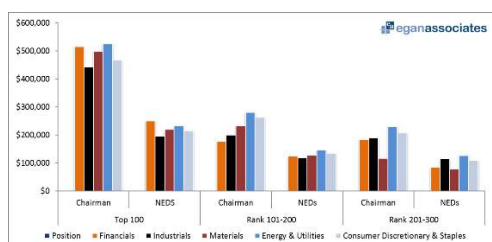


# Newsletter September 2018



## KMP Report: Non-Executive Directors' Remuneration ASX Top 300 & NZ top 50

Our review of Non-Executive Directors' (NED) remuneration covering the ASX 300 and the NZX 50 through to the end of the 2017 calendar year reveals generally modest fee increases.



## Lessons from Banking Royal Commission

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## ASIC Gives the Gift of Advice

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# KMP Report: Non-Executive Directors' Remuneration ASX Top 300 & NZ Top 50

[Our review of Non-Executive Directors' \(NED\) remuneration](#) covering the ASX 300 and the NZX 50 through to the end of the 2017 calendar year reveals generally modest fee increases. Increases appear to be more prominent at the level of Chairman than that of Director, with Directors' incremental fees being significantly influenced by an elevation in fees payable in certain committees.

With movement of the constituents in each of the ranked sectors on the ASX, a number of organisations that have progressed through the lower ranks into the ASX 200, or from the second 100 to the top 100, have not immediately adjusted the fees payable to Directors reflecting their increased market capitalisation and relative standing on the ASX.

Directors' fees are not adjusted with any direct alignment to movement in executive reward where there tends to be a lag with the frequency of increase in Directors' fees being every two or three years rather than annual in many instances. This fee adjustment strategy among listed companies is not broadly adopted by governments which adjust Directors' fees modestly on an annual basis, generally reflecting the underlying level of inflation.

In the 2017 calendar year, inflation in Australia rose to 2.1%. The mid-year Fair Work Commission's adjustment to the minimum wage was \$18.93 per hour or a 3.5% increase. Unemployment levels remained broadly consistent over the period and while there has been employment growth the level of underemployment has remained broadly consistent over the last 24 months. Our data also reveals that the frequency of Directors' meetings, both as a committee and as a Board, have also remained relatively stable. Australia's GDP growth from December 2016 to December 2017, was a seasonally adjusted 2.4% change, and the trend from the same period was 2.6%.

Overall, the consumer price inflation (CPI) rose to 1.9% from the December 2016-2017. Prior to this, the December quarter during 2015-2016 was 1.5%. The AUD/USD exchange rate in December 2016 was 0.7236 and increased in December 2017 to 0.7800. The Australian Dollar historically reached an all-time high of 1.10 during July 2011 and was a low of 0.48 in April of 2001.

The employment trend in Australia from December 2016 to 2017 increased in all states and territories, excluding South Australia, which decreased by 200 persons. The highest increases were in New South Wales (up 11,55 persons) and Victoria (up 5,600 persons). There was an increase with the unemployment trend rate, which in the Northern Territory was up 0.3 percentage points (pts), and Western Australia up 0.1 pts. In other states the unemployment rate was unchanged.

The wage price index trend from December 2016-2017 was 2.1%. In the public sector it was 2.4% and the private sector it was 1.9%. From the December quarter to 2016 – 2017 the company operating profits (CGOP) trend was 5.2% and the seasonally adjusted trend was 4.3%.

Outside of the economy, gender diversity has been a strong Board theme. Although diversity improvements have been recorded by Boards, they have decelerated, causing the

AICD to raise concerns that its target of having 30% of ASX 200 Board seats filled by women will not be met by 2018. Gender diversity continues to be a core topic among Boards, as well as the culture of the Board and the company. There have been several concerns of culture with the proceedings of the royal commission into the misconduct in the banking, superannuation and financial services industry.

Former ASIC Chairman Greg Medcraft in the revelations of the banking royal commission said,

*"I think it comes down to culture and ethics. When I raised culture as an issue three years ago, someone said to me 'culture is not the responsibility of the board.' But the reality is, a business's values are at the centre of everything and the tone is set from the top".*

Increasingly, Boards will need to consider not only prevailing legislation but community expectations when making decisions and disclosures in these areas. In general, the process of remuneration setting has been a challenge for Boards. Directors have railed against executive remuneration's complexity and questioned whether the current incentive structure works. The tension between Boards and investors who either want or do not want the inclusion of non-financial performance hurdles have also caused a high level of angst.

Egan Associates believes that Directors will need to put more time into identifying, implementing and disclosing the correct remuneration structure for their organisation.

## **New Zealand**

New Zealand's annual net migration in 2017 decreased by 600 people as this figure was 70,600 in the December 2016 year.

