Vanguard Investment Stewardship Insights

Voting insights: Executive remuneration and board accountability at Rio Tinto

May 2021

Vanguard publishes Investment Stewardship Insights to promote good corporate governance practices and to provide public companies with our perspectives on important governance topics and issues that come up for shareholder votes.

Company: Rio Tinto Plc (United Kingdom); Rio Tinto Limited (Australia)

Meeting dates: 9 April 2021 and 6 May 2021

Proposals: Item 3 – Approve Remuneration Report for UK Law Purposes; Item 4 – Approve Remuneration Report for Australian Law Purposes; Item 5 – Elect Megan Clark as Director; Item 8 – Elect Sam Laidlaw as Director; Item 12 – Elect Simon Thompson as Director; Item 19 (shareholder proposal) – Approve Emissions Targets; Item 20 (shareholder proposal) – Approve Climate-Related Lobbying

How the funds voted

At the 2021 annual meetings for Rio Tinto, which is dual-listed in Australia and the UK, the Vanguard funds supported the reelection of three directors and voted against the company's 2020 remuneration report, or 'Say on Pay'. The funds also supported two climate-related advisory shareholder resolutions on the Rio Tinto Limited proxy voting ballot.

Vanguard's principles and policies

Performance-linked remuneration (compensation) policies and practices are fundamental drivers of sustainable, long-term value. On behalf of the Vanguard funds, our Investment Stewardship team evaluates executive remuneration proposals case by case and looks for pay plans that incentivise long-term outperformance of company peers and promote sustainable value for company investors.

Moreover, boards are responsible for overseeing a company's long-term strategy and material risks. We regularly assess the board's understanding of a company's strategy and its own role in identifying, mitigating and disclosing risks, including environmental and social risks.

Analysis and vote rationale

In recent years, our engagements with Rio Tinto, one of the world's largest diversified mining companies, have included discussions about the board's oversight of strategy and risk. Last year, we engaged with board members to express our concerns about the destruction of the Juukan Gorge Aboriginal heritage site and about key oversight failures (see *Vanguard Investment Stewardship Insights: Social Risks and the Rights of Indigenous Peoples*). We also encouraged the board to evaluate a broad set of final remuneration outcomes for the outgoing company executives and to consider potential shareholder reactions to such decisions.

Ahead of the 2021 annual meetings, we again met with board members and discussed the company's prior-year performance and ongoing response to the Juukan Gorge events. Our engagement topics included board accountability and executive remuneration outcomes.

In March, it was announced that the director who led the board's review of the Juukan Gorge incident would not seek reelection at the 2021 annual meetings, and that the board chair would step down before the 2022 annual meeting. We considered these actions appropriate steps that demonstrated that the board had recognised and accepted its role in the oversight failures that contributed to the Juukan Gorge destruction.

Two other director nominees had drawn criticism related to the events for their roles as the sustainability and remuneration committee chairs, overseeing environmental and social risks – including community relationships – and remuneration decisions.

Based on our engagement and independent research, we concluded that further individual accountability measures would not be in the best long-term interest of our shareholders.

Significant changes to Rio Tinto's board and leadership team have already been made, and we recognised the need to ensure a level of stability and continuity in the board's overall composition. For example, the remuneration committee chair is currently leading the board chair succession process, while the sustainability committee chair, an Australian citizen, brings local expertise to oversight of the remediation program. The Vanguard funds consequently voted to reelect the three directors, including a final one-year term for the board chair.

We also evaluated Rio Tinto's latest remuneration report, which is put to shareholders each year as a nonbinding advisory proposal. The report showed that total pay for the outgoing CEO increased 20% from the prior year, despite financial penalties applied in the wake of the Juukan Gorge destruction. This increase was based on the company's strong stock performance, which was due in part to record-high iron ore prices.

Although shareholders have experienced strong returns in recent years, the Vanguard funds voted against the remuneration report. We remained concerned that the outgoing CEO's pay did not reflect the gravity of the risk and governance oversight gaps that contributed to the events at Juukan Gorge. We were also disappointed that the board had failed to apply further discretion to the equity awards.

We believe that the damage the Juukan Gorge events did to trust in Rio Tinto and to its reputation may not be immediately reflected in the company's share price but could negatively impact its future performance.

Shareholders were also asked to vote on climate-related resolutions filed by two activist groups. The resolutions requested that the company disclose independently verified, Paris Agreement-aligned emission-reduction targets for its Scope 1 and 2 emissions, along with its performance against those targets, and that it enhance its review of its memberships in industry associations to ensure they align with the Paris Agreement goals.

The Rio Tinto board recommended that shareholders vote in favor of the resolutions, explaining that the company was already substantially meeting the proponents' requests. We agreed, and the Vanguard funds supported the resolutions. We encouraged the company to continue making progress in these areas, as Rio Tinto has committed to a 'Say on Climate' vote at its 2022 annual meeting.

What Vanguard expects from companies on these matters

In times of crisis and material risk oversight failures, company boards should consider how executive pay decisions might affect public perception of their practices.

Vanguard expects boards to acknowledge shortcomings and take appropriate actions to hold directors and executives accountable for material failures. We also encourage boards to be receptive to feedback from shareholders and community stakeholders. As circumstances warrant, boards should consider a wide range of available disciplinary options, including pay reductions and, if appropriate, loss of employment.

When confronted with a crisis resulting from governance and risk oversight failures, companies and their boards should implement changes and improvements in their policies, processes and practices to remediate adverse impacts and prevent recurrences.