



ASIC
Australian Securities &
Investments Commission

INFORMATION SHEET 245

Board oversight of executive variable pay decisions during the COVID-19 pandemic

This information sheet (INFO 245) sets out practical guidance to support board oversight and the exercise of discretion on the variable pay outcomes of large listed companies' most senior executives (cash and/or equity). However, governance is scalable and many remuneration governance principles can be adopted by a broader range of listed companies and in any market.

This high-level guidance is informed by our review of remuneration governance practices across 21 ASX 100 companies. In addition to providing feedback directly to these companies, we have chosen to release this information sheet now to assist boards of other listed companies to navigate decisions on executive variable pay in the context of the COVID-19 pandemic.

The focus of this information sheet is on:

- the importance of [a robust remuneration governance framework](#)
- [specific factors to consider when exercising discretion on executive variable pay in the current environment](#).

A robust remuneration governance framework

The evolving COVID-19 pandemic presents many challenges to boards, management and their stakeholders. Boards are facing difficult decisions on executive variable pay at a time when companies are managing significant impacts to their operations, finances and employees. These impacts are reflected in a number of ways, including recent and rapid share price movements for investors.

Robust remuneration governance arrangements are critical to support effective and informed board decision making that is appropriate to a company's changing circumstances. This includes decisions that may appear counterintuitive or unconventional, but that are in the company's long-term interests.

Importantly, decision making on variable pay – a key influencer of behaviour – can send strong signals to executives about conduct and performance that are consistent with the long-term interests of the company. It also signals to investors the type of performance and conduct that is being rewarded in the current environment.

Specific factors to consider in the current environment

A robust remuneration governance framework is particularly important during the evolving COVID-19 pandemic. The effectiveness of board oversight and the exercise of discretion on executive variable pay outcomes would be enhanced by being:

- guided by frameworks and processes that result in the [active, timely and consistent exercise of discretion](#) – to:
 - avoid unintended variable pay outcomes arising as a result of the circumstances created by the COVID-19 pandemic
 - provide timely signals to executives on performance and conduct that is in the long-term interests of the company
- made with the benefit of [structured and contextual information from unbiased sources](#) – to ensure that decisions on executive variable pay:
 - are informed and not overly influenced by the views of interested executives
 - include consideration of the impact of the existing circumstances on the company's stakeholders
- made with the benefit of [arrangements to manage conflicts of interest](#) – to help ensure that the remuneration committee brings independent judgement to decision making, which is particularly important if management is playing a heightened role in advising the board's discretion about the impacts of the COVID-19 pandemic on meeting specific performance targets
- [transparently recorded and communicated](#) – corporate records and disclosures should include when discretion has been exercised, and the rationale, to signal:
 - what is being rewarded and why – this is particularly relevant in the current environment where there may be decisions to significantly reduce or even cancel awards, or conversely to pay an amount where targets have not been met
 - the conduct that the board deems unacceptable to both employees and other stakeholders.

Active, timely and consistent exercise of discretion

To proactively consider whether discretion needs to be exercised due to the rapid change in operating environment arising from the COVID-19 pandemic, boards can look to whether the variable pay outcome:

- is consistent with the objectives of the variable pay framework
- sends a timely signal of each executive's accountability for their conduct and performance at this time.

Discretion is likely to be a key focus for boards in their 2020 variable pay decisions. For example, targets set in 2019 in balanced scorecards may fail to address the company's shifting priorities and impacts to its operating and financial position (including the impacts of the current circumstances on stakeholders).

To help ensure that the exercise of discretion is in the best interests of the company, boards may wish to:

- *Adopt practices or frameworks to prompt the use of discretion in the company's variable pay scheme:* In practice, this can include the board being provided with targeted information to determine whether to exercise discretion at a relevant point in the variable pay scheme. This can be supported by past precedents that have led to an exercise of discretion, to bring about consistency in the approach to its exercise. Similarly, additional information can be provided at other points in the company's variable pay scheme, such as when decisions can be made to apply overall modifiers (e.g. a risk modifier) and behavioural gateways.
- *Apply practices or frameworks that guide the exercise of discretion before variable pay decisions are made:* This could include scenario planning around the circumstances in which discretion could be exercised before the relevant decision. Similarly, decision trees can be used to direct the circumstances in which the exercise of discretion (and quantum of adjustment) could be constructed and then applied to each of the executive variable pay decisions.

The challenges presented by the COVID-19 pandemic are likely to extend beyond the current performance period. Over the coming years, companies will also need to ensure that they 'look back' before the vesting of deferred pay granted during this time. This will enable the board to:

- consider making adjustments using the discretion principles developed to avoid unintended windfall gains
- address significant risk or conduct issues that have occurred since the variable pay award was granted.

