COVID-19

10 minutes on…
How companies are managing reward & performance in a COVID-19 environment

April 2020

1. Overview

As organisations continue to feel the impacts of COVID-19 on their businesses, more companies are announcing and considering changes to not just executive pay but to wider employee remuneration and/or working arrangements. The wide-ranging impacts of COVID-19 on employee engagement and management means that a range of stakeholders (for example, the Remuneration Committee, HR, Executive teams, team leaders etc.) within most companies are currently thinking through and wrestling with a range of performance management and reward related issues.

COVID-19 impacts on many Remuneration Committee matters, and potentially expands the issues and remit that Remuneration Committee members will need to be across. As well as impacts on executive pay, there will be decisions required on pay and conditions for the wider workforce during the crisis, and shareholders and the broader community will expect to see some consistency in all decisions.

The political and environmental context for decision making will be very important, and companies may need to come to conclusions at speed with significantly reduced planning time, whilst ensuring they balance multiple stakeholder interests.

In this 10 minutes on,
we focus on four key questions:

What are the key issues Remuneration Committees should be thinking about?

How have we seen companies respond so far?

How have we seen external stakeholders respond?

Checklist tool: What practical actions can companies take now?

2. Key issues to consider for the current performance year

Over the past few years, the focus of external stakeholders has shifted from a narrow focus on executive pay to broader workforce issues, accompanied by evolving community views on fairness and a societal debate on pay. This political and environmental context will likely only take on greater prominence when shareholders, regulators, and the community are judging how pay and performance issues are treated by companies, in relation to COVID-19 impacts. On the following pages, we outline a non-exhaustive list of issues companies will need to consider as part of their (often broader) responsibilities as they continue to respond to the crisis, and in particular will likely be expected to fall within the remit of Remuneration Committees:

Approach to pay and conditions for the wider workforce

There is increasing expectations from investors for boards to understand the company wide approach to pay and conditions, including for the wider workforce, during this time.

Expectations are greatest on executive pay decisions where there have been substantial impacts on:

- company performance
- shareholders eg, dividend reduction
- employees (eg, large numbers have been made redundant / placed on leave-without-pay)

Remuneration committees should be armed with information on the, extent of:

- workforce that have been either stood down temporarily or been made redundant
- pay and/or benefits reduction for broader workforce

Investors will expect remuneration committee chairs to be well-versed in their company's approach to wider workforce issues and to be able to explain how employment conditions, and pay and performance decisions for employees align with proposals being made for executives.

In year salary adjustments and salary reviews

Given the precedence already set by some companies (eg, particularly distressed companies such as airlines), and external stakeholder expectations, companies will need to demonstrate that they have at least given due consideration to in year salary adjustments for executives.

Following such deliberations, some companies may conclude that salary adjustments are not warranted (eg, if their industry/company is performing well) but remuneration committees should at least:

- revisit any determined but non-awarded executive salary increases (particularly for June year ends), and
- develop a clear rationale for why adjustments aren't needed.

Salary freezes for the broader workforce should also at least be considered, however consideration should be given to pay levels for genuinely critical roles and individuals (eg, customer-facing roles, IT). As an example, Aldi's UK store and distribution colleagues will receive a 10% bonus on hours worked, reflecting the importance of those roles in the current environment.

Adjustment to 'in-flight' targets or performance outcomes

While it makes sense for remuneration committees to retain appropriate discretion to make adjustments, decisions should generally be postponed until the end of the performance period when the situation and context may be clearer.

Already, we have seen shareholder bodies/ investors outline expectations that companies will exercise appropriate discretion as it relates to current year incentives and LTIP outcomes. This is true even for companies that are performing strongly, and may be considered to be benefiting from the pandemic. Specifically, ISS have announced that they will:

- scrutinise any changes to current year bonus targets; and
- expect companies to clearly disclose their rationale for any changes, and the associated decision-making process.

Remuneration committees should seek to understand their particular investor expectations, and should confirm that principles and guidelines for applying discretion are clear and documented. There will be scrutiny placed on the use of and rationale for the application of discretion at year-end.

