10 minutes on...

2022 Executive remuneration trends: **Sunny skies, looming clouds**

July 2023

pwc

Summary of 2022 executive remuneration practices

2022 was a year of return to business as usual. However, uncertainty still looms in the market with continuing inflationary pressures and talent shortages slowing economic recovery.

Cost of living went up more than double since last year to 7.8%[1] and unemployment fell to the lowest levels in 50 years to 3.5%[2], while market performance slowed down with Australian GDP increasing by 2.7%[3] (vs 4.2% last year). ASX 100 performance and investor confidence fell, demonstrated through a decrease in S&P ASX 100 Index (-4%[4]).

Despite investor confidence and market performance being subdued, organisations increased pay levels for CEOs and Executives, with prevalence of fixed pay increases being higher across all sectors than last year. Many companies also increased Chair and Non-Executive Director fees, following multiple years of restraint.

Despite pay increases becoming more ubiquitous, overall fixed pay remained constrained, with median CEO fixed pay moving 0.2% higher than last year and Executive fixed pay moving 2.9% higher.

This was lower than the overall Australian market, where the private sector wage growth was 3.7% p.a. to December 2022[5]. However, STI outcomes continued recovery, with increased transparency in the disclosures surrounding performance assessments and Board consideration of discretion.

1. Australian Bureau of Statistics, Selected Living Cost Index, December 2022
2. Australian Bureau of Statistics, Labour Force, December 2022
3. Australian Bureau of Statistics, December 2021 to December 2022
4. S&P ASX 100 Index value change from 1 January 2022 to 31 December 2022
5. Australian Bureau of Statistics, Wage Price Index, December 2022

Highlights

- Significantly more CEOs and Executives received fixed pay increases in FY22 compared to FY21 indicating a market catch up since the initial years of the pandemic.
- Where an increase was made to fixed pay, the median increases were as follows:
  - 5% for CEOs (with 57% receiving an increase)
  - 6% for Executives (with 68% receiving an increase)
- Similarly, more companies increased Board Chair fees (56% in FY22 vs 14% in FY21) and NED base fees (53% in FY22 vs 15% in FY21). However the median increase of 4% was lower for both Board Chair and NEDs compared with FY21 (previously 11% and 5% respectively).
- STI payments also aligned with a continuing trend of recovery in FY22 (similar to FY21) following a downward trend between FY18 to FY20, albeit actual STI outcomes for FY22 showed a marginal decline since last year. CEOs achieved 103% of target at the median (vs 110% in FY21) and Executives achieved 96% (vs 104% in FY21). 69% of KMP received STI payments exceeding 80% of target.

Notes on methodology: Our market data provided in this publication covers Key Management Personnel (KMP) at S&P ASX 100 companies (excluding foreign domiciled companies) as at 31 December 2022. All data is presented in AUD (but where appropriate, individual year on year analysis has been completed in home currency). Data is based on 2022 Remuneration Reports and other publicly available sources. Company size and performance data has been sourced from CapIQ

Summary of 2022 executive remuneration practices

Highlights (cont'd)

- 19% of companies made discretionary adjustments to their STI outcomes (vs 23% in FY21). Downward adjustments were typically made for adverse risk and reputation outcomes and where financial results were impacted by challenging social and economic environment conditions. There were minimal instances of upwards adjustments, all made for exceptional events such as extraordinary performance having clear linkage to business results or to account for one-off uncontrollable costs escalation.
- FY22 saw similar LTI vesting frequency compared to FY21, however the outcomes were higher. Vesting was achieved (all or in part) for 58% of CEOs (59% in FY21). For CEO LTI awards which had a vesting event in FY22, the median vesting outcome was 85% of maximum (compared with 74% in FY21). Full LTI vesting occurred for 20% of CEOs compared with 13% in FY21.
- The structure of executive pay frameworks is largely unchanged since last year with 91% of companies operating a traditional traditional fixed pay / STI / LTI model. Furthermore, the proportion of organisations using a fixed or service-based equity component in their frameworks are also unchanged since last year with 4% of ASX 100 companies using this feature.
- Minor changes to traditional remuneration models were observed:
    - STI deferral practice remained stable, with 87% of companies utilising deferral, with deferred portions delivered mostly in equity
    - Three years continues to be the most common LTI performance period (66% companies), with four year performance periods increasing in prevalence to 30% (24% in FY21). Relative TSR also remains the most commonly observed metric (84% in FY22), with performance rights continuing to be the preferred reward instrument, utilised within 95% of plans (up from 89% in previous year).
- Prevalence of mandatory shareholding requirements (MSRs) slightly increased with 77% of companies requiring CEOs to hold a minimum value of shares (71% in FY21). The median MSR for CEOs was 100% of fixed pay (150% in FY21).
- The number of ASX companies disclosing malus clauses has continued to increase (85% in FY22 vs 81% in FY21).

