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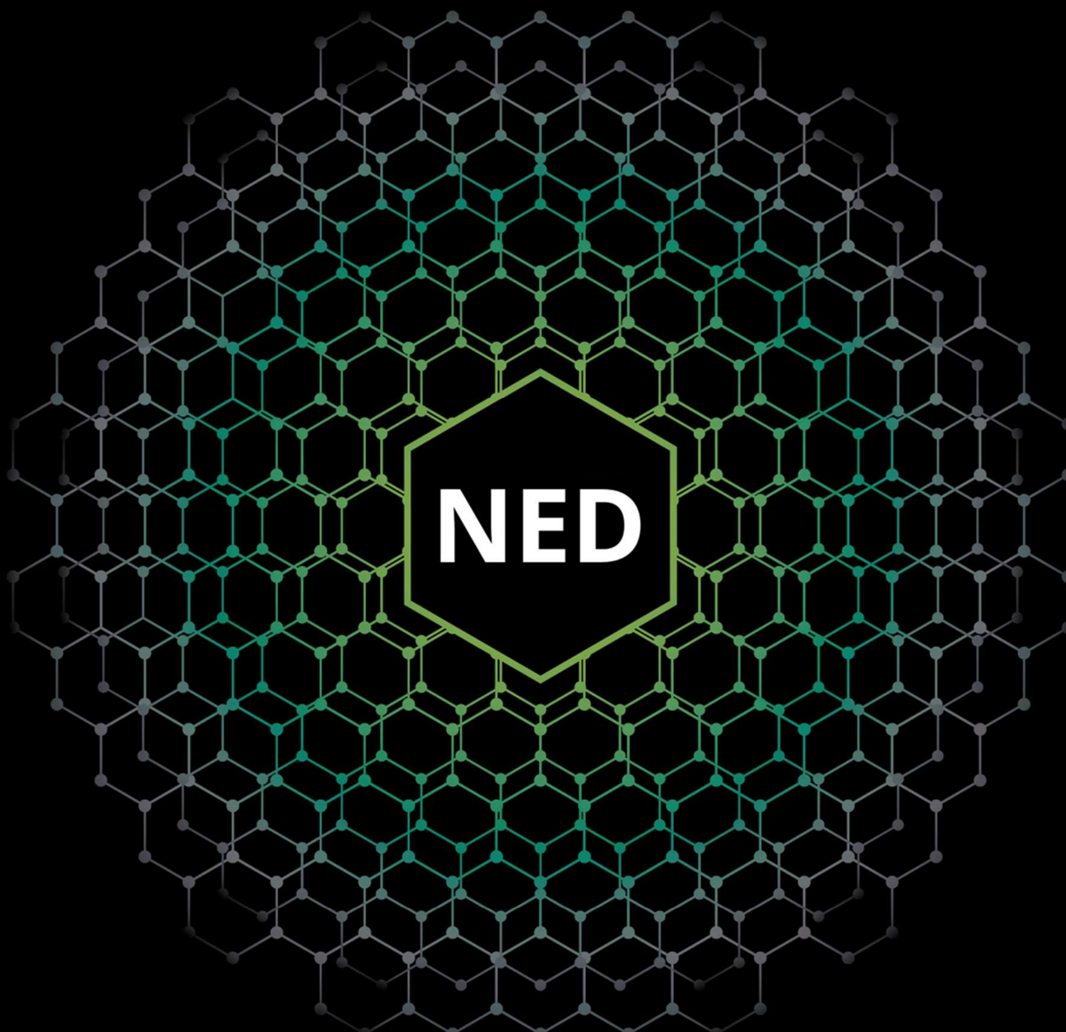


NEDs in Conversation (15 min read)

Executive pay – the perfect storm is still brewing

MAKING AN IMPACT THAT MATTERS since 1845

Summary of discussions | 27th July 2021

Most Remuneration Committees have finalised their first year-end decisions in the context of societal and economic impact of COVID-19. These pressures having been exacerbated due to the recent social unrest across the country. Boards are navigating the accelerated pace of change and executive pay continues to drive unfavourable media headlines. Is this a golden opportunity for boards to challenge and innovate remuneration policy, the implementation thereof as well as performance management frameworks?