Payment of bonuses

For all companies, but particularly those with a dramatically worsened outlook, workforce reductions, or cash constraints, consideration should be given as to whether it is still appropriate to pay bonuses.

Some remuneration committees may wish to re-evaluate the basis on which bonuses should be paid, including whether there is a different performance focus eg,

- all group results vs individual results
- behaviours or effort rather than financial results

Consideration could be given as to whether a greater proportion of their bonuses should be awarded in shares to preserve cash.

Regulatory guidance should also be considered (particularly FS companies), and/or how the company is benefiting from government support (ie, the extent to which the business has been underwritten by taxpayer support). Additionally, if companies are planning to suspend their dividends, then payment of bonuses are likely to come under greater scrutiny.

Getting the balance right, in light of the company's circumstances will be critical to maintain trust. These decisions will be complicated for companies with earlier year ends (eg, March or even June), where this year's performance may be mostly positive, although with a significantly poorer outlook.

2. Key issues to consider for the upcoming performance year

Setting of STI and LTI targets

Given most companies with June year-ends have not yet set or announced their targets for FY21 STI, it remains an open question as to what approach for target setting will be deemed acceptable to shareholders.

Remuneration Committees should at least commence giving consideration to the pros and cons of various options, particularly for STI metrics which are more likely to be impacted by COVID-19 than the longer-term incentive plans. Options may include:

- business as usual (no change to approach);
- postponing target setting;
- adopting a shorter budget cycle to take account of the volatility and allowing for periodic recalibration;
- widening target performance and payout ranges to take account of the expected volatility;
- lowering the performance threshold only;
- moving to non-standard performance measures; or
- adopting a fully discretionary approach.

Award of LTIP grants

With the significant share market losses expected to continue into the LTIP grant season, companies may receive very different outcomes to prior years in terms of instrument value and therefore, the number of instruments granted. Differences could be exacerbated by small differences in grant dates, peer groups, and valuation approaches.

- **View from investors**: typically expect grant sizes to be reduced when the share price has fallen materially compared to the prior grant (with common guidance being that this might encompass share price falls of 25% or more).
- **Market trends**: in the UK - which is already in the middle of their LTI grant season - only 5 FTSE 350 companies have adjusted their LTIP grant sizes (typically by adjusting the share price used to determine the number of awards). A number of companies noted that they retain discretion to address any inappropriate windfall gains at vesting.

In our view, the fact that the share price falls are market-wide is unlikely to shift investor expectations that grant sizes should be reduced. While reductions in grant for significant share price falls remain advisable, we appreciate this can be a challenging decision to make in a period of high volatility.

Remuneration committees should also determine how they would assess an unjustified windfall gain upon vesting and ensure they have the discretion to make adjustments at this point should this be deemed appropriate.

Provision of benefits

In the current environment of changing cost pressures, employee expectations, and a significant percentage of the Australian workforce working from home, companies may need to re-assess the benefits offered to executives and employees.

- A number of benefits may be less relevant (eg, gym memberships), and so organisations will likely need to revisit how they optimise their total reward offering.
- Companies may temporarily pause some benefits, introduce new ones that are likely to be important during the COVID-19 pandemic, or reduce the benefits program and associated cost, significantly if the organisation is facing cost pressures.
- Some benefits may become more valuable, eg, offering salary sacrifice into equity at a time when share prices are lower, giving employees ‘skin in the game’ and potential upside, while reducing cash-salary costs. Similarly, promoting all employee share plans to create an ownership mentality and alignment to a collective performance during these challenging times could also be of value.

3. How have companies responded so far?

The vast majority of listed companies have not yet made public announcements regarding fixed pay reductions, freezes, or bonus pool reductions or cancellations. Approximately 15% of ASX 100 companies (as of 20 April 2020) have made public announcements as part of a broader response to COVID-19 business impacts, regarding changes to their reward and performance approach for executives, the broader workforce, and also in some cases to fees for Board members, with more outside the ASX 100 also doing so. Somewhat unsurprisingly, the most significant decisions have been announced in those industries hardest hit such as travel, tourism, casino, and gaming. Examples of key changes we have seen announced across the segments are summarised below:

Executives

Executives have been the first segment to have their pay impacted, in some cases, only the CEO.