Fixed pay

Prevalence of pay increases bounce back, however approach to pay rises differed between Financial Services and non-Financial Services sectors

Greater prevalence of fixed pay increases compared to previous years

- Following an atypical FY21 year of pay reductions / pay freezes / limited pay rises, pay increases returned to a level consistent with prior years with the majority of CEOs and executives receiving a pay increase.
- 57% of same incumbent CEOs received a pay increase (consistent with increases in FY18-FY20 of approximately 60%-65%, compared to only 35% in FY21). This is lesser than the Executive cohort where 68% received a pay increase in FY22 (consistent with increases in FY18-FY20 of approximately 69%-73%, compared to 37% in FY21).
- However, CEO pay increases were varied between sectors, with the Material / Energy / Industrials / Utilities sectors having a greater prevalence of increases than the broader market.

Fixed pay movements higher for Executives than CEOs

- Where an increase was applied to fixed pay, there were higher increases in FY22 at median (5% for CEO and 6% for Executives) compared to FY21 (4% for CEO and a little less than 5% for Executives).
- However, given a higher proportion of Executives received fixed pay increase, CEOs witnessed significantly lower overall fixed pay movements than Executives (0.2% for CEOs vs 2.9% for Executives).
- Pay increases of CEOs relative to Executives differed between the FS vs non-FS sector:
  - In the FS sector, CEO pay increases were 12% at median as compared to Executive pay increases being 5% at median
  - In the non-FS sector, CEO pay increases were 4% at median in line with Executives pay increases being 6% at median.

More new CEOs receiving higher pay than predecessors

- Unlike previous years where there were minimal instances of new CEOs receiving higher fixed pay than their predecessors (8% in FY21), 42% of new CEOs in FY22 received higher fixed pay.
- Where fixed pay was higher than the predecessor, the fixed pay increase was 16% higher at median.
- Where a CEO was hired from the external market, fixed pay was either equal to or higher than predecessors. Where a CEO was an internal promotion, there was mixed practice with a greater number receiving lower fixed pay.

Fixed equity prevalence stagnates

- Similar to last year, 4% of ASX 100 companies provided unhurdled equity as a part of fixed remuneration (vs 5% in FY21).
- Of companies providing fixed equity in FY22, one each were in ASX 25, ASX 26-50 and ASX 51-100.

Figure 1: CEO and Executives pay movements (ASX 100, same incumbent)

	Median fixed pay movement		Median increases (increase >0%)	
	CEO	Execs	CEO	Execs
FY22	0.2%	2.9%	4.8%	5.6%
FY21	1.8%	2.2%	4.0%	4.8%

Figure 2: CEO and Executives% with no pay increase (ASX 100, same incumbent)

