10 Minutes on...

2019 Annual General Meeting season - No loosening of the grip

pwc

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After a fiery AGM season in 2018, the number of ASX 200 companies receiving a strike has reduced slightly in 2019 (with two less companies receiving a strike). And, we have seen fewer extreme 'no' votes occurring, with only one company receiving an 'against' vote of more than 50% (as compared to five in 2018), and the majority of ASX 200 remuneration reports receiving a 'yes' vote this AGM season (92.7%). However, the level of 'no' votes remains significantly higher than what we saw pre-2018, suggesting that there is "no loosening of the grip".

Companies that received high 'no' votes last year appear to have appropriately responded to shareholder feedback and sentiment for the most part. Such companies have made changes to the design and/or governance of their remuneration arrangements, leading to a turnaround in their voting outcomes this year. Australian companies continue to enhance their engagement activities with shareholders on remuneration matters, with on-going, consistent and transparent engagement increasingly becoming the expectation as part of the annual operating rhythm for Remuneration Committees.

However, we do not expect the scrutiny and activism around remuneration to dissipate.

In addition to concerns regarding remuneration structure and governance, community perceptions of excessive executive pay quantum continue to persist, with pay quantum being one of the primary explanations provided by shareholders where companies have received strikes in the past year. Concern over the fairness of pay quantum appears heightened at a time when Australia's economic growth remains slow and wage growth within the general population has not improved.

Furthermore, the acceptance by shareholders and investors of non-traditional incentive plans continues to be challenged in some high profile cases, with some organisations shifting away from such arrangements and back towards the more traditional framework. There is, however, a continued focus on simplification internationally and with some proxy advisors.

We have observed a lack of support from proxy advisors and investors for non-financial measures given views that they are misaligned to shareholder interests, unnecessary (if non-financial performance ultimately impacts financial results), and/or not clearly defined or measurable. There is a growing divide between stakeholder perspectives on non-financial measures, made more obvious with the release by the financial services regulator, APRA, of its draft Prudential Standard CPS 511 [1], which includes, amongst other proposed changes, a requirement to measure at least 50% of short and long-term incentives against non-financial metrics (we note that this has been an area of intense discussion during the consultation process with the possibility of a revised position here).

Finally, expectations continue to grow related to the enhanced use, and disclosure, of board discretion. In particular, that it should be used more often and in a more substantial way to reduce payments when broader issues have been exposed.

	2019	2018
ASX 100 [2]		
% receiving a strike	8.33% (7 out of 84)	10.84% (9 out of 83)
Average % vote 'Against' Rem report (and minimum / maximum range)	8.41% (0.3% to 47.58%)	11.82% (0.14% to 88.43%)
ASX 200 [3]		
% receiving a strike	7.27% (12 out of 165)	8.54% (14 out of 164)
Average % vote 'Against' Rem report (and minimum / maximum range)	7.61% (0.01% to 53.00%)	9.43% (0.01% to 88.43%)

1. See here for details on APRA's New Standards on Remuneration
2. Results of AGMs held in the calendar year. ASX positions based on 3-month average market capitalisation as at 30 September 2019 (excluding REITs and companies domiciled overseas).
3. Analysis based on companies who have had AGMs as at 20 December 2019.
Note: 2018 figures have been updated since last year's analysis (link) due to an update of PwC's methodology around company exclusions.

Summary of 2019 AGM outcomes

The number of ASX 200 companies receiving a strike has reduced slightly compared to last year. In contrast to last AGM season, only one company received a high 'no' vote of more than 50% this year (as compared to five).