Structured and contextual information from unbiased sources

To ensure that the exercise of discretion is sufficiently objective and informed, remuneration committees should carefully consider the type of information required to inform the board's discretion and the source of that information.

In the current context, this will inform how the change in circumstances has impacted performance measures that were set in a different operating context. For example, for balanced scorecard outcomes, this could include broader information on corporate performance and impacts on stakeholders (such as customers, investors and employees) – to balance an outcome that could be dictated by a scorecard set before the COVID-19 pandemic.

More generally, while management is likely to be a primary source of relevant information (particularly if there have been significant changes to the company's circumstances), boards can supplement the information provided by the CEO, particularly when it relates to the CEO's performance or those of their direct reports.

Other valuable sources of broader insights independent of the CEO include:

- control functions within the company such as finance, risk, compliance, internal audit and human resources
- input of independent third-party advisers or other external information sources to help with decision making during this period.

Boards and remuneration committees can also leverage insights on the company's overall performance and the individual's performance from other board committees, such as risk, audit, and sustainability/safety committees.

Many companies rely on cross-committee membership alone to facilitate information sharing. While cross-committee membership is common, better practices to harness information flows include:

- joint committee meetings, scheduled either regularly during the year or to coincide with the timing of variable pay decisions
- agenda time set aside at remuneration committee meetings to hear contributions from cross-committee members and/or with documented input tabled at the meeting from other committees, with minutes recording their contribution.

Finally, boards should consider the most appropriate way for this information to be delivered to enhance the quality of their decision making. For example:

- receiving written material before a meeting can provide the opportunity for broader reflection and context for a board discussion
- having a member from a control function present at a meeting can provide directors with an opportunity to probe the information further.

Arrangements to manage conflicts of interest

Principle 8 of the ASX Corporate Governance Council's [Corporate governance principles and recommendations](#) (4th edn, February 2019) identifies remuneration committees as 'an efficient and effective mechanism to bring the focus and independent judgement needed on remuneration decisions'.

Maintaining an independent role in overseeing and making executive variable pay decisions is therefore a key principle of good governance for remuneration committees. This requires appropriate management and avoidance of conflicts that can arise with executives being involved in decisions on their own variable pay. These conflicts can arise, for example, when executives advise the board on factors impacting their own variable pay outcomes, such as group performance.

Although it is often unavoidable for executives to be involved in compiling key information to be presented to the board about variable pay outcomes (and in the current dynamic circumstances this is likely to be even more so), there is no need for executives to be present for, or to participate in, decisions that impact their own variable pay. After interested executives have had the opportunity to provide input and advice to the board, they should leave during the decision-making process.

As suggested above, information provided by the relevant executive can be supplemented with insights from independent sources. If current circumstances make significant input of the CEO into recommendations on variable pay unavoidable, boards should consider introducing mechanisms that separate the outcome of the CEO's award from the award of other executives. For example, if the CEO is responsible for making recommendations on the size of the bonus pool for executives, a separate funding pool uninfluenced by the CEO's recommendation could be created for the CEO.

Ensuring that remuneration committees not only have sufficient information but also have sufficient time to scrutinise and debate outcomes to effectively apply independent judgement in this exceptional environment is particularly important. This involves forward planning to ensure that board and committee agendas and meeting sequencing enable robust scrutiny of executive variable pay outcomes. This would likely include scheduling at least one substantive preliminary meeting (which may include a joint meeting/s) to ensure that the committee has the necessary information at hand about the company's and the individual's circumstances and performance before making its final decisions about this year's variable pay outcomes.

Transparent recording and communication of decisions

Clear communication in corporate disclosures and to stakeholder groups more broadly about the rationale for board decisions on executive variable pay outcomes is essential for maintaining investor confidence. This includes communication to the executive team and workforce more broadly to ensure buy-in internally.

Boards can consider including the following matters in their remuneration reports:

- the rationale for the exercise of discretion, or reasons that discretion was not exercised, in the final executive variable pay outcomes
- the governance process and principles adopted in making the executive variable pay decisions
- how the company's specific circumstances and issues it faces with the COVID-19 pandemic were taken into account in its decision-making process and that this was done in a manner consistent with the principles adopted.

To ensure that the company has this information on record, it is important that relevant board and remuneration committee minutes contain an accurate corporate record of the key points of discussion and reasons as to how and why an executive's variable pay outcome was determined.

Important notice

Please note that this information sheet is a summary giving you basic information about a particular topic. It does not cover the whole of the relevant law regarding that topic, and it is not a substitute for professional advice.

You should also note that because this information sheet avoids legal language wherever possible, it might include some generalisations about the application of the law. Some provisions of the law referred to have exceptions or important qualifications. In most cases your particular circumstances must be taken into account when determining how the law applies to you.