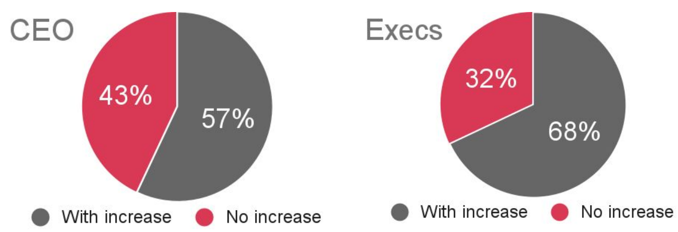
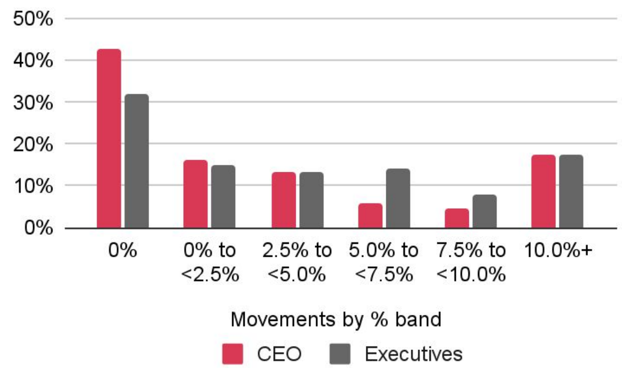


Figure 3: CEO and Executives fixed pay movements by percentage band



Short-term incentive practices and outcomes

Median STI payments continue recovery with lesser year on year variability in outcomes

Median STI outcomes continue to be near target performance levels

- STI payments continued a trend of recovery following a 3-year downward trend from FY18-FY20, with 69% of KMP receiving STI payments of over 80% of target STI (same as FY21 vs 34% in FY20).
- Near target payment levels also continued, with the FY22 median CEO outcome at 103% of target (110% in FY21) and the median Executive outcomes at 96% of target (104% in FY21).
- STI outcomes for all KMP were lowest in the Communications sector (median of 85%) and highest in the Real Estate sector (median of 118%). The FS sector saw median outcomes of 95% of target.

Variable pay bucks trend and is ‘less’ variable, however zero outcomes slightly more prevalent

- In FY22 we saw less variability in CEO STI outcomes compared to FY21 and FY20. This is to be expected given the significant reduction in variable payments made in FY20 resulting from the COVID-19 pandemic and the following recovery in FY21 which drove the increased variability in year-on-year outcomes, and this year of ‘normalcy’ has reduced the variation:
  - 50% of CEOs have a year-on-year variation of more than 20% in their payments (compared to 83% in FY21 and 86% in FY20)
  - 19% of CEOs had a variation of greater than 50% (vs 53% in FY21 and 52% in FY20).
- However, the prevalence of zero bonus outcomes increased marginally, especially for Executives:
  - 8% of CEOs in the ASX 100 (5% in FY21) and 10% of Executives (3% in FY21) received a zero STI outcome in FY22.

Increased transparency in assessment continues, as the number of adjustments to STI remained stable

- 19% of ASX 100 companies made an adjustment to their STIs in FY22, primarily downwards. Although the reasons for the adjustments were varied, consistent themes for Boards making adjustments included:
  - material cases of adverse risk and reputation outcomes (e.g. underpayment of wages, ongoing investigations, insurance settlements, increases in total recordable injury frequency rates (TRIFR))
  - STI pool being adjusted to align with impacted financial results in a challenging social and economic environment.
- Although the majority of adjustments were in-year adjustments, one company specifically disclosed that it applied clawback for one non-KMP staff resulting in forfeiture of share rights. Further detail has not been provided to articulate the rationale.
- The desire for transparency in the market continues again this year, with some companies who did not adjust outcomes providing explicitly stated justifications as to why exercising discretion was not necessary or appropriate.

Figure 4: Median STI payments FY18 - FY22 (% of Target)