New Zealand's cash rate is marginally higher than Australia's at 1.75%. The cash rate has seen a steady fall since January 2015, when it was 3.5%. The GDP annual growth in December 2016 was 4% and in December 2017 the annual growth was 2.8%.

On the 1st April 2017 the minimum hourly wage rate was \$15.75. The seasonally adjusted annual change in the unemployment rate in September 2017 was -0.3 pts. During this same period the annual change of the employment rate was +1.2pts, and the participation rate was +1.0pts.

In terms of the Boardroom, New Zealand Directors are facing similar discussions to Australian Directors on how to foster the long-term sustainability of their business, how to promote a positive culture that reduces risks as well as attracts and retains talent, and how much companies should disclose to meet community expectations without endangering company confidentiality.

In New Zealand, there continues to be concern over whether remuneration levels are adequate to attract candidates with the necessary skills to ensure best practice corporate governance.

The NZX's Corporate Governance Code is the same as it was last year with recommendations on;

- The creation of a code of ethics;
- Board composition and performance;
- Reporting and disclosure;
- Remuneration;
- Risk management;
- Auditors; and
- Shareholder rights and relations.

It will be interesting to see the effect of additional disclosures on the level of executive remuneration. If detractors of disclosure are correct, it should see significant pay rises as executives discover the salaries of their counterparts and ask for "me too" pay rises.

You can download the full report using this [link](#).

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# Lessons from Banking Royal Commission

One of the questions raised by Rowena Orr, QC in the Banking Royal Commission's session which took place on 27th April 2018 was "How can companies incentivise good quality advice where the best advice is to do nothing?"



This question embraces a number of technical issues that a remuneration professional needs to consider when designing an incentive framework, such as including non-financial gateways; using clawbacks; selection of the relevant Key Performance Indicators (KPIs); balancing financial and non-financial KPIs and the degree of Board discretion, to name a few. In

addition to these factors, a more structural consideration requires defining what "a fully performing employee" really means and how success is measured in an organisation. In essence, this is a reflection of a company's culture.

Rowena Orr's question also highlights the increasingly blurring line between the importance of financial and non-financial KPIs. The weighting of financial KPIs for sales positions are inevitably higher than the same for non-financial KPIs. Incentives or performance pay has always been perceived as a means to an end. By their very nature, they constitute the vital supplements to the salary of any sales role in any sector. However, the discussions which took place during the Banking Royal Commission sessions have once again unearthed the potentially "Machiavellian" impact of employee incentives.

## **There are two sides to every story**

If the best advice that a financial planner could provide is to sell nothing, then how can a financial institution measure the quality of this advice? What would be the cost of doing nothing for a company and who would bear the ultimate cost of that option? One could argue that market dynamics change constantly, and no one could predict that 'doing nothing would yield the best outcome' as there are also restrictions due to inaccessibility to all relevant information at any given time and everchanging market conditions.

Further to the Future of Financial Advice (FOFA) reforms and the Sedgwick Review, the banks and other financial institutions have been reviewing their existing sales incentive schemes applicable to financial planners and retail banking employees. A Net Promoter Score (NPS) has been widely used by the majority of these institutions and, yet, the recent events have indicated that as a KPI, NPS has not fully passed the test of reliability.

One could also argue how often 'doing nothing' would be deemed as the best advice. If doing nothing is the right thing then this would also reflect a potential issue with the solutions available to consumers at the time of advice.

## Is there a way out?

From a 'pure' remuneration perspective, applying clawbacks or malus clauses and non-financial gateways could present potential improvements to incentive design for positions under review. If effectively used, non-financial gateways could constitute a sound threshold where conduct of potentially unacceptable behaviour would prevent incentive payout although a plan participant has met his/her financial KPIs. Ideally, internal compliance, reward governance and corporate governance teams should be given the appropriate level of authority to investigate potential areas of non-compliance.

Alternatively, stretching the performance period of incentive plans which are applicable to sales positions to more than one year could be a consideration to strengthen the quality of customer service or advice. If not already included as a KPI, quality of advice and the longer-term impact of advice could be used as KPIs for positions under review. However, adherence to these measures will continue to depend on the very essence of the human element, personal ethics of each employee and company culture.

Ongoing discussions and findings signal a requirement for a paradigm shift for financial institutions to measure 'how' outcomes were achieved rather than 'what' was achieved.

This article is written by Zoe Lockyer. If you have any queries or wish to discuss our views further, please get in touch with Zoe at [zlockyer@eganrem.com](mailto:zlockyer@eganrem.com) or 02 9225 3225.