Panel of speakers

Sarita Martin, NED (Reunert and Nictus)

Dr Shirley Zinn, NED (Sanlam; MTN-SA; Advtech; Afrocentric; Spur Corporation; and V&A Waterfront)

Jerry Vilakazi, NED (Cell C; Sibanye Stillwater; Blue Label Telecoms; and Palama Group)

Deloitte specialists

Leslie Yuill, Director, Deloitte Africa

Tyrone Jansen, Associate Director, Deloitte Africa

Setting the scene

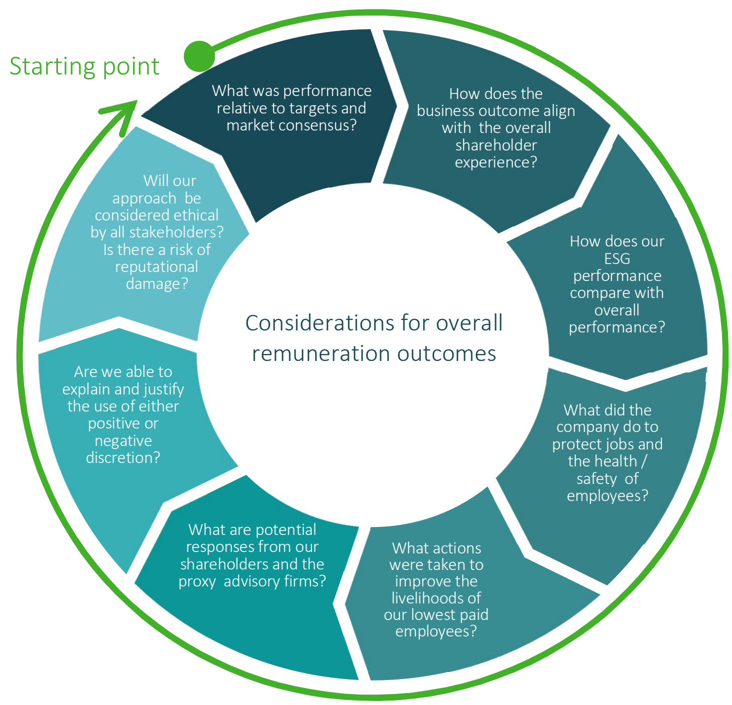
The impact of the pandemic varies widely by company and sector, and investors and proxy advisors are closely scrutinising executive pay outcomes. Media and society will further ensure these coutcomes reflect the broader shareholder, societal and employee experience. Remuneration committees are expected to use judgment and demonstrate how decisions are fair, appropriate, and consistent with the broader stakeholder objectives. At the same time, committees will be looking to set reward frameworks that incentivise executives to deliver business resilience and recovery in the year ahead.

Decision-making framework

Whilst shareholder rejection of the remuneration policy and implementation report has remained relatively static over the last three years, we have witnessed a dramatic drop in shareholder support for the implementation report during the 2021 AGM season. We have also seen an increase in negative vote recommendations by both Glass Lewis and Institutional Shareholder Services (ISS) during the 2021 AGM season.

We recommend that the remuneration committee heed these signals as shareholders and proxy advisors start to voice their discontent. It starts by evaluating whether these firms have a case to be made regarding the remuneration structure that committees oversee.

The decision-making framework on the right provides the Remuneration Committee with an integrated set of questions to ensure that a company's remuneration out-turns take all stakeholders into account.



The view from the REMCO Chair

“The more transparency there is on remuneration, the better.”

NED panelist

“When you reflect on the media headlines, inequality jumps out. This is an opportunity to reset how we deal with pay gaps and to create more inclusion.”

NED panelist

“Boards must recognise that the shareholder base is diverse and have different interests, including social and environmental.”

NED panelist

“There are other factors influencing (executive) retention beyond pay.”