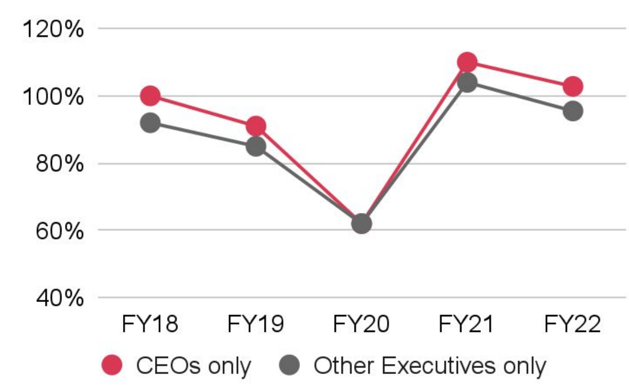
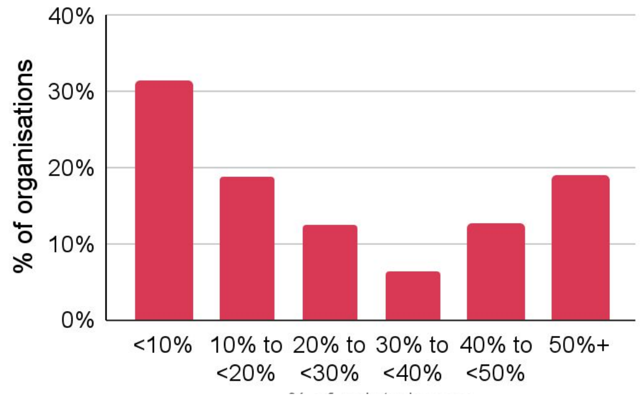


Figure 5: Year on year STI variation (ASX 100 CEOs only)



Short-term incentive practices and outcomes (cont'd)

No material changes to STI arrangements as compared to prior years

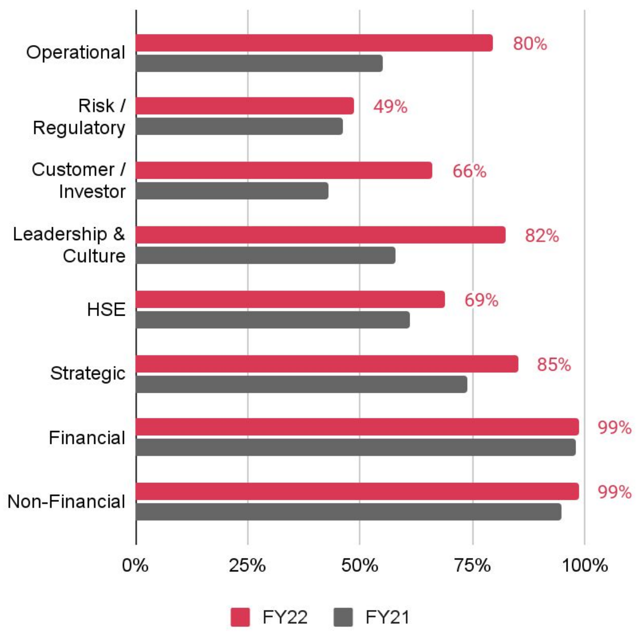
Focus on non-financial performance retains its importance in STI scorecards

- All but two companies in the ASX having a 'traditional model' use a combination of financial and non-financial metrics in their STI plan. Of the remaining two, there is one each of a company using solely financial metrics, or solely non-financial metrics.
- Strategic metrics (used by 85% of companies), were the preferred non-financial metrics used by organisations.
- However, Operational (80% of companies) and Leadership and Culture (82% of companies) metrics saw the highest increases in prevalence (~25% increase).
- This is unsurprising as companies continue to position themselves for growth and recovery in the post-pandemic environment.

STI gateways continue to be prevalent, with an increase in non-financial gateways

- STI gateways continue to be used by about 40% of the ASX 100.
- Financial gateways are the most prevalent (70% of companies with gateways), and have slightly increased in prevalence in FY22 (64% in FY21). This may be in response to the increased use of non-financial measures in STI plans, to enable the continued financial viability of plans.
- Although HSE metrics continue to be the preferred non-financial gateway (27% of companies with gateways), Leadership and Culture has slightly increased in prevalence (23% of companies, an increase of 3% from FY21).

