



nbn-Confidential: Commercial

28 November 2022

The Hon Michelle Rowland MP  
Minister for Communications  
Parliament House  
CANBERRA ACT 2600

Senator the Hon Katy Gallagher  
Minister for Finance  
Parliament House  
CANBERRA ACT 2600

Dear Ministers

## Remuneration and Short-Term Incentive (STI) Framework

Thank you for your letter of 27 October 2022 seeking further information in relation to NBN Co Limited's (NBN Co's/ the company's) application of the Australian Government's *Performance Bonus Guidance: Principles governing performance bonus use in Commonwealth entities and companies (August 2021)* and the basis for the resulting Board decisions on remuneration changes at the company, including governance and transition arrangements.

NBN Co has strict governance around employee remuneration and is very conscious of the role this plays in attracting, engaging, motivating and retaining the highly specialised employee skills needed to operate the network, forecast future trends, and to protect and evolve the network to keep pace with the demands of Australian families and businesses over the next decade and beyond. NBN Co's remuneration framework has strong oversight from its People and Remuneration Committee (P&RC), a subcommittee of the Board, and ultimately from the whole Board which has responsibility for approval of the financial and corporate targets that underpin the STI framework. The P&RC operates under a charter that is publicly available on the company's website. The Board and management understand that being a model Government Business Enterprise (GBE) means recognising and acknowledging our responsibilities to the Commonwealth and to the Australian taxpayer through the highest standards of transparency and accountability, and at the same time applying the remuneration principles and governance required of an ASX-listed company. Continuous improvement is also an important feature of the Board's process, and this letter sets out what actions the company took in 2021, what is currently done, and also some proposed additional governance measures to build and maintain public confidence in the targets set for management by the Board.

### ***Application of the Performance Bonus Guidance***

On 13 August 2021, the previous Government released the Performance Bonus Guidance (the Guidance), which states that "Commonwealth entities and companies should avoid the broad use of performance bonuses" and makes clear that an 'at risk' scheme as administered by NBN Co is considered to be a 'performance bonus'. Given the clear nature of this Guidance and discussions with Government on how the Guidance should be applied, in FY22 the Board made significant changes, including reducing the employee eligibility to a much smaller cohort of the company's most senior executives so that the scheme was no longer as 'broad' and also reducing the at-risk component of total remuneration for these executives.



As referenced in your letter, NBN Co needed to consider how, in a competitive labour market, to honour its obligations, to attract and retain the staff needed to continue to operate, protect, and upgrade the **nbn** network. The company therefore had to implement transition arrangements to minimise flight risks and maintain employee engagement to the greatest extent possible. The Guidance states that companies that “remove or reduce bonuses might consider buy-outs, partial rolling into salary, allowing existing arrangements to expire or a combination of transitional strategies. It is expected that where transition arrangements involve roll-ins, that only a portion of the available bonus is incorporated into salary.”

A key consideration throughout this process was to maintain the skills and experience that the company needs to build, upgrade, maintain, operate and protect the network. Many of the critical roles in NBN Co are drawn from a relatively small pool of telecommunications, construction, or IT and security professionals and these resources have been highly sought after in recent years.

Aligned with this, a portion of the formerly at-risk component of total remuneration opportunity was converted to Total Fixed Remuneration (TFR). The Board determined, consistent with the Guidance, that the appropriate portion to be rolled in should be no more in aggregate than 64 per cent of the maximum available incentive payment, or 87 per cent of the target STI opportunity.

For the senior executives remaining within the STI program, there was also a significant reduction in the proportion of total target remuneration at risk and this is set out in NBN Co’s 2021-22 Annual Report.

It was agreed by the Board that some at-risk remuneration was necessary to be maintained for our senior executives to ensure alignment with our corporate targets and for the application of consequence management. As a result of these changes, the reportable total STI pool reduced from \$79.1 million (approximately 3,800 eligible employees) in FY20 and \$46.5 million (approximately 3,500 eligible employees) in FY21 to \$4.1 million (45 eligible employees) in FY22.

NBN Co’s remuneration approach therefore aims to continue to focus on paying competitively to attract and retain capable employees who can deliver its vision, whilst selecting to prudently deliver a portion of remuneration to be contingent on performance. This allows NBN Co to deliver value for money and enhance alignment of remuneration to organisational success.