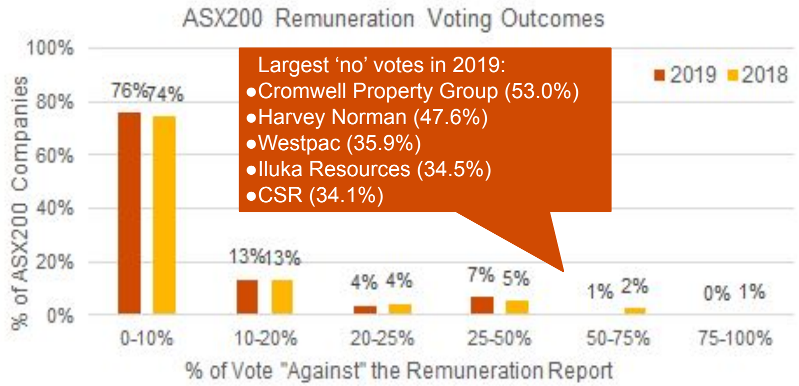
Shareholders and proxy advisors continued to be very reactive on the topic of executive pay this AGM season, and there is no indication that this amount of attention (or scrutiny) is going to abate any time soon. The key areas of concern remain relatively consistent with what we have seen in previous years. In addition, though, we have started to see particular concerns being raised in relation to companies trying to introduce changes to remuneration to pre-empt regulatory changes.

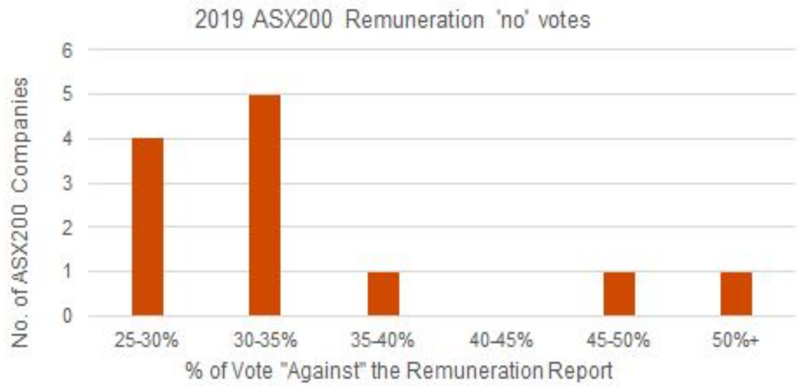
The remuneration report vote continues to act as a 'lightning rod' for shareholder concerns, for example, companies with high no votes are often also experiencing scrutiny over financial performance, compliance, societal and/or environmental issues. In addition, the recent focus on the financial services sector has seen regulators propose much more prescriptive requirements for executive remuneration governance and structure, which, if implemented, would likely change shareholder and shareholder advisory body expectations more broadly across the Australian company landscape.

In order to respond to shareholder feedback, we saw some companies who received a strike in 2018 make material changes reverting back to a more traditional incentive structure; reducing executives bonuses significantly, in some cases to zero; and providing little or no fixed remuneration increases. These actions resulted in significant shifts in voting outcomes for companies, in some cases swinging from very high to very low 'no' votes.

There were two companies (Westpac and Harvey Norman) who received a second strike in the ASX 200, but the board spill resolution was not carried in either case. There have still been no instances in Australia whereby a Board spill resolution has been carried since the introduction of the 'two strikes rule'. This suggests that, although shareholders are willing to express their discontent with remuneration and broader issues through the remuneration report vote, this does not flow through to supporting the disruption of a Board spill. We do, however, continue to see higher no votes for re-election of Remco Chairs where substantial issues regarding remuneration practices have emerged.

Key issues for companies who did receive a strike this year were:





Perceived excessive quantum

- Fixed and/or total remuneration seen as too high compared to peers or out of step with the broader economy and employee population.
- The provision of high one-off, sign-on or transaction related payments.

Consequences for NEDs

- Unmet expectations around consequences for NEDs (for example through a reduction of fees).

Targets not rigorous

- Use of measures (and/or associated targets) that are seen as too 'soft' or that should be considered part of an executives' basic job responsibilities.
- Re-setting of LTI targets or the use of cliff vesting.

