PERFORMANCE BONUSES:

HOW DOES YOUR CEO'S BONUS EXPERIENCE COMPARE?

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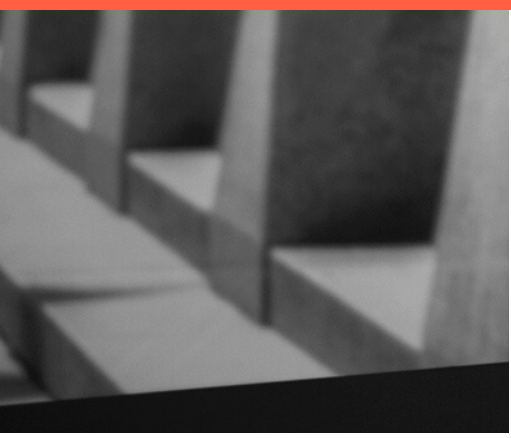
For most CEOs in Australia, Short Term Incentive ('STI') and Long Term Incentive ('LTI') bonuses represent over half of their total pay. Unlike salaries, which are fixed, these bonuses are conditional on meeting future performance targets. There are regular news reports of CEOs receiving large bonuses, but the non-payment of bonuses rarely features in the news. It is understandable that the press will focus more on controversial aspects of CEO remuneration and that large bonus payments are likely to attract more interest.

However, this bias in coverage fosters a perception that performance hurdles are easily achieved and that bonus payments are just corporate largesse. This situation can also be attributed to the complexity of many bonus packages, the wide variation in bonus designs and a lack of transparency. As actuaries working in this area, we at PFS are well placed to cut through the clutter and provide a meaningful picture of the recent CEO bonus payments experience in Australia.

THIS STUDY USES DATA COLLECTED FROM THE LATEST ANNUAL REPORTS OF THE ASX100 COMPANIES AS AT 31 DECEMBER 2019. THE DATA HAS BEEN STANDARDISED AND SEGMENTED TO ALLOW US TO EXAMINE ISSUES SUCH AS:



- STI vs LTI bonus payment rates
- Market based vs Non-market based hurdles for LTI bonuses and
- The impact of the Hayne Royal Commission on the bonuses of financial services CEOs.

We hope that the findings from this study will help stakeholders and interested parties form a more informed view on the question raised in the title of this piece.

In addition, we believe that these findings could also be useful to:

- Inform stakeholders (such as shareholder groups)
- Benchmark proposed performance hurdles and
- Assess the reasonableness of the assumptions made to assess the value of incentives when they are granted, in the light of the real-world experience.

KEY FINDINGS

- In 2019 CEOs received on average 59% of their eligible bonuses. The average vesting rate was similar for STI and LTI bonuses.
- However, the distribution of vesting differed significantly with 77% of STI grants paying partial bonuses compared to 37% for LTI grants (which therefore had a higher rate of Full Vesting or No Vesting).
- Non-market based LTI hurdles had a higher average rate of vesting, 64%, compared to the market based hurdles, 53%. The distribution of outcomes for the market based hurdles was more evenly spread. This result is consistent with hurdles that are based on relative performance rather than absolute performance.
- Bonus vesting rates for CEOs of financial services companies averaged 43% in 2019. This average was 20% lower than for CEOs of non-financial services companies in 2019.

THE AVERAGE EXPERIENCE

The table below sets out the average vesting rates for the grants included in this study.

HURDLE TYPE	NUMBER OF GRANTS	AVERAGE VESTING
All Grants	**279**	**59%**
Short Term Incentive	***94***	***58%***
Financial Services	18	43%
Non-Financial Services	76	62%
Long Term Incentive	***185***	***59%***
Financial Services	39	44%
Non-Financial Services	146	63%
Long Term Incentive		
Market Based Hurdles	86	53%
Non-Market Based Hurdles	99	64%

The analysis shows that CEOs of the ASX100 companies received 59% of their eligible bonuses in 2019 and that this average vesting rate was similar for STI and LTI bonuses.