***How the proportion of ‘at-risk’ to be converted into TFR was arrived at***

The Board consulted with the company’s independent remuneration advisor – Ernst & Young (EY) - on the application of the Guidance and a review of market practice on the removal of incentive eligibility across Australian organisations. EY’s review considered remuneration market trends on the removal or deleveraging of variable reward, and how organisations who had decided to do this considered both the changes to the remuneration mix between fixed and variable remuneration and the industry practice as to the method and quantum to accommodate the reduction in variable pay opportunity. In addition to market practice, other considerations the Board used in assessing an appropriate discounted conversion rate were:

- historical STI payout levels, generally over the 3 to 5-year period and applying a discount;
- the employee value proposition including total reward and recognition;
- employee retention, particularly high performers and the ability to continue to be able to attract key external hires, whilst in this remuneration transition; and



- the ability to attract future candidates given NBN Co is regularly sourcing candidates from technology companies where variable pay is common.

### ***Independent benchmarking to support decisions to roll in the STI***

In order to support the decision to roll in the STI at a discounted rate, external benchmarking was sought at a remuneration framework level to validate if the senior executive remuneration mix was appropriate in order to both align senior executives to company performance and retain a mechanism for consequence management. Removing STI eligibility for all employees below the Executive General Manager (EGM) level would transition the STI Program into what would commonly be termed an ‘Executive STI Program’. EY continue to provide independent benchmarking when requested by the Board in the determination of executive remuneration and market positioning.

At an individual level, senior executive roles are also externally benchmarked by independent remuneration advisors EY using disclosed data from both GBEs and ASX-listed companies, based on an approach agreed by the Board. Similar to most GBEs, NBN Co’s executive remuneration comprises fixed remuneration and STI. As advised by EY, target remuneration for GBEs is generally weighted more heavily towards fixed remuneration than for ASX-listed companies.

For the purposes of transitioning to the Guidance, an additional independent benchmarking exercise was taken on the Executive Committee positions by AON Hewitt consultants. These roles traditionally have a more highly leveraged remuneration, and it was important to understand the impact of the reduction to the variable pay opportunity against the total target remuneration opportunity, which naturally has also reduced as a result of implementing these changes.

The remuneration of the Chief Executive Officer (CEO) and each Executive Committee member is reviewed annually by NBN Co’s P&RC and the full Board.

In accordance with NBN Co’s Strategic Internal Audit Plan, NBN Co’s Internal Audit performs an annual review over the remuneration controls and processes. The audit includes a review of STI based on company performance, individual performance and target STI opportunity and for FY21-22, covered the STI transition arrangements. This overall rating of the audit was green which means internal controls were met.

### ***Rationale behind STI outcomes from FY22***

In conducting their annual remuneration benchmarking, EY also advise on how executive remuneration practices align to the market. The NBN Co STI scorecard metrics are therefore a balance of short- and long-term goals and financial and non-financial targets.

For FY22, the Board was satisfied that the gateway measures of NBN Co’s Corporate Objectives and Safety had been met in order to create the STI award pool.

The Board considered the STI award funding at 66 per cent of a maximum appropriately reflected NBN Co’s progress against its five corporate measures: Connected Premises, Customer Service Delivery, Trust and Reputation, Transformation and Financial Sustainability as detailed below:

- Connected Premises

NBN Co significantly exceeded the target on subscriber metrics (more than 8.5 million connected premises).



- Customer Service Delivery

The majority of customer service delivery metrics were met taking into consideration unprecedented weather conditions and NBN Co's response and support to expedite the restoration of services and minimise the hardship for impacted Australians.

- Trust and Reputation

The trust and reputation of NBN Co improved, while DSAT remained steady throughout the year.

- Transformation

The majority of transformation metrics pertaining to initiatives linked to IT simplification and capital expenditure efficiency were met or exceeded.

- Financial Sustainability

The revenue target was exceeded (10 per cent increase to \$5.1 billion in FY22) with strong customer growth and continued uptake of higher speed services. There was a \$1.76 billion improvement in EBITDA compared to FY21. Operational costs were 10 per cent below last year, but greater than a stretch target, in part due to impact of the weather events on service delivery costs. This overrun was offset by savings in capital expenditure and interest costs.

