INDUSTRY EXPERTS SHARE INSIGHTS ON EXECUTIVE REMUNERATION

Implications and considerations for companies and their Boards

In April 2020, Morrow Sodali's Senior Director of Corporate Governance, Jana Jevcakova hosted a webinar with industry experts Pru Bennett and Talieh Williams covering the implications and considerations companies and their Boards need to be aware of during the global pandemic of COVID-19.

One of the highlights of this webinar was the expert insights surrounding executive remuneration and the factors Boards need to consider now and moving forward. During a crisis, it is the Board of a company that investors direct their attention to. Our experts spoke about Board accountability and Board communication and how Directors will be judged on how they handle executive remuneration during these unprecedented times.

Below is a transcript of the webinar covering executive remuneration and issues companies should take into consideration when reviewing remuneration packages. If you would like to view the webinar, please go to: https://morrowsodali.com/insights/valuable-guidance-for-companies-and-boards-looking-to-engage-with-their-investors

Jana: Good Morning everybody, and welcome to Morrow Sodali's webinar on guidance for companies and Boards who wish to engage with their investors. I am joined today by Pru Bennett and Talieh Williams. There is no doubt that we are meeting under unprecedented circumstances today, and we are seeing the impact of the COVID-19 situation on listed and unlisted companies both here in Australia and world-wide. The objective of today's webinar is to delve deeper into key topics of interest and questions you may have around what to do when it comes to engaging with investors and stakeholders in light of this situation.

One of the key topics of discussion is on executive remuneration, and I'd like to start with a question regarding the expectations of investors in terms of executive pay and what factors do Boards need to consider now and going forward?

Pru: I think remuneration committees will have a really tough start to the year. **I think the starting point for short term incentives (STIs) for FY20 is most likely going to be zero.** When an STI award is made, the remuneration committee and Board need to take a step back and look at how this will be received in terms of societal expectations. A lot of these companies will be receiving funding from the government so it's important to ask if it is appropriate to pay bonuses to senior executives. If we look back to the Banking Royal Commission, of the big four banks, one bank paid zero STIs whereas three of the other banks paid incentives. All of those three banks subsequently received a strike against them. These banks didn't see how civil society viewed their behaviour and how paying these awards was contrary to civil societal expectations. Any rewards made need to be clearly communicated and justified. This might seem unfair given how hard senior leadership teams are working at the moment, but **any STI needs careful consideration and communication.**

When it comes to long term incentives (LTIs), companies need to consider the **performance metrics for LTIs and if they are relevant given the change in strategy that may take place.** Should they be deferred? Should remuneration committees consider other ways to determine the quantum to be granted such as a 12-month VWAP as opposed to a 10-day VWAP? These are the types of things remuneration committees need to consider. Most importantly, remuneration committees need to step back and see if their approach is fair and review the impact on society as a whole.

Talieh: I agree. **The simple way to put it is to answer: Is this right? Does it look right? Does it feel right in the concept of community perception and fairness?** A lot of executives are working very hard during this period but need to reflect that many Australians have lost their jobs through no fault of their own. It may be possible that many executives will lose their STIs through no fault of their own, but in doing so will still be in a much better position than many other people in society. During the Global Financial Crisis (GFC), only around 10 companies did not grant STIs in the ASX200. I would suggest there would be far more than 10 companies not granting STIs this year.

Pru: In Australia and globally we are seeing **many CEOs taking pay cuts and some CEOs are taking zero pay until the end of the financial year.** It will be interesting to see how investors respond to that. Again, this highlights the importance of communication and communicating the rationale behind any decision. When considering remuneration, Boards need to ask themselves the question "Is this right?"

Talieh: The disclosure piece remains important, and will become even more important now as **we will see Boards exercising discretion, but we want them to be very clear about what they are doing and why.** If investors don't understand why, there will be a greater chance of investors voting against the remuneration report.

Pru: The structure of pay where it's one third fixed, one third STI and one third LTI – this structure doesn't work in a crisis. Maybe it's time for a real debate around the structure of executive pay because to have two thirds of pay subject to performance or at risk, in a crisis there is a high chance of their at- risk pay being taken away. Most executives arrange their lives around this pay model so if they lose their pay during a crisis, it will have a significant impact on their way of life. **Maybe having two thirds of pay at risk is too high.** Maybe the levels of fixed pay and quantum of at-risk pay need to be addressed. **There is not enough flexibility to allow clawbacks or reduction of payouts for executives to manage their own financial circumstances.**

Jana: In Australia, there is an ongoing debate around the purpose of STIs and LTIs. If we consider that STIs are an incentive and we take them away, how do we incentivise, especially in times of a crisis?

Pru: Senior leadership teams of ASX200 companies don't need to be incentivised. They should be rewarded for significant outperformance. **If a CEO is there and complaining that they need to be incentivised, I would question if you have the right person in the role. It is more appropriate to reward outperformance.** This is where we should have a discussion and debate about the model.

Talieh: There will be **a lot of scrutiny on any retention payments** at this point of time.

Jana: We are currently in the mini proxy season with some companies having their AGMs in May/June/

July. What is your advice regarding remuneration reports for these companies at the moment, as the reports reflect on the year just passed, not going forward? Is there an expectation that these companies undertaking their AGMs at the moment should address the issues and impact of COVID-19?