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# ASIC Gives the Gift of Advice

Companies need to identify ways to make annual general meetings (AGMs) transparent, ethical, and effective. To ensure that best practice occurs during AGMs, ASIC reviewed the 2017 Annual General Meeting Season, and proxy adviser engagement practices. ASIC observed the engagement practices of four proxy advisers, CGI Glass Lewis, ISS Australia, Ownership Matters, and Australian Council of Superannuation Investors and commented on ways that companies can improve their proceedings with shareholders.



ASIC had some concerns about the engagement practices of proxy advisers noting that companies were given short response times to define key issues, and that proxy advisers did not correct errors within their report.

Other areas of concern that ASIC reviewed were;

- CGI Glass Lewis has a 'blackout' period for engagement, compared to other proxy advisers.
- There is only one proxy adviser (ISS Australia) which publishes its drafts for company review before AGMs.

ASIC reviewed 80 proxy adviser reports. (See Table 1 below)

**Table 1: Engagement with companies who were the subject of reports**

Observation	Number of cases
Engagement occurred	65 (20 of these cases related to reports that were self-selected by proxy advisers)
Proxy adviser offered to engage but company declined or did not respond	11
Company requested engagement but proxy adviser declined (this included when the proxy adviser was unavailable to meet)	2
There was no contact with the company	2
<ul style="list-style-type: none"><li>• There were instances of both companies and proxy advisers initiating engagement.</li></ul>	

\*source from ASIC review [of proxy adviser engagement practices. Pg.6.](#)



ASIC acknowledges that proxy advisers' engagement policies reflect the following;

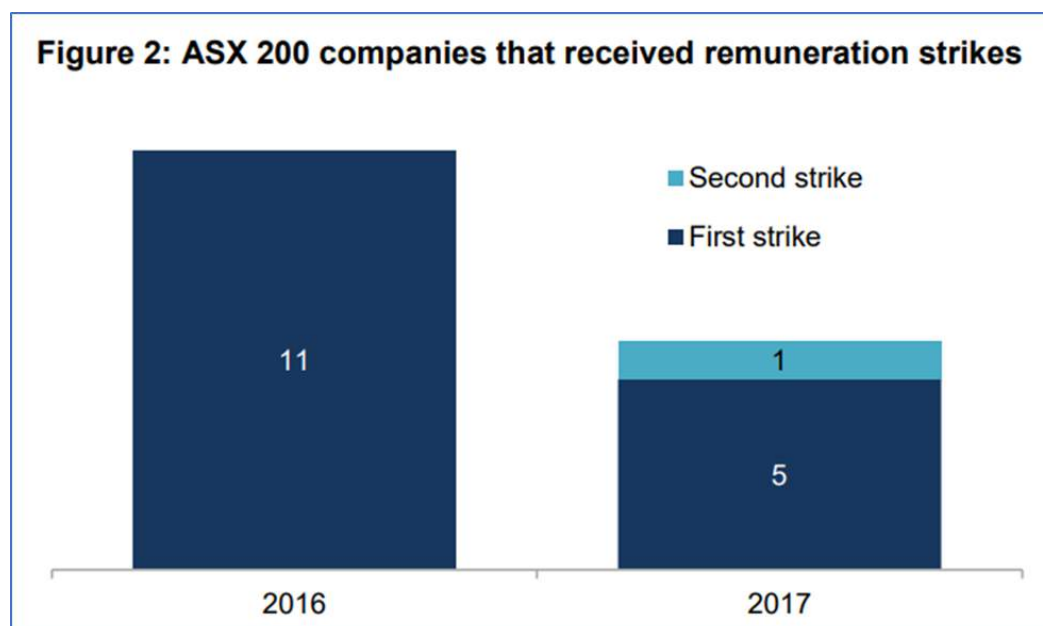
- They strive to engage with companies and make their report accessible either before or after publication,
- Are active with receiving feedback from companies if there are factual errors and need to resolve them,
- Continuously strive to be independent.

Overall, ASIC found that the current practices covered engagement sufficiently.

For investors to understand the market, proxy advisers were encouraged to have a balance between managing companies and organising their timing constraints. ASIC suggests the following guidelines for proxy advisers to follow;

1. Give clear explanations of the policies in terms of engagement,
2. Voting guidelines must be accessible,
3. Companies need to be informed of any 'against' recommendations along with the report. There should be explanations for all recommendations,
4. Reports must be precise for companies that are the subject and,
5. If there is feedback in their reports, steps should be taken to change the errors as soon as possible.

To ensure that the ASX 200 companies are following best practices, ASIC advised that companies needed to stay informed on proxy advisers' perspectives. Among the ASX 200 companies, the eleven first strikes in 2016 was reduced to five in 2017 (see Figure 2).