### **Governance arrangements**

NBN Co has always had a robust level of governance over reward and remuneration at P&RC and Board level. In CY21, the P&RC held multiple meetings at which it considered the company's reward strategy and governance framework; the Australian Government's Performance Bonus Review Interim Report, the Performance Bonus Policy (the Policy), NBN Co's response to the Policy; the Guidance, the implications of the Guidance for the STI framework and, approved revisions to NBN Co's remuneration framework and STI Program Rules arising from the application of the Guidance. At P&RC meetings held during CY22, based on the revised remuneration framework and STI Program, the P&RC considered the FY21/22 STI Program scorecard, year to date outlook, the quantum of the performance bonus pool and the allocation thereof.

As part of NBN Co's usual governance practices, considerations and decisions of the P&RC (as with all NBN Co Board Committees) were and are reported to the Board by the P&RC Chair and discussed as needed at the next available Board meeting.

The Board has responsibility for approval/endorsement of NBN Co's overarching corporate and financial targets governance including in the form of the Corporate Plan, Annual Report and company budget which are the foundations upon which the STI Program scorecard is set and measured. This involves a regular cadence of Board review of these matters throughout each calendar year. The Board Charter outlines the Board's role of engaging with Shareholder Ministers on Australian Government policy requirements, including on the implications of these policy requirements for NBN Co and annually causing these to be prepared and submitted via the **nbn** Corporate Plan. The Board ensures there is strong alignment and governance that flows from the three-year **nbn** Corporate Plan/ **nbn** Statement of Corporate Intent, the annual **nbn** Integrated Operating Plan (IOP) and budget through to the metrics that are on the executive STI program scorecard. Each of these documents are endorsed by Board Committees and approved by the Board through the Board reporting cadence.



The Senior Executive Remuneration framework is reviewed by the P&RC on an annual basis and is balanced against corporate and individual performance outcomes and the alignment of 'at risk' incentive awards to the achievement of stretch performance conditions. The P&RC is supported in this by EY, who provides independent advice on appropriate and applicable market practice, current and emerging trends in executive remuneration design and relevant legislative and regulatory developments.

Regarding the Government's expectation that restraint should be exercised to the extent possible, the Board has considered this alongside the requirement to act in the best interests of the company, which is a fiduciary duty, and in doing so has exercised discretion in determining the STI outcomes. I remain convinced that the overarching community expectation of NBN Co is that we provide access to a fit-for-purpose broadband network that is trusted, reliable, affordable, ubiquitous, and resilient.

#### ***How performance targets are set and measured***

EY has noted that NBN Co's target setting process is broadly in line with the approach used by other GBEs and ASX-listed companies, where STI targets are set by the Board or relevant committee – informed by Management plans and budgets and external expectations.

The Government's Statement of Expectations for NBN Co is also reflected in the corporate objectives and headline metrics in the STI scorecard.

Performance measures are determined by the P&RC against the measures in NBN Co's Corporate Plan at the start of the performance year as referenced in the 2021-22 Annual Report.

If gateway measures are satisfied during the performance period, the P&RC makes a determination to either adjust the STI pool up or down based on achievement of the corporate objectives and the performance measures. The range with which the Committee can operate is zero to 135 per cent of the STI target pool and this ability to flex the pool up and down is an important concept to provide stretch into the incentive arrangements.

The FY22 STI corporate measures were reviewed and assessed by NBN Co's Internal Audit at the request of management. There were No Exceptions identified in relation to the completeness and accuracy of the Corporate Measures and associated metrics reported within the Balanced Scorecard used to determine the FY22 Executive STI outcomes.

#### ***How STI framework could be improved***

NBN Co is constantly looking to improve its remuneration framework. As previously mentioned, executive remuneration arrangements are being examined by EY to understand how they are aligned to market practice and in consideration of the evolution of NBN Co's business strategy.

#### ***Forward-looking advice on how there could be greater independent assurance that remaining bonuses are linked to appropriate performance targets and confidence that bonuses are appropriate***

In order to ensure public confidence is maintained, the Board has decided on an additional layer of governance in its processes for setting annual targets and assessing company performance against these targets. From FY23 onwards, the Board will engage an independent party from a top four accounting firm to meet with the P&RC prior to the annual targets being set to provide advice to the Board on:



- the alignment and appropriateness of the STI scorecard measures with NBN Co's purpose and strategic objectives; and
- if the measures are appropriately weighted and reflect the relative importance of each measure in delivering NBN Co's strategic objectives; and
- the extent to which targets are likely to incentivise and motivate employees to perform at a high level.

