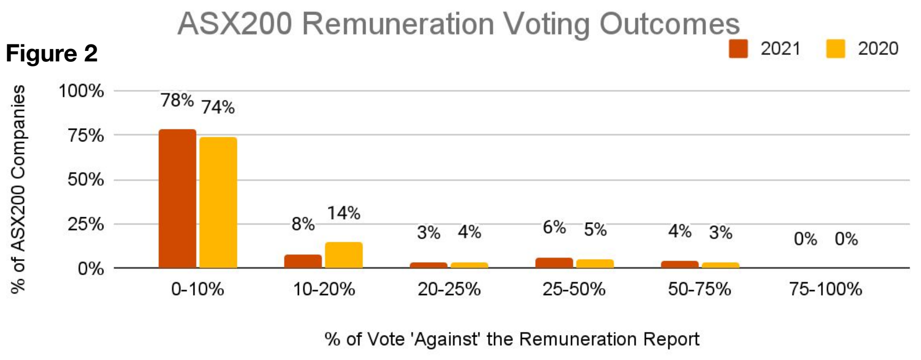
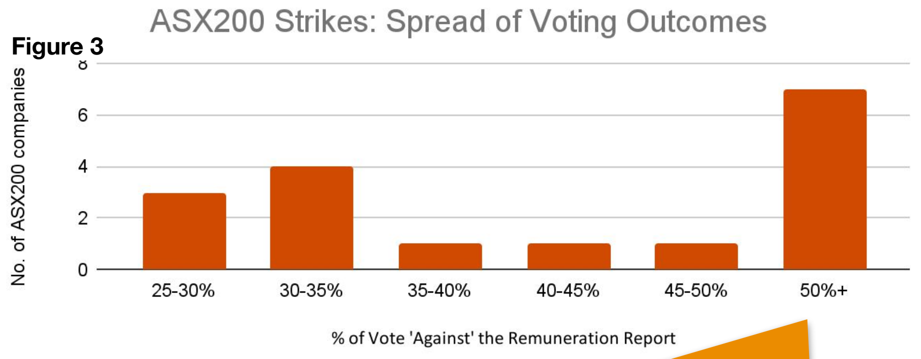


Figure 3



Largest 'no' votes in 2021:

- Dexus (66%)
- Link Administration (63%)
- Rio Tinto (61%)
- Insurance Australia Group (57%)
- Whitehaven Coal (53%)
- Scentre Group (51%)
- Platinum Investment Management Limited (50%)

What the future holds

The key issues from the 2021 AGM season remain similar to prior years. For the year ahead, organisations face more of the same scrutiny, as well as new challenges in response to the evolving COVID-19 pandemic including fixed pay pressures caused by the competition for talent as companies respond to less talent mobility due to border closures, and the fear of the "Great Resignation". Additionally, there are enhanced regulatory requirements for financial services organisations to meet.

	Preemptive actions to be considered by companies
The evolution of the application of discretion and adjustments, and disclosures	In prior years, we have noted that there is an increasing demand for the application and granular disclosure of discretion and adjustments. In our view, these have generally improved significantly in recent years, to such an extent that what was deemed to be better practice in 2020 is considered to be 'table stakes' in 2022. The bar has increased, and there is an ongoing need for all companies to consider whether their use and disclosure of discretion continues to meet that bar. For those companies that have not yet evolved their practices and disclosures, we continue to suggest that discretionary adjustments require a clear set of guiding principles that can be communicated to the market, and which consider ASIC's guidance on discretion. We also recommend that companies proactively determine and document the scenarios and circumstances in which discretion and adjustment may be applied, and how it is applied within a consequence management framework. For example, in the coming year, the pressure on the supply chain and high absences in the workforce due to more transmissible COVID-19 variants may present scenarios where discretion may be applied. In addition, any windfall gain which may arise due to an economic bounce back or share price recovery as a result of lower share prices when awards were granted may require a certain level of consideration and potential discretion. 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	As we navigate through the pandemic and in anticipation of 'The Great Resignation' there may be a requirement to review your current remuneration framework and Employee Value Proposition (EVP) to assess whether they both remain suitable in attracting and retaining key talent. For any changes to your remuneration framework, it will be important to review your stakeholder engagement strategy and engage with shareholders early to disclose the rationale for changes to the remuneration framework. The increased demand for talent places pressure on organisations to have a remuneration framework that provides flexibility to enable the tailoring of employment offers as well as an EVP that focuses on the benefits important to employees in a new flexible/hybrid working environment. In addition to the EVP, consider to what extent you wish to talk to the alignment of pay with broader business/people and stakeholder outcomes in your remuneration reports. 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. As the market's focus begins to shift towards ESG and ensuring organisations are conscious of their impact, it is important to ensure that there is a tangible and practical plan that supports the business in achieving the ESG metrics contained in the incentive arrangements.