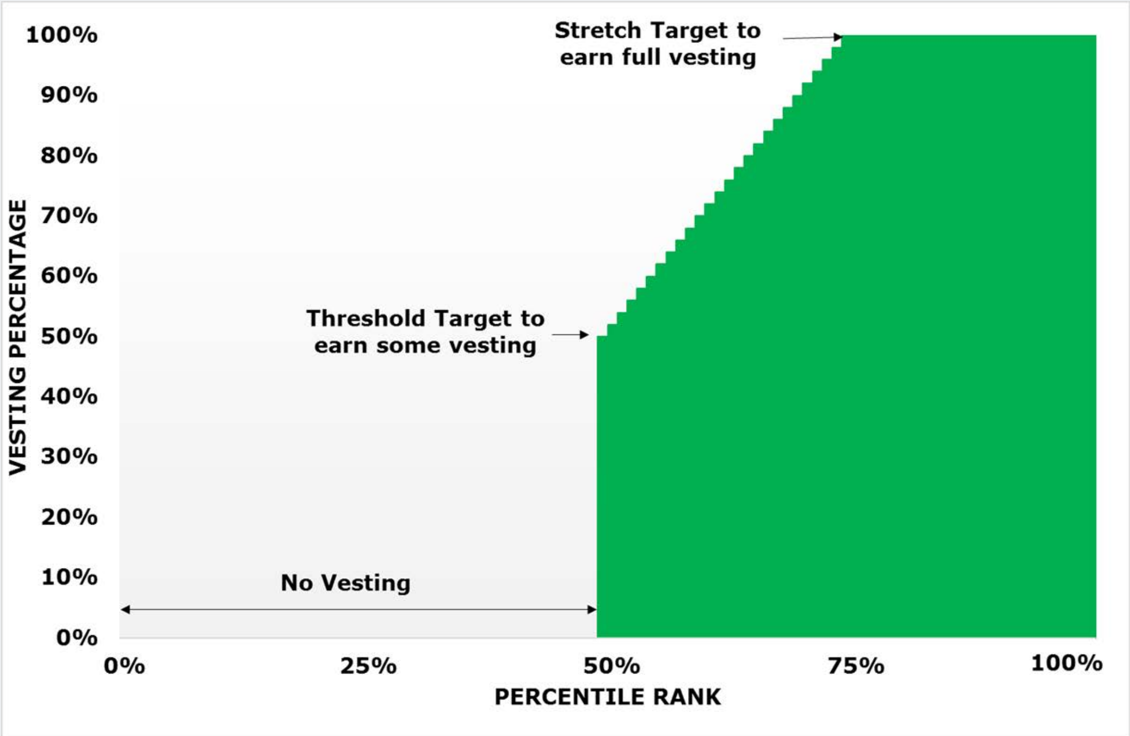
For the LTI grants, the average vesting rate for grants with market based hurdles was 53%. This result was less than the experience of the non-market based grants which averaged 64%.

Bonus vesting rates for CEOs of financial services companies were on average 20% lower than for non-financial services companies. The gap in average bonus rates was similar for STI and LTI grants that vested during the year. This result is not surprising given the governance breaches uncovered by the Financial Services Royal Commission.

STI VS LTI

Average experience can be misleading when the payout profiles are not uniform. This is the case with many relative Total Shareholder Return ('TSR') hurdles where no vesting occurs when performance is less than a threshold target, full vesting is achieved when performance exceeds a stretch target and partial vesting is payable when performance is between these two targets.