Temporary salary adjustments (15 ASX 100 companies announced intent to adjust executive salary)

- Reduction in fixed pay by between 20% to 100%, although most commonly 20% pay reduction
- Some companies have differentiated between the CEO and direct reports, with a (higher) proportion foregone for the CEO
- Duration of salary reduction significantly varied, most commonly for the remainder of the financial year, or a fixed period of 3 months. In some limited cases, application for 6 or 12 months or even an indefinite period ("until further notice") or when conditions return to normal

Incentive arrangements (5 ASX 100 companies announced intent to adjust executive incentives)

- Nil annual bonuses for FY20 to be provided to either the CEO, or the CEO and executive team
- No disclosed changes to LTI as yet, although we are aware of companies considering how to approach upcoming LTI grants

Broader workforce

Across the broader workforce, approaches are not just limited to pay but also changes to working conditions and arrangements.

Salary adjustments

- Salary adjustments less prevalent for the broader workforce relative to executives (with employees more likely to be impacted by other action such as a temporary stand down or redundancy)
- Quantum reduction typically less than executives, between 10% and 20%. Salary reduction may also be accompanied by a commensurate reduction in hours in some, but not for all cases
- Differential approach to employee segments is evident also – eg, minimum threshold of salary before a reduction applies, preservation of salary and hours for business critical roles
- While there are no publicly announced pay freezes in the ASX 100, there are examples of smaller listed companies and unlisted organisations that have announced pay freezes

Incentive arrangements

Limited disclosed practices, however we are aware some companies are reconsidering their approach to FY20 bonuses. We have seen examples outside of the ASX 100, both local and international, of different incentive practices being adopted outside of normal criteria to reflect staff contribution throughout the pandemic.

For example, in Australia: Kogan is providing a $500 bonus to all staff, international example: Aldi and Tesco UK are awarding a 10% bonus on hours worked for store and distribution staff, Facebook are applying an 'exceeds' rating for their first six month review of 2020 meaning workers will have a guaranteed six month bonus, on top of a further $1,000 bonus to be awarded to staff.

Board / Non-Executive Directors

13 ASX 100 companies have implemented reductions in fees to Boards (Chairs and NEDs). Where disclosed, these are typically in the order of between 20% and 30%, although there are examples of 50% and 100% (ie, no fees for Board members for a specific period).

The duration of this reduction is most often either 3 months, the remainder of the financial year (~3 months for June year ends) and in some cases for an undisclosed period.

It remains to be seen whether these fee reductions will extend beyond the current financial year or an initial period.

3. How have external stakeholders responded?

A number of external stakeholders have already published their own views as to how executive reward should be managed given the impact COVID-19 on the economy, including regulators (both here and overseas), proxy advisors, investors, government, and superannuation funds. See below for a summary regarding expectations and guidance on remuneration management.

Australian responses

Australian Prudential Regulation Authority

- APRA has provided a letter to ADIs and insurers outlining expectations in relation to capital management
- One of the items identified by APRA is an expectation that Boards will appropriately limit executive cash bonuses, along with reductions in dividends

Australian Institute of Company Directors

- Set out challenges likely to be faced in relation to executive and employee remuneration
- Provided guidance through key considerations for boards and remuneration committees:
  - Assess the impact of the business
  - Establish a robust framework for exercising discretion
  - Adjustments should be consistent
  - All remuneration should be on the table
  - Consider shareholder expectations and communicate early
  - Be realistic for the go-forward

Australian Council of Superannuation Investors

- ACSI's CEO encourages Boards to use discretion to review all remuneration outcomes in the coming months – taking into account the appropriateness of any payment in light of the experiences of their investors, staff, customers and the broader community. She noted that in the global financial crisis many boards failed to use discretion and reduce or zero out incentives, leading to unprecedented levels of investor opposition
- ACSI expects Boards and executives to 'read the room' and prevent this happening again
- ACSI have also commented on deep concerns about the dilution of retail shareholders under emergency capital raising rules