NED panelist

Remuneration needs to reflect the diverse interests of a widened set of stakeholders

The panel shared a view that shareholder registers are changing, including a rise in minority shareholders who are investing with the objective of accelerating change. Concurrently, it was felt that the argument that pay drives executive retention is also wearing thin with certain shareholders.

The pandemic has accelerated the trend that executives are becoming increasingly mobile globally, which is putting pressure on the retention of talent locally. However, the panel argued that boards are responsible for creating a sustainable talent pipeline, and should be diversifying succession plans with a blend of local and global talent. Whilst retention remains a serious issue, boards may look to shift the conversation around incentivisation beyond just pay, to reflect the leadership and culture expected from executives to ensure the long-term sustainability of the organisation.

The lack of transparency in executive pay is diminishing trust

The rising trend of negative votes against the Remuneration Policy or Implementation Report coupled with SENS announcements of no shows at investor meetings, is a cause for concern. The panelists suggested that boards do not wait for the no vote but accelerate a meaningful plan of engagement with all stakeholders. This practical schedule of engagement should enable boards to understand the ‘why’ behind their intended vote, and to share concerns and risks associated with the remuneration proposals.

The increasing trend of non-disclosures related to pay are, in the view of one panelist, aggravating the diminishing trust in business. It was suggested that REMCO Chairs can also improve the conversations with stakeholders by simplifying the language, frameworks and definitions used.

The proposed amendment to the Companies Act requiring South African companies to publish their pay gaps was welcomed, however, the panel reflected that whilst disclosures are important, so are the variables and organisational context. That said, one panelist suggested that improved transparency and reporting of gender pay gaps across senior management would stimulate change in underlying inequality and representation.

It was felt that accelerating this deliberate engagement with stakeholders would rebuild trust and confidence in leadership through improved transparency.

The rise of ESG

The panel agreed that there is a focus, both globally and locally on ESG, which is increasingly becoming part of the investment decision for shareholders and that ESG is critical to the sustainability of the business.

The panel encouraged boards to implement ESG metrics within performance frameworks which should be designed to create real value and remain authentic to the organisation. They cautioned that these metrics go far beyond recognising the current economic and social challenges of the country. The metrics should be sensible, measurable and executives should be held to account. In addition, this creates an opportunity for cultural change, with one panelist suggesting that the governance metrics need to stretch across the entire organisation.

Remuneration Committees should look to include value accretive ESG metrics in both the short and long-term incentive plans to encourage executives to adopt a longer-term view in the execution of the strategy.

What should proactive Remuneration Committees be considering in 2021?

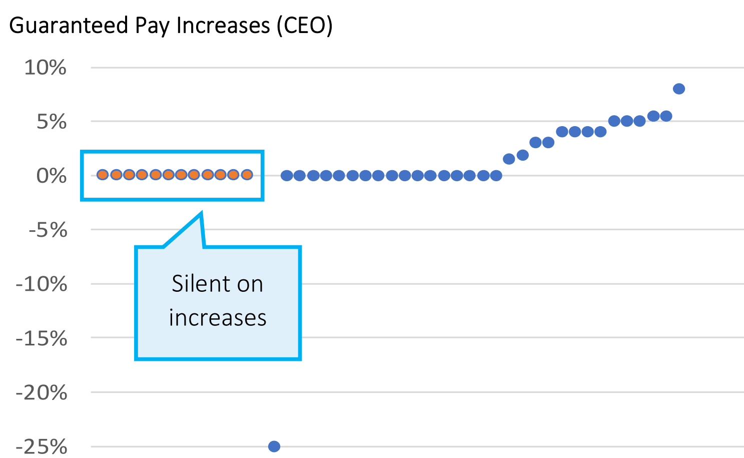
Guaranteed Pay

During 2020 **34%** of the JSE Top 50 companies did not award an increase to their CEO. A concerning trend is that >**20%** of the Top 50 companies did not disclose the increase awarded to their CEO. Should this increase not align with the broader employee experience or overall business performance, there is a risk of shareholder or proxy advisor push back at the next AGM.

In the coming months, Remuneration Committees will be considering salary levels for the year ahead, and investors have indicated that they expect to see continued restraint in this area.

