

Australian Banks

Major Bank AGM Season – Remuneration “Heat Maps”

- **Remuneration practices generally improving...** — While changes this year are quite small – a reduction in maximum STI payouts at ANZ, and introduction of mandatory minimum shareholdings at CBA and NAB – they are generally in the right direction.
- **...though progress is very slow** — There are still many areas where the link between staff incentives and individual performance delivered is completely opaque with specific goals and performance not disclosed. STI and LTI payments, relative to base pay remains, tightly bunched, with most executives at most banks achieving total IFRS-based remuneration of quite close to 3x base pay, irrespective of returns to shareholders, or individual achievements.
- **STIs lack goal transparency and alignment** — None of the major banks disclose targets or detail individual executive performance, and each apply so-called “cash profit” metrics, despite its lack of alignment with shareholder value creation. CBA does not issue any short-term incentives in equity form, unlike peers.
- **Group achievements swamping individual STI contributions** — The average dispersion of STI awards as a % of base salaries is low for each bank. This suggests the largest component of STI awards relate to Group goals and achievements, with individual performance a less prominent component.
- **Total comp still skewed to short-term payments** — Potential LTIs are less than STIs for executives at all banks. We question whether this produces the correct incentives as regards long-term shareholder value creation.
- **LTIs still paid if or when shareholders lose** — No bank applies an absolute TSR threshold meaning shareholders can suffer long periods of poor performance whilst executive awards continue to vest.
- **LTI peer groups generally not demanding** — ANZ, CBA and NAB test TSR for at least part of their awards against broad peer groups (e.g. ASX50, ASX20) despite significant structural benefits which the banking sector has over most others in Australia. In ANZ’s case, this change was made in FY13. WBC tests 50% of LTI awards against undisclosed “cash” EPS hurdles.

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Bank STI plans vs. investor preferences

What do investors want as regards STI?

Figure 1. Typical attributes of STI plans sought by investors

Attribute	Compliance from the major banks
Extra bonus should be paid for meeting specified short-term goals	Met
STI goals should be transparent to investors, unless considered commercial in confidence	Very poor compliance. Most of the majors provide detail on the subject areas, but nothing on either the quantum of the goal or the outcomes versus these goals.
STI goals should cover both financial and non-financial measures	Met
Explain measures chosen and how they relate to companies short term strategies	Mixed disclosures; most of the majors assume that it is sufficient to identify the general nature of goals, without showing how they link to short-term strategies.
Maximum amounts payable under STI should be disclosed	Met
Maximum STI should be less than maximum LTI	Nobody meets
Disclose hurdles for success and amounts payable at each hurdle point	Not met
Disclose performance measures achieved by each KM P	Not met at individual level; some commentary on group goal achievements; no explanation as to how much of STI is at risk from achievement of an individual's goals
Disclose STI remuneration by each KMP	Met
Defer significant % of annual STI into equity vesting over some years	Partially met - full vesting within 2 years is the norm
Reward individual KMP against their specific achievements	Very little dispersion of payments as % of base – a "very tight" bell curve

Source: Citi Research

What do the major banks deliver?

- All STI plans fall well short of transparency as to specific goals, hurdles, and the extent to which of the key performance measures for each Key Management Personnel (KMP) have been met.
- No bank provides any information as to how much of an individual executive's STI target relates to the individual's performance and how much relates to group level performance.

Figure 2. Major bank STI plans – FY13

	ANZ	CBA	NAB	WBC
Target % base	1x for CEO, 1.2x for other KMPs	1x	1x	1x
Upper multiple of base salary payable	2x for CEO, 2.4x for other KMPs	1.5x	2x for CEO and other KMPs ex CRO which is 1x	1.5x
Disclosure of key metrics	Only broad nature and FY13 outcomes in aggregate are disclosed	Only broad nature and FY13 outcomes in aggregate are disclosed	Only broad nature disclosed	Only broad nature disclosed
Disclosure of threshold steps	No	No	No	No
Disclosure of outcomes by KMP	No (only disclose amount paid)	No (only disclose amount paid)	No (only disclose amount paid)	No (only disclose amount paid)
Use of so called "cash" profit metrics	Yes	Yes	Yes	Yes
% of STI paid in equity instruments	50% of amount above \$100k	0% (deferred as cash plus interest)	50%	40%
STI deferral period	50% 1 year, 50% 2 years	50% 1 year	50% 1 year, 50% 2 years	50% 1 year, 50% 2 years
Option to receive deferred shares as cash	Yes	n/a	No	No

Source: Company Reports

- There have only been two instances in the last 6 years where any major bank paid average STI incentives <100% of base pay (NAB in FY12 at ~93% of base and in FY13 at ~93% of base).
- Reliance on "cash profit" metrics, despite limited link between "cash profit" and Common Equity Tier 1 generation (the driver of total shareholder returns through dividends and business growth – refer [Mythbusting III: "Cash Profit" ≠ Bank Capital Generation](#)).

Bank LTI plans vs. investor preferences?

What do investors want?