Australian Proxy Advisors (CGI and ISS)

- CGI Glass Lewis and ISS released global guidance acknowledging that incentive plans will materially change but note that companies should take a proportional approach to the impacts on shareholders and employees, as well as providing disclosure to shareholders on the rationale for making such changes

International responses

Prudential Regulation Authority (UK)

- The PRA has requested the seven largest UK banks and building societies to not pay cash bonuses to senior staff and material risk takers and also suspend dividends to be made in and for 2020. Banks were asked to take any appropriate further actions with respect to the accrual, payment and vesting of variable remuneration over the coming months.
- PRA has also urged UK insurers to think carefully about the decisions relating to variable pay in the context of prudential risk management.

European Insurance and Occupational Pensions Authority

- EOPIA have set further expectations than the PRAs letter, with specific requests for companies to:
  - Review current remuneration policies, practices and rewards and ensure that they reflect prudent capital planning in the context of the current economic situation.
  - Set the variable part of remuneration policies at a conservative level and consider postponement for these elements.
  - Explain the underlying reasons to their National Competent Authority, where firms consider themselves legally required to pay-out dividends or large amounts of variable remuneration should.

Appendix 1 - Checklist tool

The below checklist may be a helpful tool to guide a program of work for reward and performance leaders, in conjunction with remuneration committee chairs, as companies seek to stabilise at this point of the crisis. There will obviously be a different set of reward and performance tasks to undertake when companies, the sharemarket, and broader economy start to recover.

Salary adjustments and reviews

- ❑ Consider if adjustment is required to fixed remuneration (FR) to ensure affordability if business performance is adversely impacted, and/or to align to stakeholder expectations including:
  - ❑ Temporary in year FR adjustments
  - ❑ Whether FR increases will occur in the following year
- ❑ Consider whether approach will be segmented for employees with different demands (eg, critical roles where there is a significant increase to hours)
- ❑ Model the financial impact of potential changes to fixed remuneration and incentives
- ❑ Determine approach/response to any hardship issues

Adjustment of targets for FY20

- ❑ Review performance to date/forecast performance against key STI and LTI metrics
- ❑ Attempt to explain the degree of variance attributable to COVID 19 business impacts vs. BAU performance
- ❑ Determine the degree to which current performance metrics and associated targets remain relevant and appropriate
- ❑ If adjustments are deemed appropriate, develop a clear decision making process and rationale for any changes

Performance management

- ❑ Consider whether performance management should continue as normal, or consider possible changes (eg, no or consistent ratings for this year)
- ❑ Determine whether there is merit in emphasising different aspects of performance (eg, behavioural vs financial outcomes)
- ❑ Design process for conducting year end assessments given virtual working arrangements and whether tools and processes need to be simplified

Payment of bonuses – including executive bonuses

- ❑ Analyse current incentive schemes to determine likely payments/vesting based on year-to-date performance
- ❑ Consider the broader implication of reduced or no STI payment and vesting of LTI on foot of executive bonuses, and consider FY20 bonuses in context of FY21 – including any need to 'smooth' outcomes
- ❑ Identify roles or employee segments where differential treatment may be warranted either decreased, or increased bonuses (eg, frontline staff facing additional pressures and risks)
- ❑ Determine whether reductions in bonuses are warranted given business performance; industry; community and employee impacts; and/or stakeholder expectations
- ❑ Consider if the basis on which bonuses will be paid should be reviewed, eg, remove the focus on individual performance to a team/collective bonus
- ❑ Revisit governance and risk management (eg, deferral, gateways/modifiers, holding locks) and determine any necessary changes

Setting of targets for FY21

- ❑ Consider the appropriateness of setting targets in the current environment, explore other options (as outlined on page 4)