Figure 6: STI metric prevalence in ASX 100 year on year comparison



Limited change to deferral practices, however longer deferral periods more common

- The quantum and nature of STI deferral arrangements remained consistent with previous years.
- The prevalence of STI deferral arrangements remained stable (87% in FY22 vs 89% in FY21), as did deferral into equity (97% of companies). All arrangements were compulsory in nature as opposed to voluntary.
- Consistent with the last 3 years, the highest prevalence of proportion of STI deferred was 50% (utilised by 48% of companies that defer).
    - Whereas in FY21, a 33% deferral was next most common (18%), in FY22 the prevalence of 25% and 33% deferral were almost equal (13% and 11% of companies) in popularity.
- Overall, a phased vesting approach (59% of companies that defer) was preferred over a cliff vesting approach.
    - 2 year phased vesting was the most prevalent approach, followed by a single year cliff vesting structure
    - The prevalence of deferral periods of 3-years or more has increased in FY22 (31% of companies that defer vs 22% in FY21). This is likely due to remuneration regulation (APRA's prudential standard CPS 511) that took effect progressively from 1 Jan 2023, requiring prescriptive and longer deferral periods for incentives for certain cohorts of employees, including Executive KMP.

Long-term incentive practices and outcomes

Plan designs remained fairly consistent but vesting proportions increased

Relative TSR further increases prevalence as the most common LTI metric

- Nearly all LTI plans have performance based vesting (99% in FY22 vs 95% in FY21).
- TSR remains the most common measure of performance (84% of companies). Of those companies using TSR:
  - 10% used both relative TSR and absolute TSR (down from 16% in FY21)
  - 97% used relative TSR (solely or together with absolute TSR) up from 92% in FY21
  - 13% used absolute TSR (solely or together with relative TSR) down from 19% in FY21.
- 66% of companies used non-market hurdles in FY22 (vs 62% in FY21).
- The prevalence of non-financial metrics in LTI plans remained stable featuring in a little more than one-third of ASX 100 LTI plans.

Three years remains the most prominent performance period, with a slight increase in four year plans

- The median LTI performance period continues to be three years (66% of companies).
- Similar to FY21, there is a continued elongation of companies' performance periods from 3 to 4 years, reflecting alignment with remuneration regulation (CPS 511):
  - 4-year performance periods increased by 6% to 30% of companies
  - The majority (69%) of companies in the FS sector operate 4-year performance periods, as compared to the non-FS sector where 3-year performance periods were more prevalent (74% of companies).

Figure 7: Prevalence of LTI hurdles across ASX 100 FY22 LTI plans (either as a sole metric or in conjunction with another metric), percentage of companies

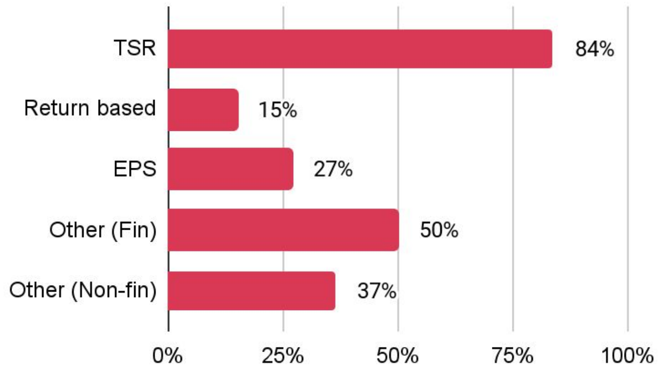
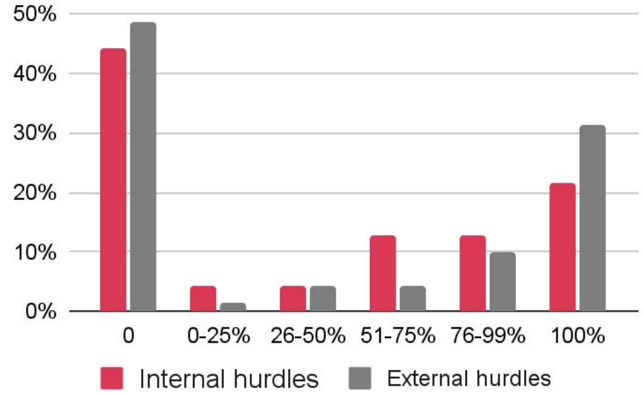


Figure 8: Distribution of vesting patterns for LTI hurdles



- Vesting arrangements remained similar to FY21, with 85% of companies operating cliff vesting and 15% using phased vesting.