Where salary increases are awarded, we have seen examples of companies awarding higher levels of increases to the lowest-paid workers, particularly those in 'front line' or critical workforce industries.

> *'Shareholders expect companies to show continued restraint. Increases to salary, if necessary, should be in line with changes to the wider workforce.*
>
> *Investors will continue to look closely at how any increases to basic salary or variable pay opportunity are justified and will expect Remuneration Committees to show restraint in relation to overall quantum.'*
>
> The Investment Association



Questions for Remuneration Committees:

- What are the proposed salary adjustments for the wider workforce, including lowest paid workers?
- How have wider company stakeholders been impacted?
- Were there any planned increases for prescribed officers (e.g. glidepath on appointment)?

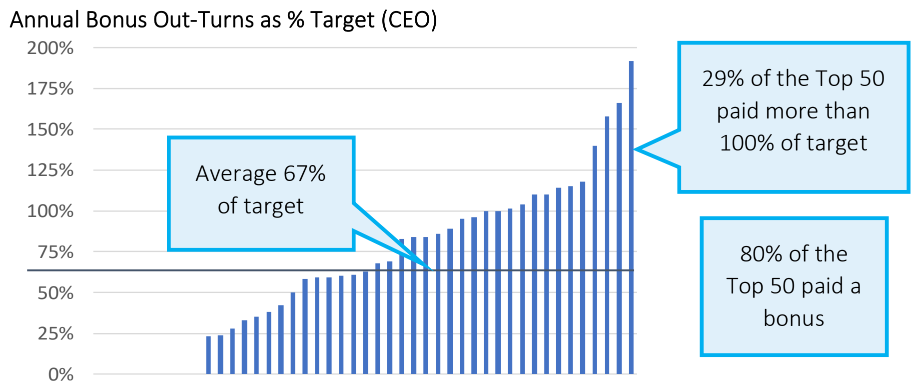
Short–term Incentives

Annual bonus out-turns will be a primary area of focus for investors in the 2021/22 AGM season, and remuneration committees are expected to demonstrate how incentive outcomes reflect the wider stakeholder and employee experience. At the end of 2020, investors and proxy agencies issued guidance for remuneration committees when considering annual bonus out-turns in relation to broader workforce impact and where there has been additional capital raising or suspended dividends.

When companies face significant business uncertainty and struggle to set annual performance targets, the remuneration committee could consider splitting the annual bonus plan into two six month performance measurement periods.

Remuneration committees would be expected to use judgment and discretion at the end of the year to ensure outcomes appropriately reflect the stakeholder experience over the year as a whole. **45%** of the JSE Top 50 companies applied discretion when awarding a bonus to their CEO. Companies are advised to consult with shareholders in advance and explain why any adjustment/discretion is considered appropriate where exceptional circumstances have been identified.

Investors and proxy agencies have indicated that enhanced disclosure is also expected where companies have made any adjustments to performance measures due to exceptional circumstances.



Proxy and investor guidance:

'Shareholders expect that financial metrics will comprise the significant majority of the overall bonus. Companies should demonstrate how personal objectives are linked to long-term value creation and should not be for actions which could be classed as 'doing the day job.' The Investment Association

'Bonuses should reflect the wider employee experience. Companies may also consider whether a higher portion of the bonus should be deferred into shares.' The Investment Association

'Remuneration committees are expected to retain a level of discretion to ensure that remuneration outcomes for executive directors align with company performance, as well as shareholder and employee experiences. Glass Lewis may recommend that shareholders vote against the remuneration report where there is substantial misalignment in this regard in the past fiscal year.' Glass Lewis

Questions for Remuneration Committees:

- How has the dividend policy been impacted?
- What has been the impact on incentives throughout the organisation?
- Have there been redundancies linked to the impact of COVID-19?
- How has the remuneration committee taken account of any direct or indirect government suor shareholder support measures?
- Does the level of bonus deferral remain appropriate?
- What are the key performance indicators for business sustainability and success in the coming year?
- How do targets align with market consensus forecasts?