TYPICAL RELATIVE TSR VESTING SCALE

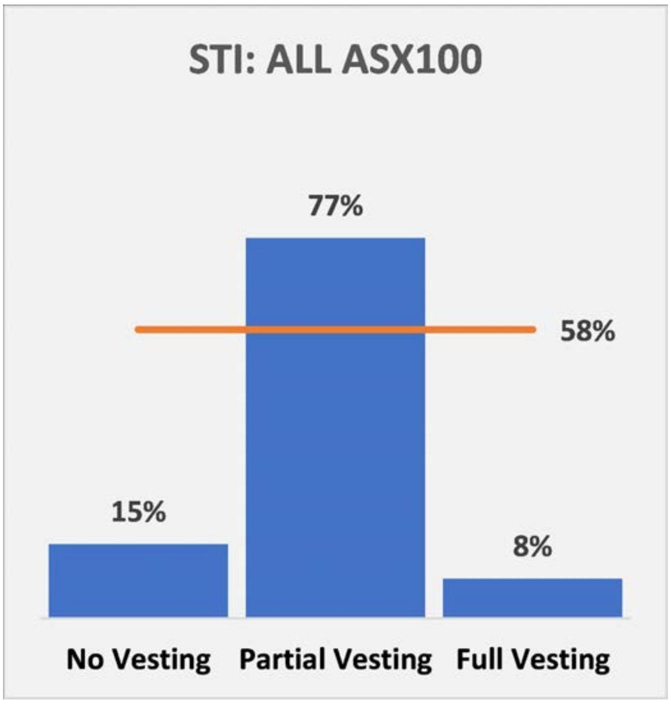


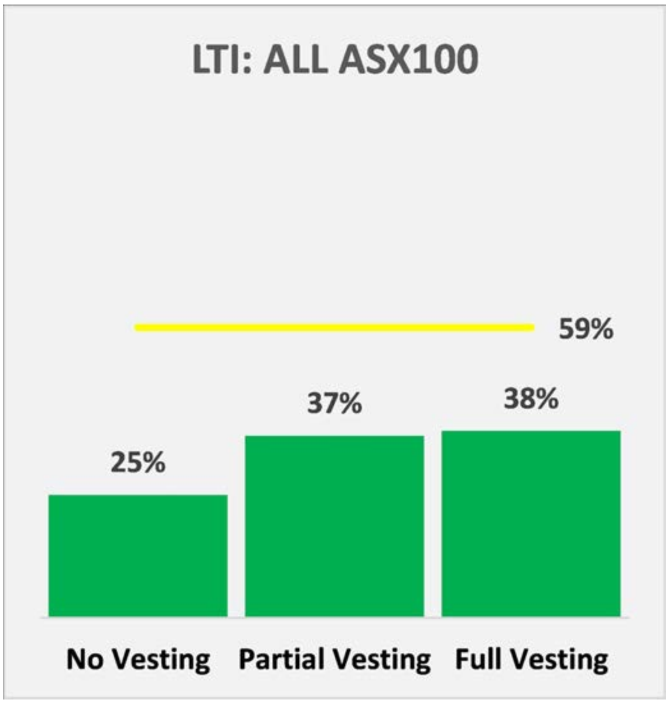
We have grouped the CEO vesting data into grants that resulted in No Vesting, Partial Vesting and Full Vesting. This distribution was compared to the average vesting rate and charted.

The charts, provided overleaf, show that while the average experience was similar the distribution differed significantly.

The STI chart shows that 85% of grants achieved some level of vesting but only 8% received the full amount. The LTI experience was evenly spread between the three outcomes with 38% of grants receiving Full Vesting and 25% not reaching the level required for any vesting.

This experience reflects the different approaches to these bonuses. STI bonuses tend to be based on a scorecard and can have many operational and financial metrics. A large proportion of these metrics are assessed subjectively and have absolute targets. LTI bonuses tend to: have fewer metrics, are less subjective and are more likely to be based on relative performance.