CEO LTI achievement similar, median outcome up

- While LTI vesting events (all or in part) were similar to previous years (58% of CEOs in FY22 vs 59% in FY21), the proportion of LTI vesting increased:
  - The median vesting outcome for non-zero vesting events was 85% (+11% than FY21)
  - 20% CEOs experienced 100% vesting in FY22 (versus 13% in FY21).

Minimum shareholding requirements

- The prevalence of mandatory minimum shareholding requirements (MSR) has seen an increase to 77% (71% in FY21) for CEOs and other Executives; and 82% for NEDs (67% in FY21).
- Although the median timeframe to achieve MSR (5 years) has remained the same, the median MSR quantum has changed:
  - 100% of fixed or base pay for CEOs (compared to 150% in FY21)
  - 100% for Executives (unchanged from FY21).
- CEO MSRs in ASX 25 companies are higher, being at median 200% of fixed / base pay (vs 100% in FY21).

Non-Executive Director fees

Increase in fees and fee pools prevalent

A majority of companies increased Base NED and Chair fees trending upwards

- There has been a large uptick in the proportion of ASX 100 companies that have increased their Board Chair (56%) and NED (53%) base fees [6]. This is in contrast to FY21 where only 14%-15% of companies increased their Board Chair and NED fees.
- This reflects a broader application of fee increases vs the more targeted approaches in previous years.
- However the quantum of increase was lower at 4% for Chairs and NEDs (vs 11% and 5% respectively in FY21).
- Fee reductions were minimal with only 2 companies reducing chair fees and 3 companies reducing NED fees.

Committee fee increases higher in prevalence

- About half of companies increased Committee fees in FY22 for Chairs (44%- 55% across various committees) and members (38% - 52% across various committees). This in stark contrast to the previous years where the majority of companies did not increase their Committee fees (87% in FY21 and 65% in FY20).
- The quantum of increases were varied by Committee among Chairs and members:
  - Highest increases were experienced by HR / Remuneration Committee and Audit and Risk Committee Chairs (10% and 19% at median respectively) whereas Standalone Audit Committee or Risk Committee Chairs received similar pay increases (5% and 6% at median respectively)
  - Among Committee members, Audit and Risk Committee and standalone Risk Committee experienced the largest increases (12% and 8% at median respectively), whereas Remuneration / HR Committee and Standalone Audit Committee members received similar fee increases (5% and 2% at median respectively.

Prevalence and quantum of fee pool increases trends up

- 18% of companies increased their NED fee pool in FY22 (vs 9% in FY21), with the median pool increase being 33% (vs 28% in FY21).
- 20% of companies have indicated their intent to increase their fee pools in FY23, with a median increase expected to be around 19%.

Figure 9: Median NED fee increases received in 2022

	Median movement (all roles)		Median increase (increase >0%)	
	Chair	Other NEDs	Chair	Other NEDs
FY22	0.4%	0.5%	4.2%	4.4%
FY21	0.0%	0.0%	11.1%	5.1%

Figure 10: Median committee fee increases (increase >0%) received in 2022

	Chair	Member	Chair	Member
	Remuneration/HR Committee		Audit & Risk Committee (Combined)	
FY22	10.4%	4.5%	19.1%	12.0%
FY21	11.1%	5.1%	9.5%	7.2%
	Audit Committee		Risk Committee	
FY22	4.9%	2.0%	6.3%	7.7%
FY21	14.8%	12.0%	12.5%	18.3%