Application of discretion

- In some cases, a view that discretionary adjustments were not seen as reflective of the circumstances (i.e. where a more significant adjustment was expected, or where adjustments led to divergence between remuneration and shareholder outcomes).

The use of non-financial measures

- The increasing weighting of non-financial measures in remuneration scorecards.
- Limited disclosure around non-financial measures, how they are assessed or how discretion is applied.

Awards despite poor company performance

- As in prior years, there are continuing themes of a lack of alignment between reward outcomes and company performance.

The top agenda items for Remuneration Committees in 2020

While the heat may have come out of the 2019 AGM season, there are a number of issues that are likely to remain at the top of the agenda of shareholders and proxy advisors in 2020… and eight actions that companies can begin to take

	Issue	Actions
Clarify the role of the Remuneration Committee	● Given the external and regulatory environment, expectations regarding the breadth and depth of Remuneration Committees' remit is likely to increase, along with an increase in time commitments for directors. Proxy advisors are also reinforcing an expectation that non-executive directors - in addition to executives - are to be held to account in extenuating company circumstances, as evidenced during this AGM season by lower votes at re-election time; some examples of pressure and resulting reductions in NED fees; and even director resignations.	**1. Revisit Remuneration Committee Charter to ensure it reflects the most up to date role and responsibilities and consider broadening the Remuneration Committee remit to cover broader talent and HR issues.** **2. Give consideration to any changing time commitments for directors and potential impacts (e.g. re-evaluation of the number of directorships held, or the ongoing appropriateness of Remco Chair fees).**
Revisit the purpose of pay	● In light of changing expectations related to variable pay governance, the expectation of enhanced use of discretion, and deferral extensions for financial services companies in particular, plan participants and stakeholders are raising concerns regarding the adverse impact on incentive plan complexity and perceived value of variable pay.	**3. Actively discuss and confirm the role of variable pay in your organisation going forward, potentially informed by a review of the effectiveness of your remuneration framework.** **4. If developing modified remuneration arrangements to address regulatory and other pressures, ensure a very strong rationale as to why a chosen solution best supports your company's strategic objectives.**
Maintain alignment of reward and performance if introducing non-financial measures	● An enhanced focus on non-financial measures is a key plank of APRA's draft CPS 511, initially affecting financial institutions but becoming broader market practice over time. ● The issue of non-financial measures continues to be approached with trepidation by investors and proxy advisors, and their acceptability is often governed by how well companies explain the rationale for the use of the measure and contribution to the creation of shareholder value, provide transparency on how performance will be measured, and provide clarity on the performance levels that warrant the incentive so that shareholders are confident an incentive is not awarded to executives for "just doing their jobs".	**5. When considering non financial measures focus on those that: are most quantifiable; can be measured on a relative basis and/or have a history of performance that can help inform target setting; and for which alignment to longer term wealth creation is most obvious.** **6. Carefully calibrate and disclose threshold and target performance and payout levels.**
Consequence and accountability and the use of Board discretion	● Recently there is increased expectation for organisations to demonstrate the application of Board discretion to better hold executives and non-executive directors to account - both in how performance metrics are assessed, as well as factors that may not be articulated or determined within the incentive framework. This year saw several companies (e.g., Westpac, nab, Woolworths) applying significant adjustments to both in year and deferred executive bonuses, as well as to non-executive director fees in some instances. ● In addition to malus and clawback requirements sent out in APRA's draft CPS 511, there may be increased regulatory pressure for companies to show the consideration and application of discretion as a result of the findings of ASIC's Corporate Governance Taskforce, specifically their report into executive remuneration, which is expected in the coming months.	**7. Proactively determine the circumstances in which discretion will be applied, ideally developing a detailed remuneration consequence policy.** **8. Enhance disclosures related to the used of discretion in the annual Remuneration Report, along with the outcomes of discretion when used, as well any circumstances where the Board chose not to exercise discretion after due consideration.**

How can PwC help?

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

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