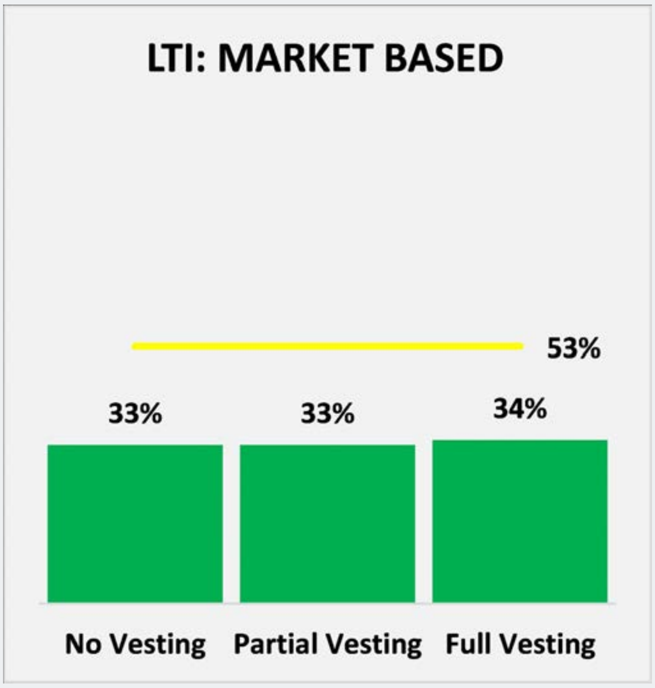


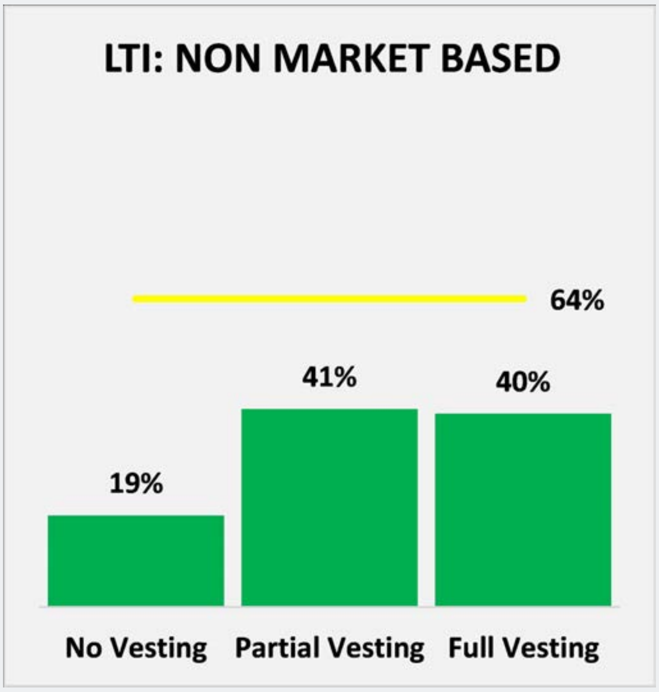
MARKET BASED VS NON-MARKET BASED LTI HURDLES

Market based LTI hurdles include: Relative TSR, Absolute TSR, Relative to Index and Price Targets.
Non-market based hurdles include: Growth in EPS, Return on Investment Targets and Revenue Targets and tend to be reported by the company.

The results for the market based LTIs show an even spread between the three vesting outcomes. This is consistent with a relative hurdle as by definition there will always be a spread of companies that perform below or above average.

The average vesting rate for the non-market based LTI grants was higher (64% compared to 53% for market based) with over 80% of grants receiving some vesting.

