GEOFF NUNN & ASSOCIATES

Governance and Board Advisors

Special Issue | Board & Executive Remuneration in the Utilities Sector

August 2021

Board & Executive Remuneration

A Sector in Transition

We've been working in the Utilities Sector since the late 1990s. When the first round of corporatisations swept Australia we were fortunate to be able to work with one of the largest water companies to review their approach to executive remuneration in response to changed governance arrangements. This was quickly followed by remuneration strategy work with a prominent electricity and gas distributor which was being readied for full privatization. Since that time we have worked with over 60 utility companies across Australia and Singapore.

Each year we undertake a benchmark analysis of board, CEO and executive remuneration practice across the Utilities Sector in Australia and New Zealand. This year we expanded our database to cover 52 organisations in water supply; electricity generation, transmission, distribution and retail, gas production, pipelines and retail. A number of observations from a remuneration perspective are apparent:

1. Most utilities proceeded with review of Fixed Annual Remuneration for their CEO and executive in 2020 and are doing so again in 2021. A small number suspended the annual review. We know of only one CEO in the sector who took a pay cut in 2020.
2. The same is true of board fees. Many proceeded with modest upward reviews during 2020. Only one report a reduction of 20% while a few others held fees steady.
3. STIs plans continued to pay out at between 50% and 80% of maximum as CEOs and executive team generally performed well in challenging circumstances. LTIs were muted as TSR and ROE dipped for many listed energy based utilities.
4. The emphasis of corporate KPIs has shifted over the past eighteen months. Financial viability remains the key driver for private sector utilities however operational continuity and customer engagement have received increased emphasis.

The Renewable Revolution

In this Newsletter we discuss developments in executive and board remuneration across the utilities sector in Australia and New Zealand during 2020 and 2021. The market for capable executives across the sector remains competitive with CIO attraction presenting challenges.

Boards and remuneration committees will continue to exercise restraint in terms of increases to fixed annual remuneration. STI will be fairly buoyant for most during 2021 and LTIs will begin to recover.

Geoff Nunn & Associates

Geoff Nunn & Associates was established in 1993 as an independent provider of remuneration and governance services to the government and corporate sectors. We specialise in working with Boards and CEOs in the areas of board and executive remuneration strategy, corporate governance, board dynamics and renewal, and governance structures.

Our Services

- Board & Executive Remuneration Strategy
- Innovative Remuneration Solutions
- Board Advisory Services
- Board Governance Advice
- Facilitated Boardroom Dialogue
- Focused Board Renewal

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Lead the Way

Remuneration Strategy Design Imperatives

CEO and executive remuneration strategy design is all about balance and context. There is no one size fits all. The are, however, some guiding design principles which need to be followed if you are going to attract the best people. Energy and water are the lifeblood of the country. You need to have the best directors and executive teams running this critical infrastructure, investing in the future and developing innovative and world first solutions.

Design Considerations

1. Remuneration decisions need to be underpinned by sound and current remuneration information. You need to be "In the Market" if you are going to attract and retain the best directors and executives.
2. You need to maximize your investment in executive remuneration. If you under-invest you'll experience difficulty in attracting the best people. They know their worth. On the other hand, if you over-invest, that is, pay to much, you'll waste financial resources.
3. You need to minimize complexity. Overly complex models, and we see them every day, detract from the line of sight around those KPIs which underpin your business strategy and performance.
4. You need to communicate your executive remuneration strategy. Participants need direct involvement in setting the corporate and individual KPIs by which their performance will be assessed and rewarded.
5. You need the right governance protocols to ensure you comply with the relevant regulatory frameworks and stakeholder expectations.

Designing an effective executive remuneration strategy is creative process. Not an accounting exercise. The numbers are important but so is the message. If you position high in the market you send a message that it's really important that you secure the right executives . They will feel valued and appreciated. However if you pitch low in the market you may send the opposite message. Cost constraints aside the message that might be received is that you don't really value your executives. This is likely to have an unconscious demotivating effect.

The KPIs embedded in any performance related variable reward plan need to be achievable and have sufficient stretch to deliver a real sense of accomplishment if they are achieved. This should occur regardless of the amount of reward attached to the goal. When that new solar farm is finally connected to the grid executives should have real cause to celebrate.

The Governance Environment

Boards and Remuneration Committees are under scrutiny like never before. The Banking Royal Commission in 2018 and 2019 highlighted the pitfalls associated an unbalanced executive remuneration strategy.

The lessons from the Royal Commission apply equally to the Utilities Sector as does some of the principles underpinning APRA CPS 511. Here are some of the key governance imperatives:

1. Remunerations Committees need to operate beyond board, CEO and executive remuneration. The need to have a watching brief which covers the entire organisation and, in some cases, its outsourced providers.
2. Remuneration Committees need to ensure that KPIs driving STI and LTI plans for the CEO and executive team balance the interests of all stakeholders.
3. Remuneration Committees need to factor-in risk in making remuneration decisions. This included the risk of inappropriate conduct, reputational risk, financial risk and environmental risk.

