People Advisory Services

Executive Pay: Insights into the 2021 AGM reporting season

July 2021

EY
Building a better working world

Introduction

The 2021 AGM season represents the first full season where companies have been grappling with the business impact of the pandemic. Some investors, such as Legal and General Investment Management, have stated that they gave companies a degree of grace in 2020 because remuneration reflected the pre-pandemic year and companies were only starting to deal with the business challenges that the pandemic presented. Moving into the 2021 AGM season shareholders and proxy voting agencies have been clear, stating that executive pay outcomes should be sensitive to the broader economic environment and be reflective of the wider shareholder and employee experience.

With this in mind, we analyse the 2021 AGM season to date, highlighting key themes across the FTSE 350.

Proxy comments

Comments by Institutional Shareholder Services (ISS) and the Investment Association (IA) are in line with previous years but this year there is an overlay of additional considerations as a result of COVID-19. Key areas of concern include:

- Salary increases in excess of that of the wider workforce. Against the backdrop of the pandemic the vast majority of companies have exercised restraint in granting pay increases with just under half of the FTSE 350 freezing executive director pay.
- Incentive outcomes that are not aligned to the shareholder experience or do not reflect the use of government support or cancellation of dividends.
- Upward discretion being applied to incentive outcomes. Discretion broadly fell under two categories:

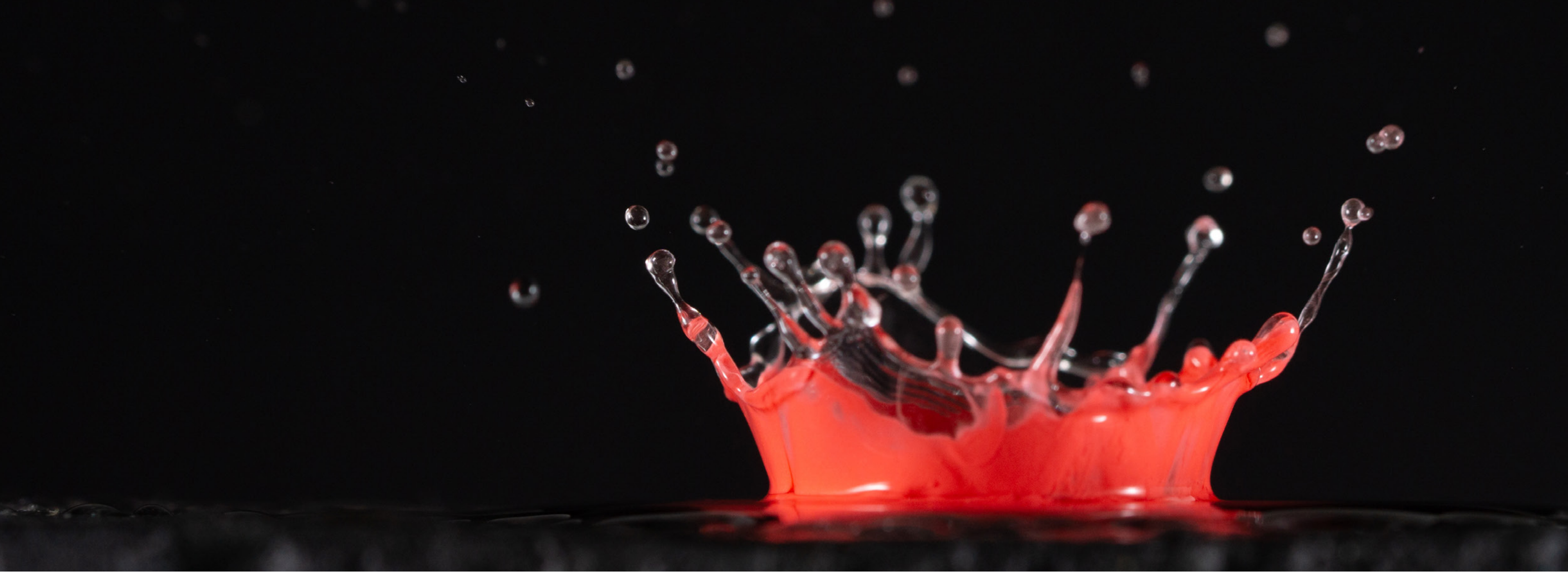
    1. **Metric substitution** For example, one company substituted the EPS portion of an inflight long-term incentive (LTIP) award with a cash flow measure in the final year of performance due to the impact of COVID-19. This resulted in this portion of the award paying out when it would have otherwise lapsed.
    2. **General discretion** For example, one company failed to achieve a profit threshold which meant that there could be no payout in respect of the strategic objectives. However, due to ‘strong financial performance in light of the pandemic’ discretion was used to pay the full 25% for the strategic element.

Restricted shares

12 companies across the FTSE 350 introduced a restricted share plan, receiving mixed reactions from the proxy voting agencies. 50% of the companies received a ‘Contentious For’ recommendation from ISS and the remaining 50% received a ‘Vote Against’ recommendation. The main reasons for concern were:

- Insufficient rationale of how the structure aligns with the company’s strategy.
- A need for increased explanation of the performance underpins.
- The reduction in quantum not being enough to justify the increased certainty of the award.