Long-term Incentives

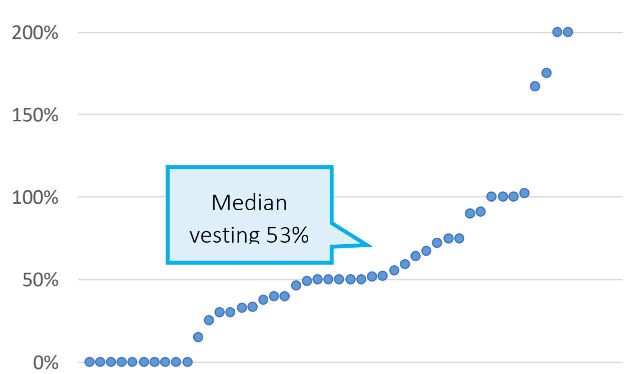
Over the coming year, remuneration committees will assess performance in respect of awards made under long-term incentive plans (LTIPs) in 2018. While we are yet to see the full impact of COVID-19 on long-term incentive vesting levels, it is expected that many in-flight awards will be 'underwater' at the current time.

Of the JSE Top 50, around **20%** of long-term incentive awards have lapsed at the end of the performance period, with median vesting of **53%** of target, which is lower than in recent years. There has also been an uptick in the use of restricted share awards and enhanced performance share awards.

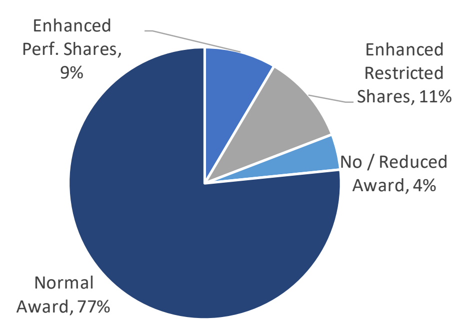
Investors and proxy agencies have clarified that they do not expect to see adjustments to performance conditions for in-flight LTIP awards. Where any adjustments are proposed, these should be subject to shareholder consultation. Companies should commit to using discretion and judgement at the end of the vesting period. This will ensure that remuneration outcomes reflect the broader stakeholder experience and executives have not benefited from 'windfall gains'.

Remuneration committees should ensure that plan documentation allows the discretion at vesting and explain their approach in the remuneration report.

LTIP vesting (CEO) (% of target amount)



LTIP awards FY20/21



Proxy and investor guidance:

'Remuneration Committees need to be pro-active in determining the appropriate LTIP award size given sustained share price falls. Making awards at maximum opportunity in cases where share prices have fallen substantially is to be discouraged.Committees should consider reducing LTIP grants to reflect the shareholder experience.' The Investment Association 'Bonuses should reflect the wider employee experience. Companies may also consider whether a higher portion of the bonus should be deferred into shares.' The Investment Association

'Committees will have to consider the appropriate performance metrics and stretch of targets. This may lead to a reduction in the performance target range or a wider performance range.It will be important for committees to disclose the process it has been through to set the targets including the use of internal budgets and consensus estimates.' The Investment Association

Questions for Remuneration Committees:

- How do LTIP awards reflect the shareholder experience and what powers exist for the committee to exercise judgement and discretion at the end of the vesting period?
- What are the key performance indicators for business sustainability and success over the performance period?
- How do targets align with market consensus forecasts?

Key contacts

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This summary is based on a virtual event with the same title that was hosted by Deloitte Africa's deputy chief executive, Sihlalo Jordan, on 27th July 2021. Speakers included:

- Sarita Martin, NED (Reunert and Nictus)
- Dr Shirley Zinn, NED (Sanlam; MTN-SA; Advtech; Afrocentric; Spur Corporation; and V&A Waterfront)
- Jerry Vilakazi, NED (Cell C; Sibanye Stillwater; Blue Label Telecoms; and Palama Group)
- Leslie Yuill, Director, Deloitte Africa
- Tyrone Jansen, Associate Director, Deloitte Africa

The research shared within the forum is a preview of the Deloitte Executive Compensation Report. The full report is due for release in August 2021.