

Geoff Nunn & Associates - Governance and Board Specialists

# Executive Remuneration—Where to From Here?

*In this special update we focus on the challenging issue of Executive Remuneration Strategy. In 2018 shareholders voted down three of the Big Four Remuneration Reports and that of the AMP. How can boards re-design their executive remuneration strategy to reduce complexity and achieve balanced outcomes?*

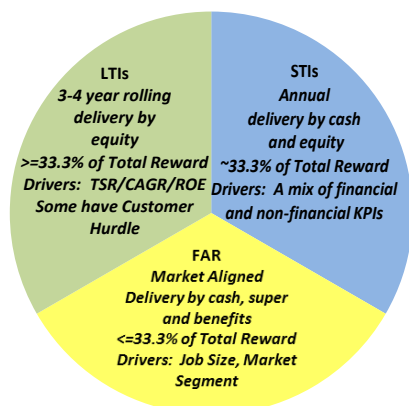
## Executive Remuneration - The Challenge for Boards

On 12 March, 2019 the NAB's Interim CEO (and incoming Chairman), Phil Cronican wrote to all shareholders. It was a letter of contrition where he focused on a number of key challenges for the Bank following the resignations of Ken Henry and Andrew Thorburn. First and foremost was the issue of rebuilding trust with all the Bank's stakeholders. Cronican acknowledged the enormity of this task.

He made special mention of the fact that shareholders had roundly rejected the 2018 Remuneration Report with the largest "No Vote" in Australian corporate history (88.4%). There was mention of re-balancing financial and non-financial metrics over the short and long term.



Boards, remuneration committees and CEOs across all sectors face considerable challenges when it comes to executive remuneration. The message that continues to emerge is that the current FAR/STI/LTI configuration will be largely retained albeit with a re-focusing of KPIs. Equity will continue to form a large part of the package with lengthened vesting periods. The following diagram illustrate the typical configuration:



This model was imported from the US in the early 2000s and has remained largely unchallenged in Australia since that time. It has been actively promoted by the major remuneration consulting and accounting firms. In combination with "Minimum Shareholding Requirements" of 100% to 500% (of Fixed Annual Remuneration) it endeavours, with the right KPIs, to align the executive's financial interests with those of shareholders. In some organisations non-executive directors are also required to hold up to one year's fees in equity in their organisation to similarly ensure their alignment.

In practice ever increasing regulation is required to govern the model and stem perceived and real excesses. Consider the BEAR, APRA Prudential Practice Guide - Remuneration and ASX Principal 8. Commissioner Hayne has recommended a stronger supervision role for APRA in the oversight of remuneration for executives in the Financial Services Sector and strengthening guidelines:

"APRA must bear steadily in mind that entities can and should use both the design and the implementation of remuneration and incentive systems to reduce the risk of misconduct. Misconduct can have significant consequences for financial soundness and stability. It undermines trust in the financial system."

*Banking Royal Commission Final Report Feb, 2019 p 345*

Anyone who has studied the annual Remuneration Reports of listed companies over the last few years will be struck by the sheer complexity of the models and lengthy reporting. Do we really need 50% of the Directors Report dedicated to executive remuneration?

We challenge boards, remuneration committees and CEOs to look beyond the current model and ask some difficult questions:

1. Is your current executive remuneration strategy closely aligned to the organisation's Core Purpose?
2. Does it sufficiently balance the competing interests of different stakeholder groups?
3. Is the model too complex? Would all stakeholders be better served by returning to a more straight forward approach?
4. Is there evidence to suggest that returning to a more basic model would negatively impact on various aspects of corporate performance?

## Executive Remuneration - Some Facts and Figures

Royal Commissioner Hayne rightly points out that there is no one size fits all when it comes to executive remuneration strategy. He suggests "Experimentation" to determine the right model for each organisation. We're not sure experimentation is the right word. The courage to challenge the orthodoxy might be more appropriate. He confronted boards, remuneration committee and CEOs directly:

**"Because it is the entities, their boards and senior executives who bear primary responsibility for what has happened, close attention must be given to their culture, their governance and their remuneration practices."**

*Royal Commission Final Report Page 4*

Figures from the Bank's 2018 Remuneration Reports tell the story:

### CEO Package Composition:

CEOs	FAR	STI	LTI
	% of Total Reward	% of Total Reward	% of Total Reward
Commonwealth Bank	26.00%	26.00%	48.00%
National Australia Bank	33.00%	67.00%	
ANZ Bank	33.33%	33.33%	33.33%
Westpac Group	34.00%	34.00%	32.00%
Bendigo & Adelaide Bank	65.00%	10.00%	25.00%

### Executive Team Package Composition:

Other Executives	FAR	STI	LTI
	% of Total Reward	% of Total Reward	% of Total Reward
Commonwealth Bank	26.00%	26.00%	48.00%
National Australia Bank	37.00%	63.00%	
ANZ Bank	33.33%	66.66%	
Westpac Group	34.00%	34.00%	32.00%
Bendigo & Adelaide Bank	60.00%	20.00%	20.00%

It is interesting that the Bendigo and Adelaide Bank places significantly less remuneration at risk although it does require part of the fixed component to be taken as deferred equity. Also of interest is the fact that most industry super funds have minimum at risk remuneration in their executive packages. Yet from a member perspective they generally outperform their financial services counterparts.

### STI Performance Drivers

Bank	Financial Drivers	Non-Financial Drivers
	% of Total	% of Total
Commonwealth Bank	60.00%	40.00%
NAB (Combined with LTI)	75.00%	25.00%
ANZ Bank	50.00%	50.00%
Westpac Group	60.00%	40.00%
Bendigo & Adelaide Bank	Not Disclosed	Not Disclosed

### LTI Performance Drivers

Bank	Financial Drivers	Non-Financial Drivers
	% of Total	% of Total
Commonwealth Bank	75.00%	25.00%
NAB (Combined with STI)	75.00%	25.00%
ANZ Bank	100.00%	0.00%
Westpac Group	100.00%	0.00%
Bendigo & Adelaide Bank	100.00%	Customer Hurdle

### Minimum/Mandatory Shareholding Requirements (MSR)

Bank	CEO	Other Executives
	% of FR	% of FR
Commonwealth Bank	300.00%	200.00%
National Australia Bank	200.00%	100.00%
ANZ Bank	200.00%	200.00%
Westpac Group	500.00%	\$1.2m
Bendigo & Adelaide Bank	Not Disclosed	

Over the last thirty years we've had to opportunity to work with a diverse range of organisations on the development of executive remuneration strategy. These have included listed and privately owned companies, government entities of all descriptions, NFPs and educational institutions. We've seen it all. And developed lots of innovative models. Are you up for the challenge of developing a new approach?

### The Offer

The executive remuneration strategy issues outlined in this Update have broad based applicability across all industry sectors. They reflect the contents of the Royal Commission's Final Report. Should you wish to avail of our expertise to assist your board and executive team review its approach to executive remuneration strategy call or email Geoff on 0418 595 107 or gtnunn@gna.net.au

### Geoff Nunn and Associates

Geoff Nunn & Associates was established in 1993 as an independent provider of remuneration and organisation services to the government and corporate sectors. We specialise in working with Boards and CEOs in the areas of executive remuneration strategy, corporate governance, board dynamics and renewal, governance structures. Advice has been provided to over 1000 organisations Australia, New Zealand and Singapore.



### Contacts

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