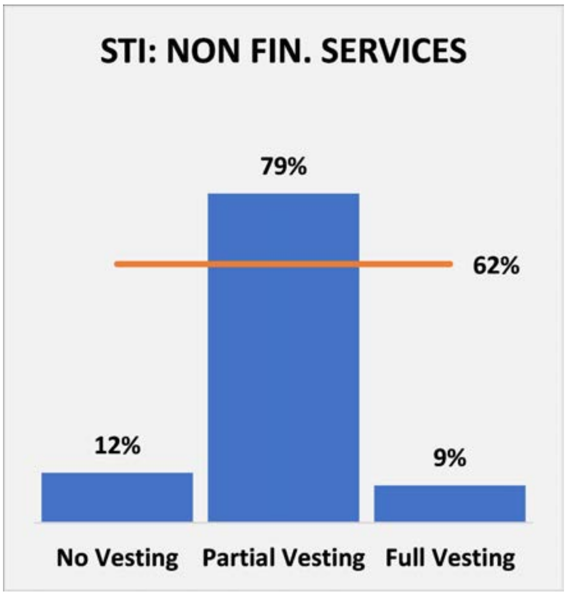


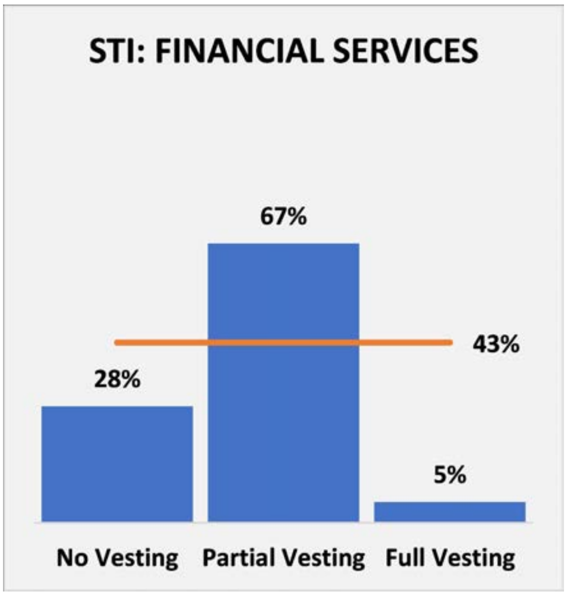


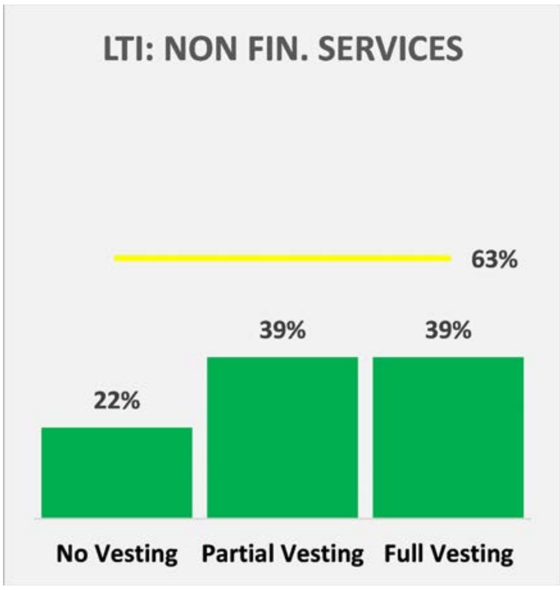
THE IMPACT OF THE FINANCIAL SERVICES ROYAL COMMISSION ON CEO VESTING RATES

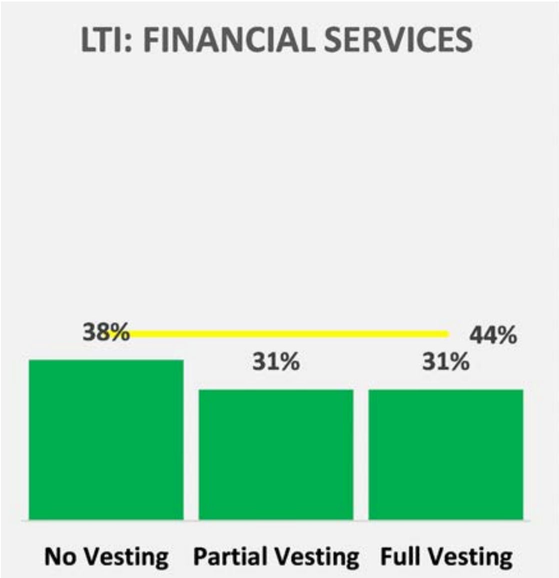
Financial services companies make up a significant proportion of the ASX100. In February 2019, the Financial Services Royal Commission reported detailed findings of systematic failures in governance and mismanagement in the industry.

Our study shows that bonus rates for CEOs in financial services companies, in 2019, were significantly lower than for non-financial services companies with average bonus rates 20% lower for the STIs and LTIs included in the study. These lower average rates were driven by significantly higher instances of No Vesting outcomes.









THE DATASET

This study examined the latest annual reports of the ASX100 companies as at 31 December 2019. CEO bonuses that vested during the financial year were included except for:

- Companies that reported using US standards
- Companies that did not report 2018/19 results by March 2020
- Any bonuses that had no performance condition and
- Any bonuses that were paid in 2019 but were earned in previous years.

ANY QUERIES REGARDING THIS STUDY OR OTHER EXECUTIVE REMUNERATION MATTERS CONTACT THE TEAM AT PFS CONSULTING TODAY

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