Board diversity and executive remuneration

MODULE 4 | PART A.3 | STUDENT COMPANION

Why diversity matters

Reason	What it means for the board
Fairness	Discrimination on grounds such as race, sex, sexual orientation or religion is unlawful, and larger employers report on gender equality to a national agency.
Performance	Directors with different experiences notice different risks, ask different questions and bring wider networks. A diverse board also helps attract talent from every background.

Legislated quota A fixed minimum, backed by penalties	**Targets and disclosure** Measurable objectives, reported publicly	**Voluntary campaigns** Business-led commitments and peer pressure
Moves numbers fast, but can face legal and fairness challenges. Example: California's 2018 law for public companies, struck down by a Los Angeles court in 2022.	Australia's main approach. ASX recommendations: a diversity policy with measurable objectives; ASX 300 boards aim for at least 30% of each gender within a set period.	Flexible and fast to start, but progress depends on willingness and leadership.

Culture makes any approach work

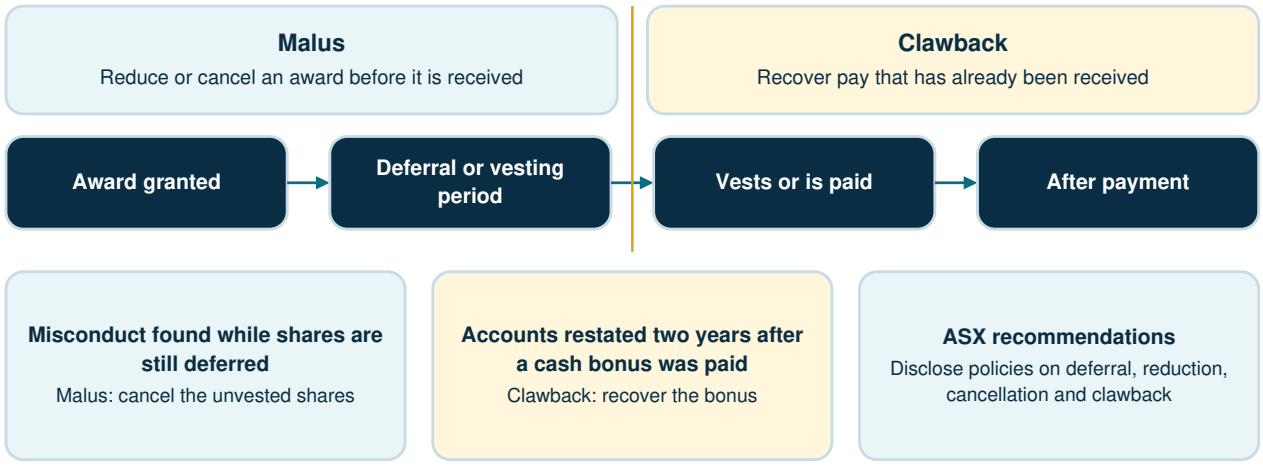
Diverse shortlists for senior roles | sponsoring promising people early | checking equal pay for equivalent roles | making flexible work and returning from parental leave normal

Executive remuneration: the design rules

Non-executive director Paid for time and responsibility	**Executive** Fixed pay plus pay at risk
Fixed fee	**Fixed pay:** Salary and superannuation
Superannuation and expenses	**Short-term incentive:** Yearly, mostly cash, against key performance indicators
May own shares, bought like any investor	**Long-term incentive:** Three to four years, delivered in shares, options or rights
No performance incentives: protects independence	**Guard rails:** Caps, deferral, non-financial measures, malus and clawback
Shareholders approve the total fee pool	

Design rule	Why
No incentives for non-executive directors	A bonus tied to targets would compromise their independent judgement.
Balance short-term and long-term pay	Rewards that only look at this year encourage short-termism.
Include non-financial measures	Safety, customers and risk management matter as much as profit.
Cap incentive plans and keep board discretion	Uncapped plans can pay out far more than anyone intended.
Defer part of variable pay	Problems can surface before the money is locked in.
Nobody decides their own pay	An independent remuneration committee designs packages.

