GEOFF NUNN & ASSOCIATES
Governance and Board Advisors

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The Remuneration Governance Conundrum

A Remuneration Market Correction in 2020-2021?

By the time you read this newsletter the number of companies that have frozen or cut board fees and executive remuneration will have increased significantly. More will follow over the next two months. For most its more about appearances rather than making a material financial difference. On 13 March, 2020 Virgin Australia announced a 15.0% cut in board fees, a freeze to executive salaries and a zero set on STIs and LTIs. The amounts involved were insignificant when compared to $7.0 billion of debt and minimal cashflow. Administration was inevitable.

In our last advice we canvassed the possibility cuts and freezes might lead to a correction in the executive remuneration market. This now seems a reality. If a sufficient number of companies report a zero increase or a reduction in same incumbent remuneration then the market will flatten or go backward. Just the same as the housing market when the median house price falls. It could be quite significant when you take into account that many STI and LTI plans will either be set to zero by board decision or fail to activate because KPIs are not met.

Board & Executive Remuneration Reviews FY 2020?

In this environment boards and remuneration committees face a conundrum. Whether to proceed with the next annual board and executive remuneration review or affect a freeze. To answer this question you need to consider the perspective of your key stakeholders. Let's consider a few:

1. **Regulators and Industry Associations:** Various regulators and industry bodies have been suggesting, for some time, that the top end of the executive remuneration market is overinflated. APRA has been focused on increased governance oversight to curb what was perceived to be excesses in executive remuneration in the financial services sector. See draft APRA Standard and our commentary: https://www.gna.net.au/apra-draft-standard-cps-511

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In this Newsletter we talk about the dilemma facing remuneration committees in considering the 2020 annual review. We canvas the possibility of an executive remuneration market correction in 2020-2021 and discuss the recent "No" vote on the AMP 2019 Remuneration Report. See Pages 2-3.

A Word From Di Percy

How is your organisation coping with the crisis? As you expected? Why are some people stepping up while others struggle? To what extent is it a cultural factor? Find out in the *DNA of Culture: for Directors and CEOs*. Out soon.

Geoff Nunn & Associates

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

Our Services

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

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The Remuneration Conundrum

Board & Executive Remuneration Reviews FY 2020 (Cntd)

1. **Regulators and Industry Bodies (Cntd):** As mentioned in our previous newsletter APRA has issued guidance to major financial institutions to be cautious in paying STIs in and environment when dividends are being reduced, deferred or set to zero (as in the case of the AMP). Other bodies such as the ACSI have suggested that financial performance does not always justify STI and LTI awards.
2. **Owners & Investors:** On 8 May, shareholders voted down the AMP 2019 Remuneration Report. The "no vote" was a substantial 67.1%. A strong negative response to the size of the total remuneration opportunity for the executive team at a time when dividends have been cut to zero and the company recorded a $2.5b loss. It sends a clear message to boards and remuneration committees about the need for restraint . Organisations and board remuneration committees need to be mindful of the fact that investors will not respond well to significant increases or bonus payments when returns are low or non-existent.
3. **Customers and Clients**: Depending upon your client base you need to consider the wisdom of proceeding with board and executive remuneration reviews at this time. If your customer base is made up of the general public you need to be aware that many may have lost their livelihood and might be compromised financially. It would not look good to be awarding significant increases and paying bonuses in this environment. If however, your client base is mostly made up of corporates and individual who are largely unaffected then it may well be business as usual for board and executive remuneration reviews.
4. **CEOs & Executives**: Here the arguments are mixed. Some believe that financial rewards are an important ingredient in driving performance. Therefore to withdraw or defer rewards will prove demotivating to some at a time when critical engagement is needed. The counter argument is that most executives are driven by inner motivating factors. The challenges around navigating in this uncertain environment will prove to be a significant motivator. Our own experience of working with companies facing this dilemma supports the latter view.
5. **Other Employees:** If your organisation is asking other employees to accept some belt tightening it would be inappropriate to proceed with board and executive reviews. Nor would it be appropriate to make significant STI and LTI awards. Interestingly Australian universities are currently in negotiations for pay cuts of 5.0% to 15.0% to save jobs across the sector (source: ABC News 13.5.2020).

APRA Chair Wayne Byres

Board & Executive Remuneration Freeze?

If your organisation is considering a freeze or reduction to board fees or executive remuneration there are a number of factors to consider.

