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In light of Westpac allegations, NAB takes steps to rebuild shareholder trust

Company/ASX Code	National Australia Bank Ltd/NAB
AGM date	Wednesday 18 December 2019
Time and location	9.30 am Darling Harbour Theatre at International Convention Centre, Sydney
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Dennis Shore
Pre AGM Meeting?	Yes, with Chair Phil Chronican, Director Anne Loveridge, Executive General Manager Investor Relations Sally Mihell, and General Manager Performance and Reward Richard Doody

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required

Summary of ASA Position

Last year, then Chair of NAB, Dr Ken Henry AC, declared that trust is the foundation of NAB's business. He stated that the Board accepts accountability for "conduct that is simply unacceptable" and that "the Board and NAB's people share an absolute conviction to earn the trust of our customers". In ASA's view, NAB also needs to regain shareholder trust, particularly retail shareholders.

Since last year, former CEO Andrew Thorburn resigned and Dr Henry announced his intention to step down after a new CEO was in place. Ross McEwan, the new CEO received the keys to the executive washroom on 2 December 2019 and interim CEO Phil Chronican formally commenced as Chair on 15 November 2019. Less coverage was given to the departure of Chief People Officer, Lorraine Murphy, who departed shortly after Mr Thorburn and on similar terms.

Mr Chronican is "acutely aware of what is expected of him and the Board and will actively pursue Board renewal and is determined to make things right, earn trust and build confidence in the future of the business". He also acknowledges that the bank has lost trust with customers and the broader community.

Remuneration practices have been dramatically overhauled. A major factor in ASA voting against the remuneration report last year was that Directors did not suffer any financial consequence (as has happened at CBA and ANZ) and in ASA's view, executives experienced relatively modest financial penalty for overseeing egregious conduct. These issues seem to have been addressed.

Governance and culture

The findings of the Royal Commission into the Australian financial services industry have been well documented, and the industry will need to change a lot before it can catch up. The incoming Group CEO, Ross McEwan has been identified as having the right mix of skills and experience to make things right while delivering expected and acceptable returns for investors. A clear priority will be to address the possibility of similar AUSTRAC breaches as revealed recently at Westpac.

The Chair expressed his view that NAB is further down the path to achieve these outcomes, having started earlier and with more comprehensive targets than the other banks. NAB has ensured there are proactive systems to provide remediation to customers who have been victims of the dodgy practices by the bank.

Financial performance

In the circumstances the underlying financial results have been described as "solid". However, the impact of large remediation payments resulted in a 16% lower dividend and has required capital raising to ensure compliance with future Australian Prudential Regulation Authority (APRA) requirements.

Overall net profit on a statutory basis fell by 13.6% from Financial Year 2018 (FY18). This was mainly due to an increase of $1,100 million (after tax) for customer-related remediation. An additional customer-related remediation loss from discontinued operations of $257 million (after tax) was also experienced. There was a further $470 million decrease due to a number of factors including lower wealth income resulting from fee reductions and repricing and removal of grandfathered commissions. A decrease of $530 million (after tax) was incurred in restructuring-related costs and there were accelerated amortisation costs (after tax) related to software capitalisation.

Absolute total shareholder return for the year improved from negative 5.4% to 13.3%.

Cash return on equity (RoE) fell from 11.7% to 9.9% and cash earnings fell by 10.6% to $5.1 billion. Statutory net profit fell from $5,554 Million to $4,798 Million. However if the impact of discontinued operations is excluded, this was a fall in profit of only 3.8%.

Common Equity Tier 1 (CET1) ratio was at 10.38% and the group expects to achieve APRA's unquestionably strong capital benchmark from 1 January 2020 (total capital ratio was 14.68% for FY19 and 14.12% for FY18). The priority segments net promoter score (a measure of customer satisfaction) was -14 (a 2-point increase from 2018) but resulted in NAB moving from #2 to equal #1 amongst major banks.

Key events

The changes outlined below dominated the agenda for the company during 2019. The search for a new CEO and the timing of his availability were significant factors shaping the banks activities. The managed transfer that saw the Chair-elect assume CEO duties will provide him with useful insights.

NAB released an update in November on its Self-Assessment response and Royal Commission implementation. NAB supports 72 of the 76 Royal Commission recommendations, and will go further on another and is seeking clarification on the other 3. The establishment of a team of 950 people to drive customer remediation appears to be evidence that this is a priority.