The Remuneration Committee needs the right skill mix amongst its members including remuneration governance, performance management, business strategy and risk assessment. The Committee needs access to specialist remuneration advice and sound data upon which to make informed decisions and recommendations.

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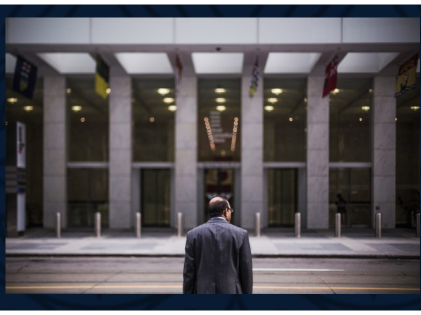
Board Remuneration
The Final Frontier



Recognising Governance Excellence

Directors fees need to be equitable and appropriate for the size of the company and the market in which it operates.

Directors bring their expertise to contribute to business success and ensure that governance obligations are met. They seek to focus management on the company's core purpose. This needs to be recognised and rewarded

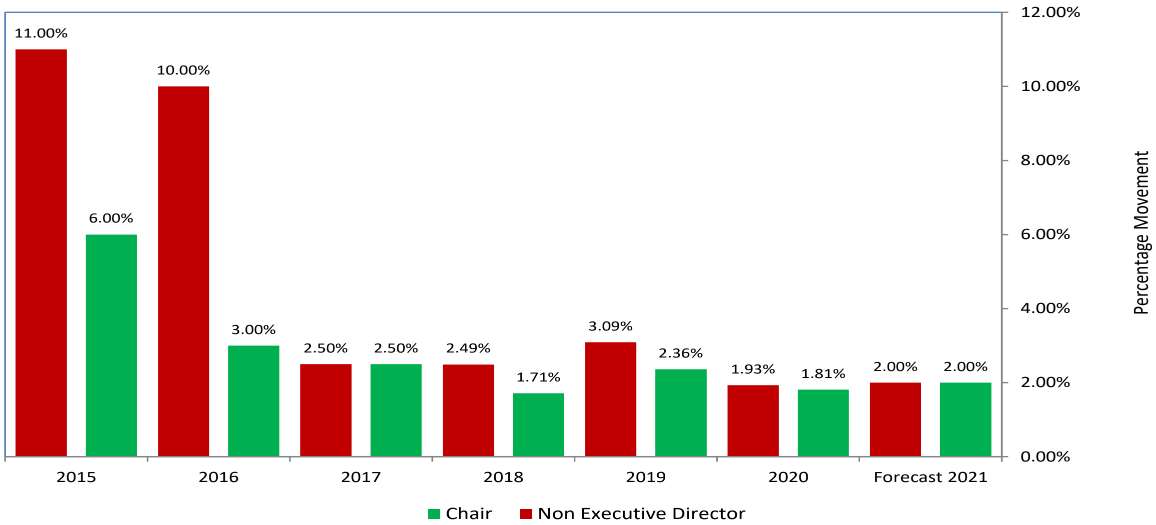
The role of the Board is critical to organisational success. Shareholders, regulators and other stakeholder continue to demand greater accountability from Non-Executive Directors (NEDs). Fair and equitable remuneration is essential. And yet this part of remuneration strategy is often neglected by directors themselves. Remuneration Committees devote considerable energy to the CEO and executive remuneration and often overlook their own board fees for the very considerable contribution they make to company success.

Our focused approach can help you get it right and ensure your directors receive fair and reasonable compensation for the expertise they bring to the boardroom table. Contact Geoff Nunn on +61418 595 107 or email gtnunn@gna.net.

The NED market has flattened over the last 5 years.. Our analysis indicates a steady as it goes approach. Last year (2020) movement dipped below 2.0% and we estimate that this trend will continue for 2021 & 2022.

A few factors to consider in formulating board remuneration strategy:

1. **There are distinct markets for non-executive director remuneration:** larger listed companies, privately owned corporations, government entities and SMEs all have very different NED remuneration practice.
2. **When setting NED fees boards need to ensure that they have access to up to date information and analysis.** The few board remuneration surveys that are available tend to show quite diverse practice. Specific data for your sector needs to be sourced where available.
3. **Board fees need to be reviewed annually.** Market movements generally tend to be more modest than those reported for the executive remuneration market. But not by much. Our analysis of movement in board fees over the last five years is set out below.



Directors fees need to reflect company size, scope and complexity of operations, the market in which the company operates and the skill sets required of NEDs.

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