Factors to Consider in Decision Making:

- The direct financial impact of any downturn your business is experiencing.
- The cost of board and executive remuneration in relation to your overall cost base.
- The view of key stakeholder groups including shareholders, regulators, customers and suppliers.
- The relative position you have taken in the market. If you are paying in the upper quartile it may be appropriate to wind back.
- The balance of FAR/STI/LTI in executive packages. If "At Risk" components activate there may be a long term upside if share prices are down.
- The relative cost of delivering on vested STI and LTI amounts. Deferral may be an option.
- The relationship of board and executive remuneration to management and employees covered by enterprise agreements.
- The impact of any lay-offs or redundancies your organisation has had to undertake.

A Compromise Position

If your business is compromised in some way by recent events is may be best to defer the annual review for a period of six months and make a decision in December based on conditions at that time. Deal with anomalies only on 1.7.2020. Likewise defer decisions on STI and LTI awards even if thresholds are exceeded.

To discuss your decision process contact Geoff on 0418 595 107 or gtnunn@gna.net.au

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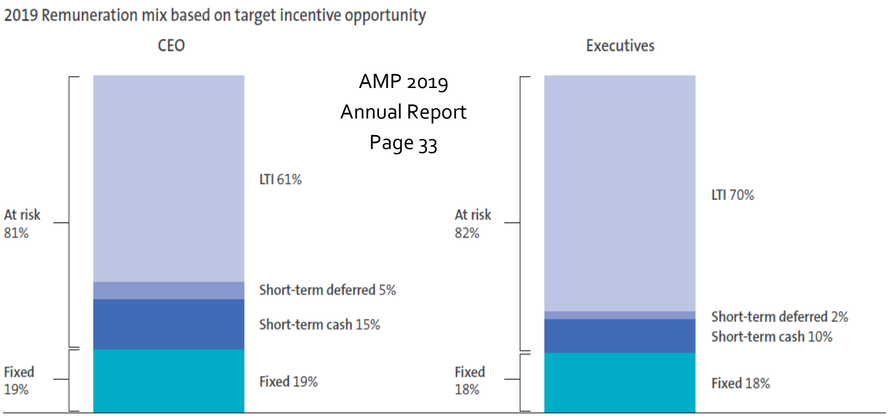
2020-2021 The Governance & Leadership Landscape

Board & Executive Remuneration: The AMP Case Study

Let's have a brief look at what the AMP Board took to shareholders on 8 May 2020. The 22 page Remuneration Report outlines an executive remuneration structure of some complexity: See below:



The bulk of the At Risk component is delivered via equity related vehicles. It constitutes 80%+ of Total Reward Opportunity. Somewhat surprisingly the STI awarded averaged around 30.0% of opportunity with the CEO running at 63.0% for 2019. This is despite a $2.5b loss and zero dividend to shareholders. See next page for statutory disclosures.

The drivers of STI are as follows:

1. Reset the AMP Strategy
2. Deliver on the 2019 Financial Plan
3. Separate AMP Life
4. Transform AMP Wealth Management
5. Prioritise Client Remediation
6. Strengthen Risk and Control Environment

Detailed metrics are not provided for the STI. LTIs have a TSR/CAGR hurdle against peer organisations. The CEO had a "Replacement Recovery Incentive" of 2.5m AMP share rights tied to continued employment and share price (50.0% @ $2.45, 100.0% @ $2.75). It did not activate and was cancelled by a 99.0% shareholder vote at the AGM. A strong message.

The AMP has minimum shareholding requirements for the Chair, NEDs, the CEO and other executives. For the Chair and other NEDs it is the equivalent of one year's base fee. For the CEO it is 300,000 shares and for other executives it is 60,000 shares.

The complexity of executive remuneration structuring adds little value in terms of delivery of results. The likelihood of most retail investors being able to fathom the detail is quite low.

David Murray AMP AGM 8.5.2020 West Australian

Does This Structure Add Value?

No doubt the AMP Remuneration Committee sought expert advice in developing this complex and somewhat unwieldy structure. The underlying premise would seem to be that the "At Risk" component in total does not fully activate until such time as there is a genuine recovery in share price and total shareholder returns. The reality is that this objective might take some time to achieve. While ambitious plans are in place it could be 3-5 years before the AMP is able to regain the confidence of its shareholders and clients.