Divestment of the Wealth business is on track for 2020.

Key Board and senior management changes

As noted CEO Andrew Thorburn resigned effective February 2019 and previous Chair Ken Henry AC stepped down from the Board in November 2019. The longest serving current director (Anthony Yuen) will retire after the AGM and a new one (Kathryn Fagg) will be endorsed at the AGM. Another new director will follow. Significantly the Board has established a new standing Customer Committee to ensure address issues raised by the Royal Commission

There has also been significant senior staff restructuring, which seems to be ongoing. Long-term EGM Investor Relations, Ross Brown, has retired and has been succeeded by Sally Mihell.

Summary

(As at FYE)	**2019**	**2018**	**2017**	**2016**	**2015**
NPAT ($m)	4,798	5,554	5,285	352	6,338
UPAT ($m)	5,097	5,702	6,642	6,483	6,222
Share price ($)	29.70	27.81	31.50	27.87	29.98
Dividend (cents)	182	198	198	198	198
TSR (%)	13.3%	(5.4%)	20.1%	(0.7%)	(2.0%)
EPS (cents)	168.6	201.3	194.7	8.8	252.7
CEO total remuneration, actual ($m)	2.338*	6.202	4.065	4.060	4.233

*CEO Andrew Thorburn resigned effective February 2019 and interim CEO Phil Chronican was in the position until current CEO Ross McEwan was appointed in November 2019. The remuneration report does not meaningfully detail the interim CEO's arrangement and therefore comparisons with the Australian Full time Adult Average Weekly Total Earnings are not meaningful in this particular case.

Item 2	**Adoption of Remuneration Report**
ASA Vote	**For**

Summary of ASA Position

As has been well reported, NAB incurred a massive "first strike" at the 2018 AGM of 88.43% against the Remuneration Report, which according to press reports gave the bank the dubious distinction of the highest first strike ever received by a company.

As much as anything this could be seen as the only real way shareholders could vent their anger against the Royal Commission revelations. The company has done a lot of listening and consulting with stakeholders (although we are disappointed that ASA was not included amongst stakeholders this time as we were in 2018).

ASA was of the view that in 2018 the company had made a genuine effort to tackle the unfathomable nature of many variable reward systems employed by companies with the introduction of a “hybrid variable reward” that combines short and long term rewards to reinforce a focus on long term outcomes.

However in light of revelations that emerged from the Royal Commission it was clearly inappropriate in timing and content with employees being able to be rewarded when clearly not deserving. Feedback to the company confirmed that shareholders thought the amount of variable reward was too high and not consistent with the reasonable expectation of shareholders. In keeping with the ASA feedback the lack of an explicit long-term performance hurdle was viewed as inappropriate. Shareholders did not like dividends being paid on unvested deferred shares and overall felt there was insufficient rigour and transparency in the process.

So, have these concerns been adequately and appropriately addressed? There is much to like about the new package but also some room for improvement.

On balance we will support the remuneration report because it has addressed the patently inappropriate short-term rewards to continuing executives last year. In fact most executives will forfeit short term variable rewards for 2016 through 2018 and receive none for 2019. Moreover the 2013 LTI award did not vest and neither did the 2014, subject to one more test after 5 years. The previous lack of a financial impost for the board has also been addressed and continuing Board members will have their base fee for 2019 reduced by 20%.

The new remuneration package for executives is largely in line with ASA expectations. A specific long term variable award has been restored for executives (relative TSR) and a dividend equivalent will not be paid on deferred shares that vest. ASA prefers 2 long-term metrics and the Remuneration Chair (Anne Loveridge) undertook to consider such an inclusion, noting that the current plan will continue to be refined to match shareholder expectations and in light of requirements when considering APRA’s prudential standard for remuneration (CPS511), which is due to take effect in 2021. In keeping with ASA expectations, deferred shares (performance rights) will be issued at face value and will have a 4 year vesting period.

Overall at least 50% of total remuneration will be delivered as deferred equity. And at least one third of variable reward is subject to long-term shareholder return performance. The annual (short term) award will be delivered 50% as cash with the remainder as deferred rights vesting in equal instalments over 4 years. Dividends will not be paid during the deferral period and no equivalent at all for Long-term awards that vest.