What the future holds (cont'd)

	Preemptive actions to be considered by companies
Addressing pay pressures	With the pay pressures brought about by the increased competition for talent, and an expectation from proxy advisers around pay increases being in line with the broader workforce, companies continue to be constrained in how they address pay pressures for Executives. To address these issues, we anticipate companies will consider alternative methods for continuing to incentivise executives and meet the market challenges, including changes to pay mixes to increase the weighting on variable remuneration, and alternative designs for variable remuneration that could, for example, alter the certainty of payment. Such alternative methods may be more acceptable externally than simply increasing fixed remuneration.
Rigour in target setting and performance assessment	Ensure performance metrics and targets are sufficiently challenging and are differentiated from activities deemed part of executives' 'day jobs'. Recognise that accurate target setting in an uncertain environment may be challenging in and of itself, but even more challenging when coupled with the additional complexities we are starting to observe with staff shortages, impacts on the supply chain, and the volatility of performance over the next year. The target setting process will require increased consideration from the Board in line with the development of guiding principles on the use of discretion. 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, regulatory/compliance and reputational issues), and stress test from multiple stakeholder perspectives (e.g. management, community, regulatory, proxy advisor, customers, employees).
Better alignment of pay and performance	Where applicable, increasing the level of detail on performance metrics and the associated vesting/payout schedule. 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). Be prepared to exercise downwards discretion if the broader performance context doesn't warrant bonuses as determined through a formulaic process. Provide further detail to realised pay disclosures to demonstrate ROI for shareholders including performance outcome achieved, value derived through share price appreciation, and how this aligns to the shareholder experience. The impact from COVID-19 will likely continue for years to come with the associated impact on STI outcomes and vesting of LTI, a continued focus for shareholders. An organisation's recovery from the pandemic should likely align to the payment and vesting of the executive team's incentive arrangements with those able to bounce back and deliver returns to shareholders more likely to pay or vest a higher proportion.
Removal of the taxing point on cessation of employment	On 25 November 2021, the Government introduced legislation into Parliament to give effect to the Budget announcement to remove cessation of employment as a taxing event for Employee Share Scheme (ESS) interests. The legislation will apply to all ESS interests to which a deferred taxing point occurs on or after 1 July following the legislation receiving Royal Assent. The earliest effective date will be for taxing events that occur on or after 1 July 2022 ***provided*** the relevant Bill receives Royal Assent by 1 July 2022. The removal of cessation of employment as a taxing point aligns an individual's tax obligation to a time when they are able to access the value in their equity holding. It removes the cash flow burden and, we expect, presents an opportunity for companies to reassess the instruments used as part of their incentive programs with a move away from Indeterminate Rights, which was a means to alleviate cash flow complexities associated with tax on cessation. We suggest reviewing such arrangements and considering a shift to simpler, more common equity instruments such as Performance Rights or Options, in anticipation of the change to the tax rules.

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

Katie Williams
Ph: (02) 8266 0273
Email: katie.williams@pwc.com

May Kai-Best
Ph: (02) 8266 5633
Email: may.kai-best@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

Our Reward Advisory Services

- Reward strategy
- Transactions and deals
- Incentive plans (local and global plans)
- Performance metric selection and calibration
- Reward modelling and valuation
- Tax, regulatory and accounting advice
- Employee Share Trusts
- Performance management
- Research, data analytics and benchmarking
- Design and implementation for AU companies
- Board Advisory and corporate governance
- Remuneration reports, disclosure and communications

pwc.com.au