Executive Remuneration in UK listed companies

Shareholder Expectations during the COVID-19 Pandemic

The Investment Association has been asked by Remuneration Committees of UK listed companies and their advisors to provide shareholder expectations on how committees should be reflecting the impact of COVID-19 on executive pay. These expectations are evolving as the ongoing impact of the pandemic becomes clearer, we expect that we will update this guidance as the situation develops or other issues arise. The IA's Principles of Remuneration continue to provide a useful guide to shareholder expectations and good practice.

Shareholders recognise that Remuneration Committees will need to sensitively balance the need to continue to incentivise executive performance at a time where management teams are being asked to demonstrate significant leadership and resilience and ensure the executive experience is commensurate with that of shareholders, employees and other stakeholders.

The impact of COVID-19 will be different for each and every company, whilst there are minimum expectations for every company, shareholders expect Remuneration Committees to take account of their individual circumstances particularly considering the impact on their stakeholders.

The main areas we have been asked to address are:

Should a Company that has suspended or cancelled a dividend in relation to FY2019 consider adjusting bonus outcomes for FY2019?

Where dividend payments are suspended or cancelled, members expect Boards and Remuneration Committees to consider how this should be reflected in their approach to executive pay.

For some companies, bonus outcomes will have been decided and may even have been paid before the dividend payment was cancelled, however shareholders would expect Remuneration Committees to consider the use of discretion or malus provisions to correspondingly reduce any deferred shares related to the 2019 annual bonus in such instances.

Alternatively, shareholders would expect this to be fully reflected in the FY2020 bonus outcomes.

Would shareholders support performance conditions being adjusted to take account of COVID-19?

IA members have stated that they do not expect Remuneration Committees to adjust performance conditions for annual bonuses or in-flight long-term incentive awards to account for the impact of COVID-19.

Where the Remuneration Committee consider that performance of the company and shareholder experience is not commensurate with the executive remuneration outcomes, then Remuneration Committees should use their discretion to ensure a good link between pay and performance. In such cases Remuneration Committees should engage with their shareholders and disclose the reasons for the use of such discretion.

Where companies have already granted 2020 LTIPs (as is likely for December year-end companies), what do shareholders expect from Remuneration Committees to ensure that a windfall gain will not been received by executives?

The majority of members have stated that for December year-end companies that have already made grants, if the share price fall is solely related to COVID-19 market movements then they will accept that there does not need to be an adjustment to the grant size.

Nonetheless, it is important for the Remuneration Committee to confirm that they will look at the general market and share price response over the performance period to ensure that windfall gains will not be received on vesting. Shareholders will expect the Committee to use their discretion to reduce vesting outcomes where windfall gains have been received.

Remuneration Committees should set out in their next Remuneration Report the approach they will take and factors they will consider when judging if there has been a windfall gain from the LTIP grant.

Shareholders would expect any longer-term individual share price underperformance to be accounted for. If, for instance, the share price was down 30% in the year prior to the COVID-19 market reaction, an appropriate scaling back should be applied.

Where companies expect to make LTIP grants in the coming months, what are shareholders expectations on long-term incentive grant sizes and performance conditions?

Shareholders feel that it is important for Remuneration Committees to take into consideration the individual circumstances of the company and the impact of COVID 19 on the company.

There are concerns from companies and shareholders over the ability to set meaningful three-year targets at the current time and questions over the appropriate grant size given the share price reaction to COVID-19.

In particular, Committees should be considering if it is appropriate to make LTIP grants at the current time and whether given the current market environment it might be more appropriate to postpone the current LTIP grant. Members believe that there are a number of options depending on the individual circumstances of the company:

1) Grant on the normal timeline setting performance conditions and grant size at the current time.

2) Grant on the normal timeline setting the grant size now but committing to set performance conditions within the next six months.

3) Delaying the grant to allow the committee to more fully assess the appropriate performance conditions and grant size. In such circumstances Committees should aim to make the grant within six months of the normal grant date.

The Committee should explain the approach they have taken to their shareholders. Whichever approach committees take, they should be clear about the discretionary powers available to the Committee on vesting and commit to using them to ensure that outcomes will reflect company and executive performance as well as the experience of shareholders and stakeholders including employees. Shareholders will expect the Committee to use their discretion to reduce vesting outcomes where windfall gains have been received.

Committees will have to adopt an approach that is appropriate to the company and the specific impacts of COVID-19 on the business. Whichever approach is adopted, committees should be careful not to isolate executives from the impact of COVID-19 in a manner that is inconsistent with the approach taken to the general workforce.

The issues on performance conditions and grant size are outlined below.

Grant size

Remuneration Committees need to be pro-active in determining the appropriate LTIP award size in the current market environment 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.

Performance conditions

Remuneration Committees will have to consider if the performance conditions for future LTIP grants are still appropriate in the current market environment. Shareholders want performance conditions to be appropriately stretching. Committees may wish to make an LTIP grant at the usual time while delaying setting performance conditions for a reasonable period of time (up to six months), until the impact of COVID-19 on the business is clearer.

If Committees decide to delay LTIP grants until further clarity is established, shareholders would still expect best practice to be a performance period of three years following grant. However, where this is not possible, committees may shorten the performance period by up to six months, contingent on the explanation provided by the committee and adequate post-vesting holding provisions being in place. Where the performance period is shortened, grant sizes should be similarly reduced.

What are shareholders expectations if a company seeks additional capital from shareholders or takes money from the government such as furloughing employees?

Shareholders expect executive remuneration to be aligned with the experience of the company, its employees and its other stakeholders.

Where a company has sought to raise additional capital from shareholders, or has required Government support such as furloughing employees, shareholders would expect this to be reflected in the executives' remuneration outcomes.

The Principles of Remuneration are clear that executive remuneration should be reflective of the pay and conditions in the wider workforce. COVID-19, and the measures taken to avert its wider spread, will result in many employees being furloughed or asked to take pay-cuts. Remuneration Committees and management teams should be even more mindful of the wider employee context through this period. Failure to do so may have significant reputational ramifications.

Members have noted the number of companies who have already proposed temporary salary reductions for executives or decisions to freeze the variable pay, shareholders will support those companies that do so and recognise that if they are asking employees to take temporary reductions such an approach should be followed by the executives too.

Many companies will have their three-year Remuneration Policy up for a shareholder vote at the forthcoming AGM. How will shareholders consider proposals to change remuneration structures, including increases to variable pay opportunity?

Many companies will have spent significant time consulting with their shareholders on the new remuneration policies which will be put to shareholders through this AGM season. Shareholders do not believe that these companies should be rewriting their remuneration policies at this time, but if companies are seeking to propose variable pay increases in the current year, the Remuneration Committee should carefully consider if such an increase is appropriate in 2020.

For those companies that are yet to consult on a new Remuneration Policy, it may not be appropriate to bring forward remuneration policies with substantial changes if the company is significantly impacted by COVID-19. For these companies, it may be more appropriate to wait until there is greater clarity on the future market environment before proposing significant changes to their policies.

Remuneration Committees will need to sensitively balance the need to continue to incentivise executive performance at a time where management teams are being asked to demonstrate significant leadership and resilience and ensure the executive experience is commensurate with that of shareholders, employees and other stakeholders.

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