Overall potential rewards have been significantly reduced from 2018 to 150% for all executives. The annual award is also overlaid by the “One NAB Score”, which appears to be a robust index to modify the individual achievements of executives over 5 equally rated measures (customer, risk, people, transformation and financials). Each of these measures (and stretch opportunity) are well articulated. The One NAB Score measures the Group performance over the financial year and is 50% weighted for Return on Total Allocated Equity (ROTAE), 25% on cash earnings, 12.5% on Net Promoter Score and 12.5% on transformation (2/3 non-financial and 1/3 financial). For 2019 this was set at 0%.

Overall ASA is comfortable in supporting this resolution, which seems to significantly address the remuneration challenges of the past year.

Item 3	**Spill Resolution (conditional on outcome of Resolution 2)**
ASA Vote	**Against**

Summary of ASA Position

This resolution will only be considered if more than 25% of votes are cast against the remuneration report. It is possible with ongoing revelations about banks that there will still be a large vote against the remuneration report, especially from retail shareholders. However, given that ASA has supported the Remuneration Report we currently do not have any justification to support a spill. Given the suite of actions NAB has taken and, in particular, CEO and Board renewal, and, substantiated commitment to further addressing customer, shareholder and community interest, we oppose the motion to spill.

Item 4 (a)	**Re-election of Philip Chronican as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Chronican has been a Director since 2016 and has been interim CEO since March 1 until assuming the role of Chair from 15 November. He had a distinguished career with Westpac and then ANZ and is highly regarded in the industry. He has no other listed company directorships and therefore will be able to dedicate himself to the challenge ahead of him.

Item 4 (b)	**Re-election of Douglas McKay, ONZM as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr McKay has been a Director since 2016 and is chairman of BNZ and a member of the Board's nomination and Governance, Audit and Customer Committees. He is also a director of 2 New Zealand listed companies. Mr McKay has strong relevant professional experience and qualifications. He complies with ASA's expectations for workload of a director.

Item 4 (c)	**Election of Kathryn Fagg, AO as a Director**
ASA Vote	**For**

Summary of ASA Position

If elected, Ms Fagg will be confirmed on the board after appointment on 16 December, 2019. She has strong qualifications as a professional engineer and experience in a range of industries, including banking, and as a past Board Member of the Reserve Bank of Australia. She is Chairman of Boral Ltd and a director of 2 other listed companies but will retire from the Board of Incitec

Pivot on 20 December, 2019. She therefore complies with ASA's expectations for workload of a director. She was awarded her AO for distinguished service to business and finance, to the central banking, logistics and manufacturing sectors, and to women. She has received numerous recognitions and is also a Board member of CSIRO.

Ms Fagg appears to be an excellent addition to the Board

Item 5	Selective Capital Reduction of Convertible Preference Shares (CPS)
ASA Vote	For

Summary of ASA Position

This is a fairly standard request to provide the company with appropriate flexibility and authority to repay the issue price of the CPS. The terms of the Resolution are not opposed by ASA.

Item 6	Requisitioned Resolution promoted by Market Forces (a and b)
ASA Vote	Against

Summary of ASA Position

Resolution 6a seeks to insert a new clause into the NAB constitution, which if successful would then seek to implement a further resolution, 6(b) that would require the company to include in its annual report information related to the climate goals of the Paris Agreement.

This two-part resolution has been requested by an advocacy group, concerned with the company's approach to climate change. The resolution is not endorsed by the board. On the face of it, a resolution to increase shareholder power may appear beneficial to shareholders but under the existing framework, shareholders who wish to raise an issue must propose a constitutional amendment in order to provide for such a power. We are reluctant to vote in favour of changing company constitutions – our preference is for a public policy consultation on whether there should be a right to more non-binding shareholder resolutions.

Item 7	Requisitioned Resolution promoted by the ACCR (Australasian Centre for Corporate Responsibility)
ASA Vote	Against

Summary of ASA Position

This resolution calls for NAB to suspend membership of certain industry associations, where this lobby group believes these associations are lobbying against the climate goals of the Paris Agreement.

This resolution is contingent on passing of resolution 6(a). If resolution 6(a) is passed, we intend to vote against this item as ASA would prefer to assess the Company's position over time and assess how such resolutions could affect long-term shareholder concerns and values.

ACCR's history with such resolutions in top 200 companies can be viewed at: https://accr.org.au/shareholder-action/resolution-voting-history

The individual involved in the preparation of this voting intention has a shareholding in this company.