
# Executive Remuneration in UK listed companies

## Shareholder Expectations during the COVID-19 Pandemic

In April 2020, the IA provided additional guidance on Shareholder Expectations during the COVID-19 pandemic. This guidance seeks to update IA member expectations on how Remuneration Committees should be reflecting the impact of COVID-19 on executive pay. The IA's Principles of Remuneration continue to provide a useful guide to shareholder expectations and good practice.

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. Committees will have to adopt an approach that is appropriate to the company and the specific impacts of COVID-19 on the business.

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. 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.

**If a company has taken Government support or additional capital from shareholders what should the impact be on Executive Pay?**

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

Where a company has raised additional capital from shareholders, or has required Government support through the Job Retention Scheme, taking government loans or used/using other similar Government schemes which offer direct support to companies, shareholders would expect this to be reflected in the executives' remuneration outcomes and generally would not expect the payment of any annual bonuses for FY2020 or FY2020/21, unless there are truly exceptional circumstances.

The Principles of Remuneration are clear that executive remuneration should be reflective of the pay and conditions in the wider workforce. COVID-19 has resulted in many employees being furloughed, asked to take pay-cuts or resulting in large scale redundancies. Remuneration Committees and management teams should be even more mindful of the wider employee context through this period and the impact that it should have on pay outcomes for the executive directors.

Failure to take account of Government or shareholder support, and the company's approach to all employee pay, on variable pay outcomes for executive directors may lead to workforce morale or productivity issues and also have significant reputational ramifications for the company and its shareholders.

**How should Remuneration Committees consider the impact of other indirect government support such as Business rate relief?**

The Government has announced a number of indirect support measures for some sectors, such as the business rate relief, whereby businesses in the retail, hospitality and leisure sectors in England will not have to pay business rates for the 2020 to 2021 tax year. For some sectors this will have a significant positive impact on financial performance and therefore remuneration outcomes. Therefore, shareholders would expect Remuneration Committees to disclose how they have taken into account the impact of these government measures on remuneration outcomes.

**What do shareholders expect if a Company has suspended or cancelled its dividend in relation to FY2019 or FY2019/20?**

As set out in April, where dividend payments for FY 2019 or FY 2019/20 were suspended or cancelled, members expect this to have a corresponding impact on remuneration outcomes. Shareholders expect Remuneration Committees to clearly disclose how the cancellation of an intended dividend has been reflected in 2019 or 2020 remuneration outcomes either through the use of discretion or malus provisions to correspondingly reduce any deferred shares related to the 2019 annual bonus. Or 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 in-flight annual bonuses or long-term incentive awards to account for the impact of COVID-19.

Members would ask companies to confirm in their Remuneration Committee Chair's statement that they have not adjusted performance targets during the year.

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.

Shareholders would not expect LTIP grants to be cancelled and replaced with another long-term incentive grant. In addition, shareholders do not expect remuneration committees to compensate executives with higher variable remuneration opportunity in 2021 for lower remuneration received in 2020 due to the pandemic.

**Issues to consider for individual elements of pay:**

**Salaries**

Shareholders expect companies to show continued restraint. Increases to salary, if necessary, should be in line with changes to the wider workforce. Investors will continue to look closely at how any increases to basic salary or variable pay opportunity are justified and will expect Remuneration Committees to show restraint in relation to overall quantum. Members continue to be concerned by incremental increases to both fixed pay and variable pay opportunity which, on aggregate, can lead to substantial increases in overall remuneration.

**Bonuses**

Members noted that whilst they understand that more companies are likely to use their discretionary powers with regards to variable pay in the coming year, it is important that this is matched with increased disclosures concerning the rationale and outcomes for such discretion. This includes a higher level of disclosure on how Committees have determined financial targets (especially when they are lower than the previous year), and why they may have allowed for pay-outs under non-financial elements only. As noted above, shareholders generally do not expect bonus payments when the company has taken Government or shareholder support. Bonuses should reflect the wider employee experience. Companies may also consider whether a higher portion of the bonus should be deferred into shares.

Enhanced disclosure expectations will also apply when companies have made adjustments to variable pay performance measures as a result of exceptional circumstances such as rent concessions or waivers. When these items are included in the calculation of performance measures, members expect disclosure as to what has been included/excluded and the rationale, especially since such items may be material to pay-out/vesting.

**Long Term Incentives**

<u>Windfall gains</u>

Remuneration Committees should set out in their Remuneration Report the approach and factors they will or have considered when judging if there has been a windfall gain from LTIP grants made in 2020. For those that reduced the size of the grant, this should also be stated.

<u>Grant size for future awards</u>

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.

<u>Performance measures</u>

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. Given the difficultly of setting long term performance conditions, Remuneration Committees will have to consider the appropriate performance metrics and stretch of individual performance targets. This may lead to a reduction in the performance target range or a wider performance range. Nonetheless, it is crucial that targets remain sufficiently stretching and targets should not be adjusted to compensate Executives for reduced remuneration outcomes as a result of the COVID-19 downturn. It will be important for Committees to disclose the process it has been through to set the targets including the use of internal budgets and consensus estimates.

The Remuneration Committee 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 performance outcomes are not consistent with overall company performance or windfall gains have been received**.**

**Alternative Remuneration Schemes**

A number of Remuneration Committees are considering if the use of restricted shares is more appropriate for their company in the current environment – especially given the difficulty of setting meaningful long-term performance conditions at this time. Whilst 2020 has seen shareholder approval of a number of new Restricted Share Schemes, shareholders will still consider the strategic rationale for the implementation of such schemes. This will continue to be a key driver for shareholders and the inability to set meaningful performance targets is not a reason in itself to move to a restricted share model.

As with other Long-Term Incentives, Restricted Share Scheme awards should consider whether the size of the grant is appropriate where share prices have fallen and would otherwise risk windfall gains on vesting. Where companies introduce a Restricted Share Scheme, the Remuneration Committee should consider share price factors in addition to the usual discount rate of at least 50% from the LTIP grant level that is expected by members to avoid awarding the same number of shares as would usually have been granted.

**New Policies**

When considering changes in remuneration policies, structures or performance metrics it is important for shareholders to have sufficient information to make informed voting decisions. Remuneration Committees will have to continue to evaluate if it is the appropriate time to make 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. Minor changes should still be addressed, with policies updated to reflect best practice and UK Corporate Governance Code requirements, including changes to post-cessation shareholding requirements, bonus deferrals and malus and clawback provisions.

**16 November 2020**

**Addendum to the Executive Remuneration in UK listed companies - Shareholder Expectations during the COVID-19 Pandemic – 24 February 2021**

The IA published *Executive Remuneration in UK listed companies - Shareholder Expectations during the COVID-19 Pandemic* in November 2020. Given the uncertainties arising from the current Lockdown and ongoing COVID-19 restrictions on the economy, we understand this is impacting some Remuneration Committee's ability to set long term performance targets. The IA is therefore adding the following guidance:

**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 long term incentive performance conditions to be appropriately stretching. For companies who have been significantly impacted by the COVID-19 pandemic, Remuneration Committees may wish to make an LTIP grant at the usual time while delaying setting the performance conditions for these awards for a reasonable period of time (up to a maximum of six months), until the continued 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.

The company should publish the performance conditions as soon as possible after they have been set via an RNS.