Murray argued at the AGM that the AMP needed the brightest and the best to lead their recovery initiative and therefore has to pay accordingly. No doubt the AMP has a very capable and experienced executive team. However, given the magnitude of the challenges and negative shareholder sentiment it is unlikely that they will actually receive the amounts set out on the following page. The following quote from a just released Fidelity report might provide a useful guide to develop executive remuneration strategy:

"In the summer of 2019, the influential Business Roundtable of top US executives rejected the decades-old notion of shareholder primacy and instead advocated embracing wider stakeholder interests. So far, this has proven to be largely a statement of intent, but we think that will change.........

We expect not only investors, but society in general, will require firms to consider the welfare of their employees, communities and suppliers - ahead of short-term profits - as part of ensuring the long-term sustainability and resilience of their businesses."

The New Economic Order, Fidelity Int., 5.5.2020 p 10.

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AMP 2019 Annual Remuneration Report
Statutory Disclosure & STI Awards

7.3.1 Statutory disclosure

The table below shows the remuneration that was received by executives in 2019 as well as any incentive rewards that have been awarded but not yet received. This includes fixed remuneration and the value of current and previous incentive payments which have not yet vested.

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		Short-term employee benefits			Post-employment benefits		Share-based payments[4]		Long-term benefits		Termination payments	
		Cash salary[1] $'000	Cash short-term incentive $'000	Other short-term benefits[2] $'000	Superannuation benefits $'000	Other post-employment benefits[3] $'000	Rights and options $'000	Restricted shares $'000	Deferred incentive[5] $'000	Other[6] $'000	Cash payments $'000	Total $'000
Current disclosed executives												
Francesco De Ferrari Chief Executive Officer	**2019** 2018	**2,177** 156	**1,320** –	**1,711** 341	**22** 5	– –	**4,124** 375	**4,072** 399	– –	**5** –	– –	**13,431** 1,276
Megan Beer Chief Executive, AMP Life	**2019** 2018	**860** 861	**225** –	**56** 45	**25** 25	– –	**641** 618	– –	– –	**13** 9	– –	**1,820** 1,558
David Cullen Group General Counsel	**2019** 2018	**668** 426	**260** –	**8** 29	**25** 15	– –	**531** 45	– –	– –	**13** 88	– –	**1,505** 603
Jenny Fagg Chief Risk Officer	**2019** 2018	**877** 797	**200** –	**43** 159	**22** 57	– –	**283** 330	– –	– –	**2** 2	– –	**1,427** 1,345
James Georgeson Chief Financial Officer	**2019** 2018	**182** –	**78** –	**1** –	**7** –	– –	**115** –	– –	– –	**3** –	– –	**386** –
Helen Livesey Group Executive, People and Corporate Affairs	**2019** 2018	**802** 666	**280** –	**16** 55	**22** 22	– –	**617** 507	– –	– –	**17** 8	– –	**1,754** 1,258
Craig Ryman Chief Operating Officer	**2019** 2018	**846** 755	**200** –	**43** 54	**25** 25	– –	**552** 575	– –	– –	**40** 52	– –	**1,706** 1,461
Adam Tindall Chief Executive, AMP Capital	**2019** 2018	**878** 853	**1,442** 785	**30** 41	**25** 25	– –	**1,090** 1,272	– –	**639** 262	**19** 71	– –	**4,123** 3,309
Alex Wade Chief Executive, AMP Australia	**2019** 2018	**909** –	**400** –	**581** –	**39** –	– –	**392** –	**659** –	– –	**1** –	– –	**2,981** –

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	Maximum STI opportunity value $'000	% of maximum STI opportunity awarded	% of maximum STI opportunity not awarded	% of target STI opportunity awarded
Francesco De Ferrari	2,640	63%	37%	75%
Megan Beer	1,440	26%	74%	42%
David Cullen	1,120	29%	71%	46%
Jenny Fagg	1,440	17%	83%	28%
James Georgeson	1,120	31%	69%	50%
Helen Livesey	1,360	26%	74%	41%
Craig Ryman	1,440	17%	83%	28%
Adam Tindall[1]	n/a	n/a	n/a	n/a
Alex Wade	1,552	32%	68%	52%
Sally Bruce	1,280	21%	79%	34%
Gordon Lefevre	1,544	16%	84%	26%
Paul Sainsbury	1,280	0%	100%	0%
Fiona Wardlaw	1,544	0%	100%	0%

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