Controls on pay: malus, clawback and transparency



Control	How it works
Remuneration report	Listed companies publish a detailed report each year, and shareholders vote on it.
Two-strikes rule	25% or more against at two AGMs in a row triggers a spill vote (see Part A.2.4).
Termination payments	Since late 2009, payments above one year's average base salary need shareholder approval.
Pay ratio (United States)	Listed companies disclose chief executive pay as a ratio of median employee pay.
Financial sector (Australia)	The prudential standard requires direct board oversight, balanced measures and multi-year deferral of senior executives' variable pay.

Real examples. Persimmon (UK): an uncapped 2012 incentive plan led to a chief executive award of about GBP 75 million after reductions; the chair and remuneration committee chair resigned in December 2017. Wells Fargo (US): after unauthorised customer accounts were exposed in 2016, the board stripped a further US$75 million from two former executives in April 2017, on top of earlier forfeitures.

Key terms

Term	Meaning in plain words
Goal congruence	Pay designed so that an executive's self-interest points the same way as the shareholders' interests.
Fixed pay	Salary and superannuation, paid regardless of performance.
At-risk pay	Pay that is reduced or not paid at all if targets are missed.
Key performance indicator	A measurable target used to judge performance, financial or non-financial.
Deferral	Holding back part of a reward for several years before the executive receives it.
Malus	Reducing or cancelling an award before it is received.
Clawback	Recovering pay that has already been received.
Ratchet effect	Pay creeping upwards because no remuneration committee wants to pay below the market average.

Sources: Persimmon plc announcements, December 2017 and November 2018; Wells Fargo board sales practices investigation report, 10 April 2017; California SB 826 and Crest v Padilla (Los Angeles Superior Court, 13 May 2022).

Practice questions

MODULE 4 | PART A.3 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - redesign the Tidewater Energy pay package

Imagine **Tidewater Energy Ltd**, a listed company. Its chief executive receives a fixed salary of $1.2 million and a short-term bonus of up to 150% of that salary, paid entirely in cash and based only on this year's profit. Long-term shares vest after one year if the share price has risen, with no cap. The non-executive directors receive a bonus when the profit target is hit. The chief executive's contract promises 18 months' base salary on termination. Identify five problems and recommend a fix for each.

Question 2 - malus or clawback?

Decide whether malus or clawback is the relevant tool, and explain why. (a) Two years after a cash bonus was paid, the accounts it was based on are restated for a material error. (b) Serious misconduct is discovered while a manager's deferred shares are still due to vest next year. (c) An unvested long-term award relates to a period in which the company badly breached its risk appetite.

Worked answers

MODULE 4 | PART A.3 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Tidewater Energy

Problem	Fix
Short-term bonus depends only on this year's profit	Add non-financial measures (safety, customers, risk) and defer part of it.
Bonus paid entirely in cash	Pay part in deferred shares so value depends on longer-term performance.
Long-term shares vest after one year	Measure over three to four years, with service conditions.
No cap on the long-term award	Cap the award and keep board discretion to adjust outcomes.
Directors' profit bonus	Remove it: non-executive directors should receive fixed fees only.
18 months' base salary on termination	Above one year's average base salary, so shareholder approval is needed; better to limit it to 12 months or less.
No malus or clawback	Add both, linked to misconduct and material misstatement.

Question 2 - malus or clawback

- **(a) Clawback.** The bonus has already been paid, so the company must recover it.
- **(b) Malus.** The shares haven't vested, so the board can reduce or cancel them before they're received.
- **(c) Malus.** The award is unvested, so it can be reduced to reflect the risk breach.

Common slip: thinking clawback and malus are the same. The dividing line is whether the executive has already received the pay.