Figure 3. Typical attributes of LTI plans sought by investors

Attribute	Compliance
LTI should not be viewed just as a retention mechanism	Met
Preference for TSR vs. peer group, providing peer group can be reliably determined	All majors use wider peer group of financial stocks, arguably making hurdles easier to meet, given that majors are part of a stable oligopoly with considerable scale advantages over many of the other peer group stocks
Hurdles based on EPS growth and ROE are also appropriate in some circumstances	
LTI awards be available to be achieved each year	Met
When the board's rem committee exercises discretion within announced schemes these should be reported	Not known
Hurdles for LTI awards should involve above median performance	All require TSR component to be at 50% peer group, though Australian banks are generally able to outperform the peer groups that have been chosen because of the concentrated nature of Australian banking competition.
Maximum awards should be only for exceptional performance	
Avoid cliff vesting; preference for sliding scales of vesting	Generally met
Rem form should discourage excessive risk taking by execs	Generally met via deferral periods
Adjusted or underlying accounting measures are appropriate where elements of revenue and expense are outside the influence of management	
Where underlying measures are used, rationale should be provided	No rationale produced for WBC use of so called "cash profit" metric, other than it produces a smoother profit outcome. The explanation should be on the basis of alignment to shareholder returns, on which "cash profit" can never be as well aligned as Regulatory Adjusted Profit.
Should be based on above average corporate performance, suitably risk adjusted, with performance metrics stress tested	
Dual performance hurdles recommended - both absolute and peer group relatives	Not met - though criteria is not considered as important by some investors

Source: Citi Research

What do the major banks deliver?

Figure 4. Major bank LTI plans – FY13

	ANZ	CBA	NAB	WBC
Upper multiple of base salary payable	1x for CEO, 0.5x for other KMPs	1x	1x for CEO, 0.5x for CRO and 0.86x for other KMPs	0.94x
Granting of individual LTI rights irrespective of individual's performance	Yes	Yes	Yes	Yes
Disclosure of key metrics	Yes	Yes	Yes	No (TSR disclosed, "cash" EPS is not)
Disclosure of threshold steps	Yes	Yes	Yes	TSR disclosed, "cash" EPS is not)
Absolute TSR threshold	No	No	No	No
Relative TSR percentile hurdles	Yes	Yes	Yes	Yes
Relative TSR peers	50% AMP, ASX, CBA, IAG, MQG, NAB, OBE, SUN, WBC, 50% ASX50	ASX top 20 ex resources and CBA	50% tested against ASX50, 50% tested against sample of ASX200 financial stocks	AMP, ASX, ANZ, BEN, CBA, IAG, LLC, MQG, NAB, SUN
Use of so called "cash" profit or "cash" EPS hurdles	No	No	No	Yes
Disclosure of all hurdles	Yes	Yes	Yes	No (TSR disclosed, "cash" EPS is not)
Disclosure of outcomes by KMP	Yes	Yes	Yes	Yes
% of LTI paid in cash	0%	0%	0%	0%
% of LTI in equity instruments	100%	100%	100%	100%
Dividends received on unvested instruments	No	No	No (from FY12 onwards, prior awards still pay dividends to KMPs regardless of vesting)	No
Option to receive deferred shares as cash	Yes	Yes	No	No
Deferral period for LTI vesting	3 years	4 years	4 years (or 5 years if not vesting after 4)	3 years

Source: Company Reports

What is new this year?

- There were significantly fewer changes to remuneration plans in FY13 (Figure 5) than we saw last year (Figure 6).

Figure 5. Changes to remuneration structures in FY13

Changes	Comments
ANZ	
Maximum STI opportunity reduced from 250% to 200% of target	Ratio remains higher than peers, given average target is a higher multiple of base on average
Introduction of ASX50 as TSR comparator group for 50% of LTI award	We believe the relevant benchmark should be peer major banks, given the benefits which the industry enjoys relative to most other sectors
CBA	
Introduction of mandatory shareholding policy from FY14, requires CEO and Group Executives to accumulate CBA shares over a 5-year period equal to 300% of fixed remuneration for CEO and 200% of fixed remuneration for Group Executives	A welcome change
NAB	
Introduction of mandatory shareholding policy from FY14, requires CEO and Group Executives to accumulate NAB shares over a 5-year period equal to 200% of fixed remuneration for CEO and 100% of fixed remuneration for Group Executives	A welcome change
WBC	
n/a	n/a
Source: Citi Research	

Figure 6. Changes to remuneration structures in FY12

Changes	Comments
ANZ	
Mandatory deferral thresholds for STI payments reduced from \$200k to \$100k	Part of broader industry trend towards greater deferrals
Any equity awards which vest may be paid in cash instead of shares	
CBA	
No changes	
NAB	
New STI award deferral now paid as performance rights rather than shares so KMPs do not receive dividends on unvested awards	Finally now aligned with institutional investors attitudes
New LTI now rights-based award rather than share-based award so KMPs do not receive dividends on unvested awards	Finally now aligned with institutional investors attitudes
New LTI award hurdle now 100% TSR rather than 50% TSR and 50% so called "cash profit" metrics	Welcome change after listening to investor concerns
New LTI awards performance period extended from 3 to 4 years	In line with trend towards longer deferrals
WBC	
CEO and other KMP target pay mix aligned to 34% fixed, 34% STI and 32% LTI (LTI increased from 29% for CEO and 17% for other KMPs in prior year)	Change in the right direction as WBC was unduly biased towards STI
Reduced maximum STI opportunity to 1.5x target from 2.0x target	
Source: Citi Research	

Appendix A-1

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