6. Companies that reversed temporary fee reductions due to COVID-19 are not considered as increases in these figures

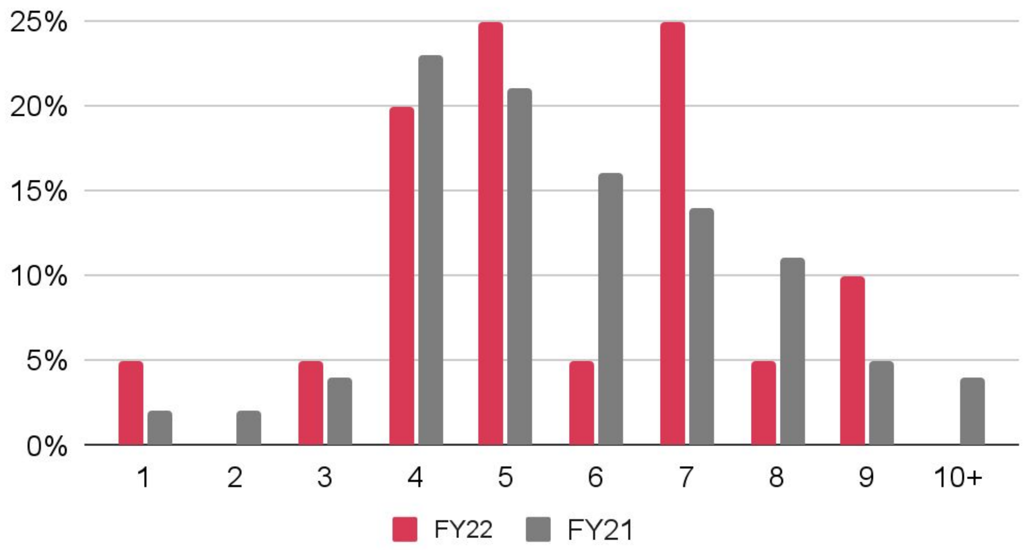
Non-Executive Director meetings

RemCo meetings experience a slight decrease in FY22

Remuneration Committee meetings: The number of meetings lower than pandemic era years

- While the median number of RemCo meetings held remained the same year-on-year (5 meetings), the proportion of companies holding between 4 to 8 RemCo meetings decreased marginally (80% of companies in FY22 vs 85% of companies).
- The FS sector recorded a higher median of meetings at 7, compared to non-FS organisations with a median of 5.
- The number of companies that saw RemCos meet 6 or more times decreased this year (45% in FY22 compared to 50% in FY21), contrary to the 18% increase observed from FY20 to FY21. This decrease may be due to economic conditions stabilising after the exceptional circumstances experienced in the pandemic years, requiring less effort from Boards and Committees towards remuneration decision-making.

Figure 11: Number of RemCo meetings disclosed in FY22 and FY21



Remuneration trends: what we expect

Attraction and retention of talent to continue to inform pay, balanced with cost pressures

- Last year we expected CPI-style increases for Executives across various industries to become more prevalent and FY22 reporting validated this expectation for non-CEO Executives in particular.
- With increasing cost pressures, we expect there may be a return to a more targeted approach to increases, with salary budgets focused on the broader workforce experiencing increased costs of living.
- However talent pressures and retention issues are likely to continue to be felt, for example with reducing differentials between fixed pay of incoming v predecessor CEOs and in some cases the need for sign-on bonuses.
- Similarly while incentive plan periods are elongating (eg increased deferral periods, holding locks or performance periods) we anticipate that there will be greater focus on changes to leaver provisions (eg definitions of good leavers) to enable ongoing retention and higher perceived value.
- After a year of higher prevalence of base and Committee fee increases compared to previous years, we also expect less prevalence in NED fee increases in the coming year.