Award of LTIPs

- ❑ Analyse upcoming LTIP grants based on projected share price to determine the magnitude of difference in number of instruments granted compared to historical grants
- ❑ If share price has moved significantly (eg,more than 25%) on prior grant:
  - ❑ Consider reducing value of grant
  - ❑ Consider delaying LTI grant
  - ❑ Determine appropriateness of targets and metrics
- ❑ Review executive minimum shareholding requirements (if in place) to determine impact of recent share price movement on executive holdings

Optimising total reward offering

- ❑ Review existing benefit arrangements. Consider:
  - ❑ Removing/ suspending benefits that no longer have value (eg, gym membership)
  - ❑ Enhanced comms to benefits that have highest perceived value;
  - ❑ Redirecting funds from benefits that aren't providing value in current environment to further support staff working remotely

Stakeholder engagement

- ❑ Determine critical stakeholders: employees, regulators, investors and proxies, external market, ASX
- ❑ Develop consistent messages given decisions made on prior listed topics
- ❑ Agree engagement strategy and timing, including compliance with legal obligations
- ❑ Where required, engage with relevant parties to discuss any variation on contracts and enterprise agreements, and understand external stakeholder perspectives on pay

Governance

- ❑ Review existing framework and guidelines around the application of discretion (including malus and clawback) and target setting to ensure they are robust. If such framework does not currently exist, consider developing one to support the board/remuneration committee's decision-making

Appendix 2 - Detailed market responses already observed

ASX 100-listed market practice for COVID-19 remuneration adjustments (as at 20 April 2020)

Note, this list is not exhaustive. PwC will maintain a regularly updated version as more information becomes available, either via ASX announcements or the media.

Company	Executive remuneration adjustments		Non-executive Director fees adjustments	Broader employee population impact
	Fixed pay/salary	Incentives		
Auckland Airport	The Chief Executive and the Leadership Team h agreed to reduce their remuneration by 20% (understood to be until the end of the financial year but not specified)		The Board of Directors agreed to reduce their fees by 20% (understood to be until the end of the financial year but not specified)	Consulting with a large number of its employees around a proposal to reduce hours and salaries by 20%
Boral Limited				Support employees impact by temporary closures in certain areas with access to paid leave, unpaid leave, flexible and remote working arrangements (where possible) and assistance with accessing relevant government support
Cochlear Limited	CEO and President will take a 30% reduction in base salary and Senior executives will take a 20% reduction in base salary. This is for an initial 3 months	CEO and President will not receive any STI for FY20.	NED will take a 30% reduction in Board and Board Committee fees	
Crown Resorts Limited	20% reduction in fixed pay for CEO and certain senior management until 30 June 2020		20% reduction in Chair and NED fees until 20%	Approximately 95% of staff have been stood down on either a full or partial basis; the Crown has provided an ex gratia payment of two weeks pay to FT and PT employees stood down; and $1000 to casual workers. Employees can also draw down on existing annual leave and long-service leave entitlements
Flight Centre	Senior executives 50% reduction in pay at least until the end of FY20	No STI for executives during FY20	NED forgo 50% of their fees for remainder for FY20	6,000 (3,800 in Australia) support and sales roles will either be stood down temporarily or, in some instances, will become redundant. FLT will retain up to 70% of its global workforce. For those stood down temporarily, FLT will remain connected to them and will aim to bring them back to work as soon as travel bans are lifted. For others, FLT has assisted in placing them into other roles with other potential employers.

Appendix 2 - Detailed market responses already observed (cont.)

ASX 100-listed market practice for COVID-19 remuneration adjustments (as at 20 April 2020) (cont.)

Note, this list is not exhaustive. PwC will maintain a regularly updated version as more information becomes available, either via ASX announcements or the media.