Pru: For companies with a 31 December year end, the calibration of pay, particularly STI outcomes, would have been done in January before the crisis developed to what it is now so it would be wrong to think remuneration adjustments have been made. These companies can, however, communicate remuneration structures and outcomes and the impact the current crisis may have on these going forward.

If you look at Santos, ESG issues aren't being dropped as a result of the current crisis. Two of their climate change proposals received over 40% and two directors had 12% and 14% votes against them which is high from an Australian perspective. Those companies can't expect a light touch. Communicating what's happening going forward and be clear about the impact on your remuneration going forward.

Jana: In terms of STIs and LTIs targets, many companies have already decided what they are. What is your advice to these companies going forward?

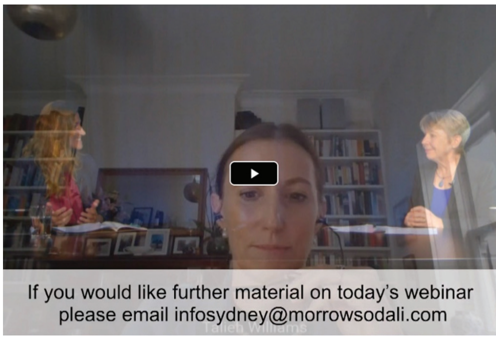
Pru: This is difficult to answer at the moment. **Companies need to rethink their strategies going forward. For LTIs, they could perhaps be deferred to the following year until Boards are in a better position to identify the right performance metrics going forward.** The performance rights, and the metrics attached to these that were agreed to two or three years ago, may not be right or relevant at the moment. If they are relevant, make sure there is a clear explanation as to why and how they are relevant in the current environment.

Jana: When determining quantum and allocation of equity grants, what is your view when companies have policies that need to be agreed to now, particularly when there has been a lot of volatility around the share price?

Pru: A 12-month VWAP is one solution/suggestion in order to negate short-term effects on share price. More work needs to be done on this with more discussion and debate by asking the remuneration committees whether this number is fair. How does this look in civil society? There is potential for both windfall gains and losses throughout this period. **Particularly where there are windfall gains, Boards need to consider using discretion and communicate how and why this discretion was used.**

Jana: I would like to thank both Pru and Talieh for your time today, and our listeners for joining us. In light of these unprecedented times, it is clear that proactiveness, as well as the messaging and transparency regarding the treatment of awards under executive remuneration frameworks will be critical. This will help to ensure both investors and stakeholders are well informed, and that they also understand the strategy and reasoning behind company decisions.

I just wanted to finish on a quote:
"**Tough times don't last too long. Tough people do".**
Keep healthy and safe. Thank you



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Jana Jevcakova

Jana advises listed company boards and management teams on all aspects of Environmental, Social and Governance (ESG) practices and disclosures. Jana is one of Asia Pacific's leading experts in corporate governance and proxy research and has advised many large domestic and institutional investors.

Jana was previously Director of Research, Australia for leading global proxy advisor, CGI Glass Lewis, and has deep expertise in engaging with ASX300 Boards of directors and executives. Jana is passionate about helping companies optimise their governance disclosures and enhance their investor relationships by applying best practice ESG.

Jana maintains deep relationships with asset owners and managers that informs Morrow Sodali's advisory and engagement work.

- Master of Professional Accounting - University of New South Wales
- Master of Commerce, Funds Management - University of New South Wales
- Graduate Degree in Finance, Banking and Investments - Technical University Kosice, Slovakia
- GRI Certified

Pru Bennett

Pru Bennett is a senior corporate governance advisor who assists Australian corporate clients on issues relating to stakeholder management, ESG strategies and stakeholder communications.

Until January 2019, Pru Bennett was a Managing Director at BlackRock and Head of BlackRock's Investment Stewardship team for the APAC Region based in Hong Kong. In that role Pru led a team that was responsible for engagement and proxy voting activities in relation to the companies in which BlackRock invests on behalf of clients.

Pru is an active participant in the public debate on corporate governance, stewardship and responsible investment and as such regularly speaks and writes on the importance of these issues for company performance and investment decisions. In 2018 Pru received the Asia Industry Leadership Award from 100 Women in Finance. In 2013, Pru was named as one of Australia's top 10 Women of Influence in Corporate Governance.

- Bachelor of Commerce - University of New South Wales,
- Member of the Institute of Chartered Accountants Australia and New Zealand
- Graduate of the AICD

Talieh Williams

Talieh was appointed as VFMC's Head of Investment Stewardship in February 2020.

Talieh is responsible for leading VFMC's approach to investment stewardship, active ownership and ESG integration across VFMC's investment portfolio.

Prior to joining VFMC, Talieh lead the ESG function at UniSuper for over a decade where she developed UniSuper's approach to responsible investment (encompassing active ownership and ESG integration across all asset classes). This also included developing (and overseeing) UniSuper's three dedicated sustainable investment options. In her role at UniSuper, Talieh also sat on the boards of the Australian Council of Super Investors, the Investor Group on Climate Change and the Responsible Investment Association of Australasia.

With 20 years professional experience, Talieh has also worked in management consulting, the oil industry and commercial legal practice.

- Bachelor of Laws (Honours)
- Bachelor of Planning and Design and a Master of Social Science (International Development)
- Graduate of the AICD