Increased scrutiny on STI and LTI measures and outcomes

- Scrutiny on STI and LTI outcomes is likely to continue to increase driven by greater usage of non-financial metrics in incentive plans and upcoming LTI grants eligible for vesting tested against targets set against the context of the COVID-19 pandemic and higher expectation.
- Notwithstanding increased priority placed by investors on performance against non-financial metrics (eg ESG), there is still a reticence to accept diminished results as a return. With non-financial metrics including ESG measures here to stay, undoubtedly there will be increased scrutiny on the specific metrics that are used to assess performance, and the resulting remuneration outcomes this delivers to executives particularly where financial performance is poorer. And, while ESG metrics have historically focused on safety metrics, we anticipate increasing focus on a broader metric set including environmental and diversity and inclusion.
- Similarly LTI outcomes are likely to face higher scrutiny with grants made against the backdrop of the COVID-19 pandemic due for vesting in the coming years. Investors are likely to focus particularly on whether there are windfall gains as a result, while Boards will need to consider whether the outcome is ‘fair’ for executives as well as shareholders.

Continued enhancements to disclosure, specifically for application of discretion and consequence management

- The demand for transparency by proxy advisors, shareholders and, in the case of financial services (FS) companies, regulators continues unabated, and the impacts of APRA’s CPS 511 - a regulatory standard for FS companies - will likely see heightened transparency in target setting, performance assessment, incentive outcomes and application of remuneration consequence.
- FS companies have typically been first movers in the use of and application of discretion, and also consequence management. Notwithstanding, this year the majority of companies that actually made adjustments to their STI outcomes was in companies outside of the FS sector. This illustrates that the changes seen in FS companies including discretion and consequence management will continue to have widespread impacts beyond that sector.
- Additionally, where Executive pay increases continue to be awarded in the subdued economic climate, we anticipate additional disclosures around their link to business performance, rationale for year-on-year increases and consideration of Executive pay rises in context of the wider workforce.

Key actions Boards and Reward leaders should be discussing as a result

1

Continually sharpen the articulation of the link between pay and performance

- Develop strong rational and narrative for the alignment of pay outcomes and performance, particularly with higher scrutiny on cost pressures, focus on LTI grants that are vesting with targets set during COVID and ongoing focus on STI outcomes and use of discretion.
- When introducing new metrics (eg within ESG) clearly define the metric, how it contributes to strategy and shareholder benefit, as well as explaining the reward outcome - ie it may be the metric itself as well as the outcomes that will need to be clearly justified.
- For any pay rises, consider whether these are appropriate aligned with the broader business context and whether there are alternate approaches i.e. consider the mix between fixed and variable pay, explore increases to variable pay opportunities as a partial substitute to increases to fixed pay quantum.

2

Prepare for robust disclosures and reporting

- Proactively anticipate how disclosures can be improved to align with market expectations of more transparent disclosures and the impact of the upcoming finalisation of FS regulation around reporting (eg APRA's CRS 511).
- Determine whether there are sufficient internal mechanisms to meet external (regulatory or shareholder) expectations of reporting based on a clear understanding of the level of detail to be included in report.
- Identify early in the year any hotspots and where there are possible alternate interpretations / conflicts, establish clear principles for how these can be managed (eg discretion principles, scenario modelling).

3

Consider non-traditional structures to address specific priorities (where needed)

- As business conditions being experienced by companies are varied by industry, operations, level of global connectivity and nature of investors, consider whether tweaks to traditional pay structures are appropriate.
- Some examples of this can be the inclusion of fixed equity in executive remuneration or use of equity in NED fees structures for growth focused companies, introduction of alignment rights to address retention pressures or create a more direct link to shareholder experience and the use of LTI mega grants for companies focusing on strategic turnaround.

4

Review and (if required) update existing incentive documentation to comply with legislative and regulatory changes

- The introduction of new securities laws in October 2022 alongside the retirement of regulatory relief historically provided by ASIC Class Order 14/1000 for new offers on and from 1 March 2023 means that while it may be easier to grant equity to a broader population, for some grants, attention needs to be given to not only incentive plan documentation (including employee share trust deeds) but also the structure of grants to ensure these align with updated regulatory requirements.

How can PwC help?

To have a deeper discussion, please contact your PwC specialist

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- Incentive plans (local and global plans)
- Performance metric selection and calibration
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- Tax, regulatory and accounting advice
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- Performance management
- Research, data analytics and benchmarking
- Design and implementation for AU companies
- Board Advisory and corporate governance
- Remuneration reports, disclosure and communications