EY has provided NBN Co with a list of example indicators for the Board to consider when assessing the appropriateness of STI scorecard measures, weightings and targets. In addition to already strong alignment of the STI to the budget/business plan, the Board proposes to enhance the annual assessment of the STI by obtaining independent assurance as to appropriateness of the STI scorecard measures. These include various benchmarking and market practice factors. EY has also suggested that this assessment could be balanced against other additional factors such as NBN Co's remuneration principles, the need to attract, motivate and retain executives, and shareholder and community expectations.

As part of this additional step, the Board will receive advice from the independent party, which will form part of the Board's final considerations and decisions.

#### ***How transition risks are being managed and cultural impacts thus far***

NBN Co undertook an extensive review, change management and employee engagement program over a period of five months to manage transition risks. The change management approach included:

- strong and clear messaging to support employees with understanding the changes to the STI program and remuneration;
- employee and leader drop-in and feedback sessions; and
- hyper-care teams to support queries.

Management has also worked to engage high performers who have consistently delivered exceptional value to NBN Co and its stakeholders by:

- focussing on NBN Co's performance culture and providing differentiated remuneration outcomes based on performance, criticality and development;
- providing career development, promotion and external exposure opportunities;
- heightened focus on NBN Co's Employee Value Proposition (EVP), to ensure that the breadth of NBN Co's offering engages and attracts employees; and
- effectively applying formal recognition.

NBN Co's employee engagement survey conducted in July 2022 revealed that employee engagement has remained high with NBN Co placed in the top quartile of companies with an engagement score of 81 per cent. However, we are closely monitoring voluntary turnover rates in areas in high demand such as technology skills.

#### ***Opportunities to improve transparency in public reporting***

NBN Co provides a comprehensive set of remuneration disclosures, and its practices are consistent with the content and transparency of an ASX listed firm.



The company's Remuneration Report disclosure is independently audited by PricewaterhouseCoopers (PwC) on behalf of the Commonwealth Auditor General who has confirmed that NBN Co has applied the requirements of the Public Governance, Performance and Accountability Rule 2014 (the PGPA rule) in its disclosures, which includes the assessment of Senior Executives as Key Management Personnel (KMP) in accordance with the meaning defined in AASB 124 Related Party Disclosures. The constituent parts of remuneration disclosed is also determined in line with AASB standards, for example long service leave and base salary (where base salary includes annual leave paid and the movement in the annual leave provision during the period) are calculated in accordance with AASB 119 Employee Benefits.

NBN Co also aligns with the disclosure requirements as outlined in the *Corporations Act 2001* which include, but are not limited to, disclosures of Board policy for determining the nature and amount of remuneration of the Directors and KMP's, a detailed summary of any performance conditions that may apply, a summary of the methods used in assessing whether a performance condition is satisfied and an explanation of the relative proportions of those elements of the person's remuneration that are related to performance and those elements of the person's remuneration that are not.

The Remuneration Report disclosure is reviewed by the P&RC of the NBN Co Board and approved by the Board as part of the process of finalising the **nbn** Annual Report.

The Remuneration Report disclosure also provides the details of Non-Executive Director (NED) remuneration which is set through the determinations of the Commonwealth Remuneration Tribunal. The NED remuneration section of the Remuneration Report details the fee structure and the amounts paid. As noted earlier, this data is independently audited by PwC.

Additionally, NBN Co is also an active participant in the Department of Finance (DoF) GBE Forum, which is an opportunity for the company, shareholder agency representatives and other GBEs to engage on best practice governance policies and shared learnings, including on the Government's workplace policies and reviews of performance bonus arrangements for senior executives.

Please do not hesitate to contact me at your convenience should you wish to discuss any of the above matters.

Yours sincerely

Kate McKenzie  
Chair, NBN Co

Copied to:

Mr Stephen Rue, Chief Executive Officer, NBN Co

Mr Jim Betts, Secretary, Department of Infrastructure, Transport, Regional Development, Communications and the Arts

Ms Jenny Wilkinson PSM, Secretary, Department of Finance