Company	Executive remuneration adjustments		Non-executive Director fees adjustments	Broader employee population impact
	Fixed pay/salary	Incentives		
GPT Group		CEO has elected to to decline to receive an LTI grant in 2020 for the three year period for 2020 to 2022. No CEO incentive resolutions this year	The Non-Executive Directors have voluntarily elected to reduce their directors' fees by 20% for the next three months (April to June 2020)	
Harvey Norman Holdings Limited	Executive Chairman, CEO, CFO and the Executive Directors will forego 20% of their salaries for the next three months (April to June 2020)			
IDP Education	Detail not disclosed other than "reduction of senior staff salary"	Detail not disclosed other than "savings on short term incentives"	Detail not disclosed other than "reduction of board fees"	Detail not disclosed other than reduction in senior staff salary, use of paid leave, savings on short-term incentives and delayed hiring of new roles
Mirvac Group	20% reduction for CEO and eight executive leadership team to be reviewed in a few months time		20% reduction to be reviewed in "a few months time"	
Newcrest Mining Limited				Special leave arrangements for employees directly or indirectly impact by COVID-19
NewsCorp	Executives would take a significant pay cut - no further detail			
Oil Search Limited	Executive team have agreed to a 20% salary cut for the next 6 months		Board has agreed to a 20% salary cut for the next 6 months	100 jobs from Sydney and Anchorage offices
Qantas	Group CEO and Group Executive Management will take no salary for the remainder of FY20 Executives initially had a 30% reduction in pay, and this was increased to 100%	Annual management bonuses set to zero for FY20	Qantas Chairman and Board to take no fees for the remainder of FY20	2/3 staff temporarily stood down as of 19 March Employees stood down will be able to withdraw annual and long service leave, and other mechanisms will be introduced eg, leave at half pay

Appendix 2 - Detailed market responses already observed (cont.)

ASX 100-listed market practice for COVID-19 remuneration adjustments (as at 20 April 2020) (cont.)

Note, this list is not exhaustive. PwC will maintain a regularly updated version as more information becomes available, either via ASX announcements or the media.

Company	Executive remuneration adjustments		Non-executive Director fees adjustments	Broader employee population impact
	Fixed pay/salary	Incentives		
Qube Holdings Limited	Managing Director has elected to reduce fixed remuneration by 50% and Senior management also committed to significant reduction in their fixed remuneration. These measures, which include utilisation of annual and unpaid leave, will apply from 1 April to 30 June 2020.		The Board has elected to reduce fixed remuneration by 50% which will apply from 1 April to 30 June 2020.	
Scentre Group	Senior Leadership team (including Group CEO and Group CFO) has agreed to a 20% reduction in fixed remuneration. Similar arrangements are also being implemented throughout the Group's broader executive team. Commencing 1 May 2020 with Board reviewing these arrangements in August 2020.		Board agreed to a 20% reduction in base Board fees. Commencing 1 May 2020 with Board reviewing these arrangements in August 2020	
Sydney Airport Limited	20% reduction for CEO		20% reduction for Director fees	
Tabcorp Holdings Limited	The MD & CEO, David Attenborough, has taken a 20% reduction in his fixed remuneration until 30 June 2020.			
The Star Entertainment Group	For the remainder of FY20, CEO's salary has been reduced by 40%. Other senior executives also agreed to reductions (no % disclosed). Reductions remain under review during the period of business shutdown		NEDs fees have been reduced by 50% for the remainder of FY20. Reductions remain under review during the period of business shutdown	Temporarily standing down 8,500 members of staff (90% of the workforce), including termination of contractors and casuals obtained through labour hire agencies
Treasury Wine Estates Limited				TWE will manage workload based on business activity levels and seek to align remuneration levels with the corresponding level of business activity and government requirements going forward to safeguard the ongoing roles of employes until trading levels return to normal.TWE will provide employees with greater flexibility to access leave entitlements where appropriate

How can PwC help?

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

Sydney

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

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

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

Julia Nguyen
Senior Manager
Ph: (02) 8266 2618
Email: julia.n.nguyen@pwc.com

Frederick Guanzon
Senior Manager
Ph: (02) 8266 6326
Email: frederick.guanzon@pwc.com

Melbourne

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

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

Sarah Ryan
Senior Manager
Ph: (03) 8603 2959
Email: sarah.l.ryan@pwc.com

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