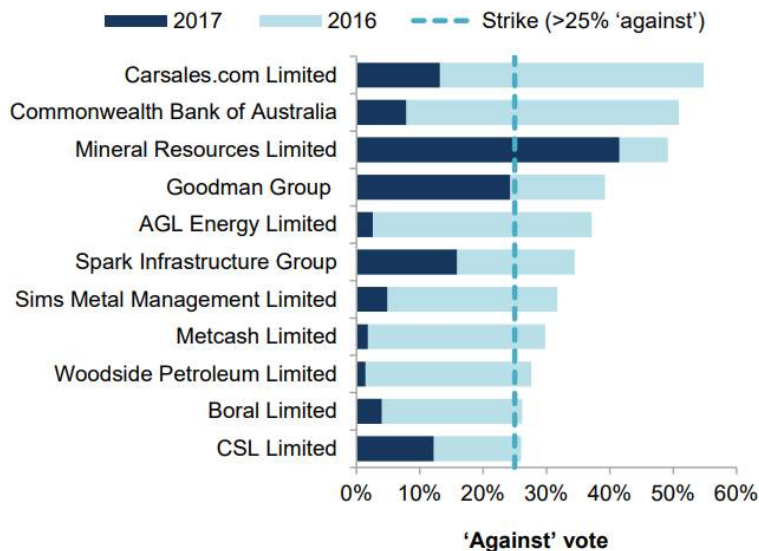


\*Sourced from [ASIC's Annual general meeting season report. Pg. 6](#)



Although there had been a decline in the number of strikes that ASX200 companies received over the 2016 and 2017 years, there had been an increase in the number of companies receiving a close call 'against' vote. This ranged between 20-24% in 2017 (See figure 3).

**Figure 3: 'Against' votes on the remuneration report in 2017 for ASX 200 companies that received a first strike in 2016**



\*Sourced from [ASIC's Annual general meeting season report. Pg. 6](#)

According to ASIC there were several reasons for companies receiving 'against' votes on the remuneration report. This included excessive quantum of pay, the structure of pay and lack of clarity around policy.

### Incentive Plan Design

For companies to be successful ASIC encouraged them to design their incentive structures to raise long-term company value. This might also involve the use of non-financial targets. Remuneration structures should be clear to ensure objective measurement of performance.

Companies' incentive structures should be transparent and disclosed in their remuneration report. ASIC believes that if companies follow these suggestions, it will help shareholders to have a clearer understanding of performance-based payments.

## Other Areas of Consideration

In its report, ASIC also evaluated ways that companies could create meaningful engagement with shareholders during AGMs. They found that companies were considering restructuring their AGMs using advances in technology to improve engagement with shareholders.

They suggested that there were other areas that needed to be restructured at AGMs. A key area of concern for ASIC was changing the resolution. ASIC identified that 25 companies in the ASX 200 continued to make a resolution through a show of hands, instead of a poll.

Their concern for using a poll rather than a show of hands was to ensure that all shareholders could vote if they were unable to attend the AGM. ASIC explains;

*“We strongly encourage companies to adopt a poll on all resolutions as a matter of course, as good corporate governance. Polls more democratically reflect the principle of ‘one share one vote’ and reflect the wishes of shareholders attending the meeting as well as those who have voted by proxy.” Pg. 15.*

Although most companies developed strategies to engage with shareholders, some did not create effective structural changes for AGMs.

ASIC’s report gives insightful advice to companies and shareholders and contains useful recommendations for proxy advisers to ensure that AGMs are meaningful for companies and their shareholders.

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# About Us

For more than 25 years, Egan Associates has advised leading organisations and emerging enterprises in Australia and New Zealand on the remuneration of Board Directors, executives and key staff members, as well as performance management, corporate governance and Board effectiveness.

Our Services include:

- **Remuneration reviews and benchmarking:** for CEOs, executives, senior management and professional positions, including specialist roles
- **Annual incentive plan structures:** advice on performance criteria, target and maximum payment levels as well as deferral and clawback provisions
- **Long term incentive plan structures:** advice on participation, performance hurdles, equity instruments, valuation and allocation, as well as provision of performance monitoring services
- **Corporate transactions / IPOs:** assistance transitioning pre-IPO reward arrangements into the listed company environment (or any other corporate transformation) considering issues including escrow provisions
- **Government pay reviews:** assistance at federal, state and local level in administrative, policy and corporatised environments on reward for senior executives, professional and administrative staff, and governing Boards
- **Board fee reviews:** benchmarking Board fee levels, including Chairman and Director retainer fees, Committee Chairman and member fees and fees for adhoc engagements.
- **Board effectiveness:** assistance with Board reviews, Board skills matrices, scenario planning and Board documentation.



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