Despite the ISS voting recommendations, all Restricted Share Plans were approved at their respective AGMs, with only two receiving a vote for of less than 80%.



ESG

The inclusion of Environmental Social and Governance (ESG) metrics in incentive plans is not a new concept, companies have included metrics relating to employee engagement, customer and health and safety for some time. However, there is continuing evidence that the nature of ESG metrics used in incentive plans is evolving. Analysis shows that there is now wider adoption of metrics that are reflective of key societal issues such as diversity, climate change and sustainability. Below are three examples of these types of ESG metrics adopted this year:

- **FTSE 100 company** As part of their LTIP, one company is introducing a scorecard of sustainability and environmental measures relating to reducing absolute emissions from direct operations by 55% by 2030.
- **FTSE 250 company** Including a carbon emissions target in their LTIP based on their journey to net zero.
- **FTSE 250 company** As part of a broader scorecard of measures one company included the following three metrics related to diversity in their latest annual bonus plan:
  - Increase the percentage of females in the top 3 levels of the company.
  - Increase the percentage of Black, Asian and Minority Ethnic employees in the top 4 levels of the company.
  - Achieve an inclusion target above sector peers.

The need for businesses to take serious action on ESG concerns is no longer up for debate, this is an area that investors are now seriously focusing on. In terms of whether it is appropriate to reflect these measures in incentive plans, the IA have stated that remuneration committees should consider how material and quantifiable they are, and that they must be clearly linked to the implementation of the company strategy.

Engagement

In November 2020, the Financial Reporting Council (FRC) published a review of corporate governance reporting which revealed that organisations 'tick box compliance' approach to corporate governance reporting has led to boilerplate language and ineffective reporting. From a remuneration reporting perspective, the FRC have highlighted two specific areas that organisations should seek to address:

- Improving explanation on the strategic rationale for executive directors' remuneration policies, structures, and performance metrics. Companies should better explain how remuneration practice supports company strategy and performance, for example, how it supports the achievement of key performance indicators. Companies demonstrating best practice in this area use consistent terminology and presentation between the remuneration and strategic reports.
- Improving engagement with the workforce. The FRC have stated that effective engagement is more than reporting that the company has sought the workforce's views on remuneration via surveys. They state that engagement should be two-sided. It should describe the method of engagement, the parties involved, what explanation was given to the workforce as to how executive remuneration aligns with wider company pay policy and present the views of the workforce.

Shareholder reaction

As evidenced below, companies have generally received strong shareholder support for their remuneration resolutions:

	Median shareholder support – remuneration report	No. of companies receiving <80% – remuneration report	Median shareholder support – remuneration policy	No. of companies receiving <80% – remuneration policy
FTSE 100	96%	7	94%	4
FTSE 250	98%	15	94%	6

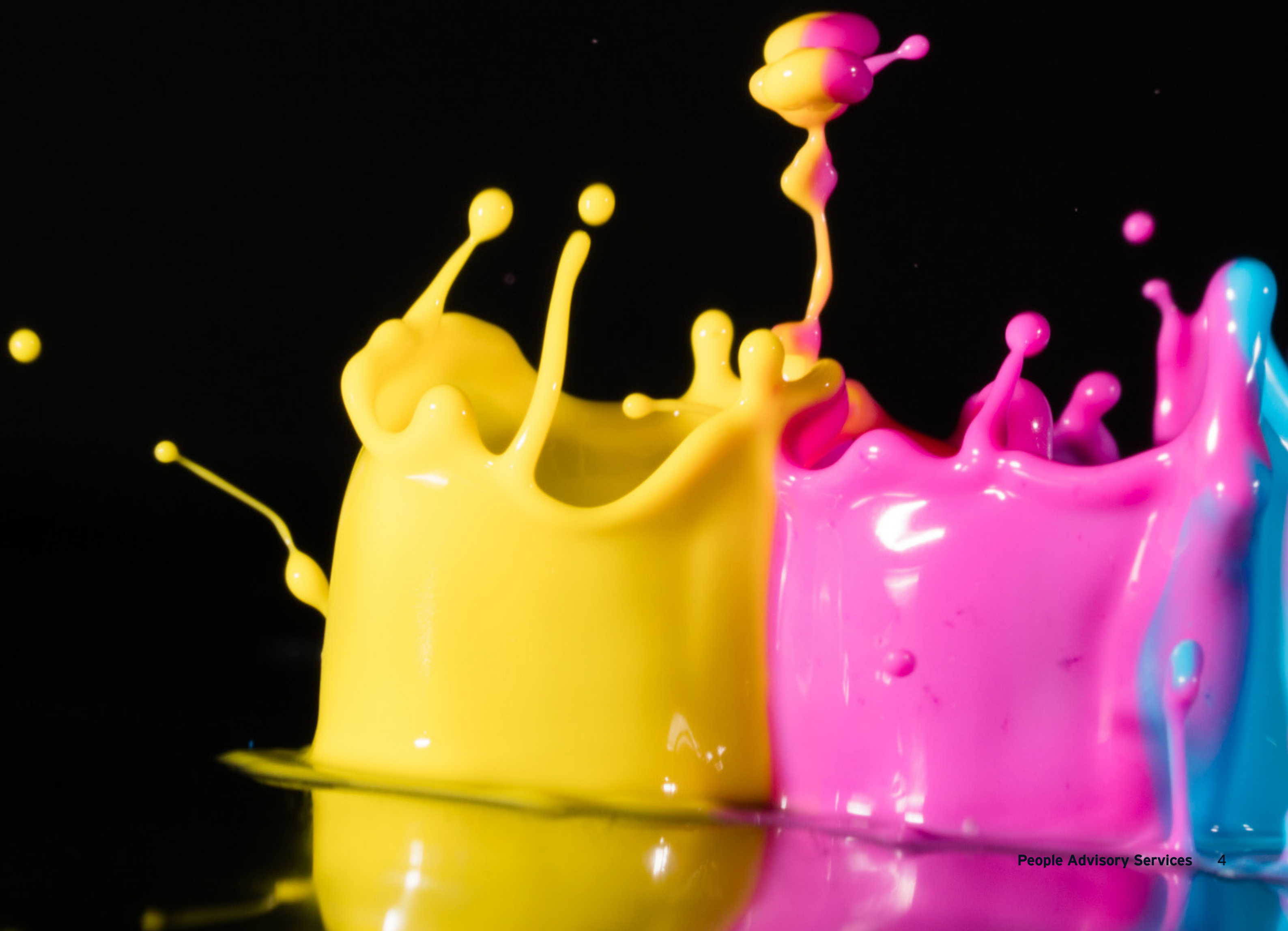
Below is a selection of some key themes coming from proxy voting agencies for those companies receiving less than 80% shareholder support:

Company	Theme	Recommendation	Outcome
Company A – remuneration report	Adjustments made to inflight LTIP award which resulted in significant vesting when awards should have lapsed. New awards were made under a plan that previously had a c. 40% vote against.	ISS recommendation	AGAINST
		IVIS recommendation	RED
Company B – remuneration policy	Significant increases to variable pay award levels for the second consecutive year. Rationale provided is not sufficiently compelling.	ISS recommendation	AGAINST
		IVIS recommendation	AMBER
Company C – remuneration policy	Decrease in pension contributions to align with wider workforce will not occur until 2025.	ISS recommendation	AGAINST
		IVIS recommendation	RED
Company D – remuneration report	2019 and 2020 LTIP awards for retiring CFO vested early based on a performance assessment and pro-rated for time, instead of original performance and vesting conditions. The 2020 award was still granted after the intention to retire was announced.	ISS recommendation	AGAINST
		IVIS recommendation	BLUE
Company E – remuneration policy and report	CFO's 8.5% salary increase was reinstated in November after it was voluntarily waived for COVID-19 and a further 6.25% increase was also applied. The CFO was also granted a 2021 LTIP of 200% of salary under the exceptional limit in the current policy.	ISS recommendation	AGAINST
		IVIS recommendation	AMBER
Company F – remuneration policy and report	The 2021 LTIP grants significant block awards to executives, with vesting subject to share price performance. Performance targets are not sufficiently stretching and share price performance is largely contingent on external factors, outside of the executives' control.	ISS recommendation	AGAINST
		IVIS recommendation	AMBER
Company G – remuneration report	The CFO's salary was increased by a total of 7% in 2020 following expansion of role. Subject to continued development and performance, a further increase of 3% above the UK workforce may be applied in 2022.	ISS recommendation	AGAINST
		IVIS recommendation	AMBER
Company H – remuneration policy	LTIP award levels are being increased from 250% to 375% of salary for the CEO and from 200% to 300% of salary for the CFO, phased over two years.	ISS recommendation	AGAINST
		IVIS recommendation	AMBER

Conclusions

The financial impact of the pandemic has led shareholders to increase their focus when reviewing executive pay outcomes. With a number of high profile exceptions the high levels of shareholder support for remuneration resolutions, coupled with restraint on executive pay outcomes, demonstrates that companies have generally taken extra care to navigate the shareholder and wider stakeholder sentiment this AGM season.

The challenge for remuneration committees moving forward will be to balance the need to retain and motivate executives against the backdrop of heightened scrutiny of executive pay outcomes. This broadens scrutiny beyond the need for approval of policy, with the rationale for the way decisions have been made and policy implemented during the year remaining a key focus. Companies will continue to need to demonstrate that executive pay reflects the shareholder and wider stakeholder experience in order to ensure shareholder support and avoid potentially significant votes against the remuneration report. Even though this is not a binding vote, experience shows that negative reaction and shareholder criticism can be reputationally damaging to both the company and to the remuneration committee. Transparent and clear disclosure and explanation is a key tool in managing this difficult debate.



Contact

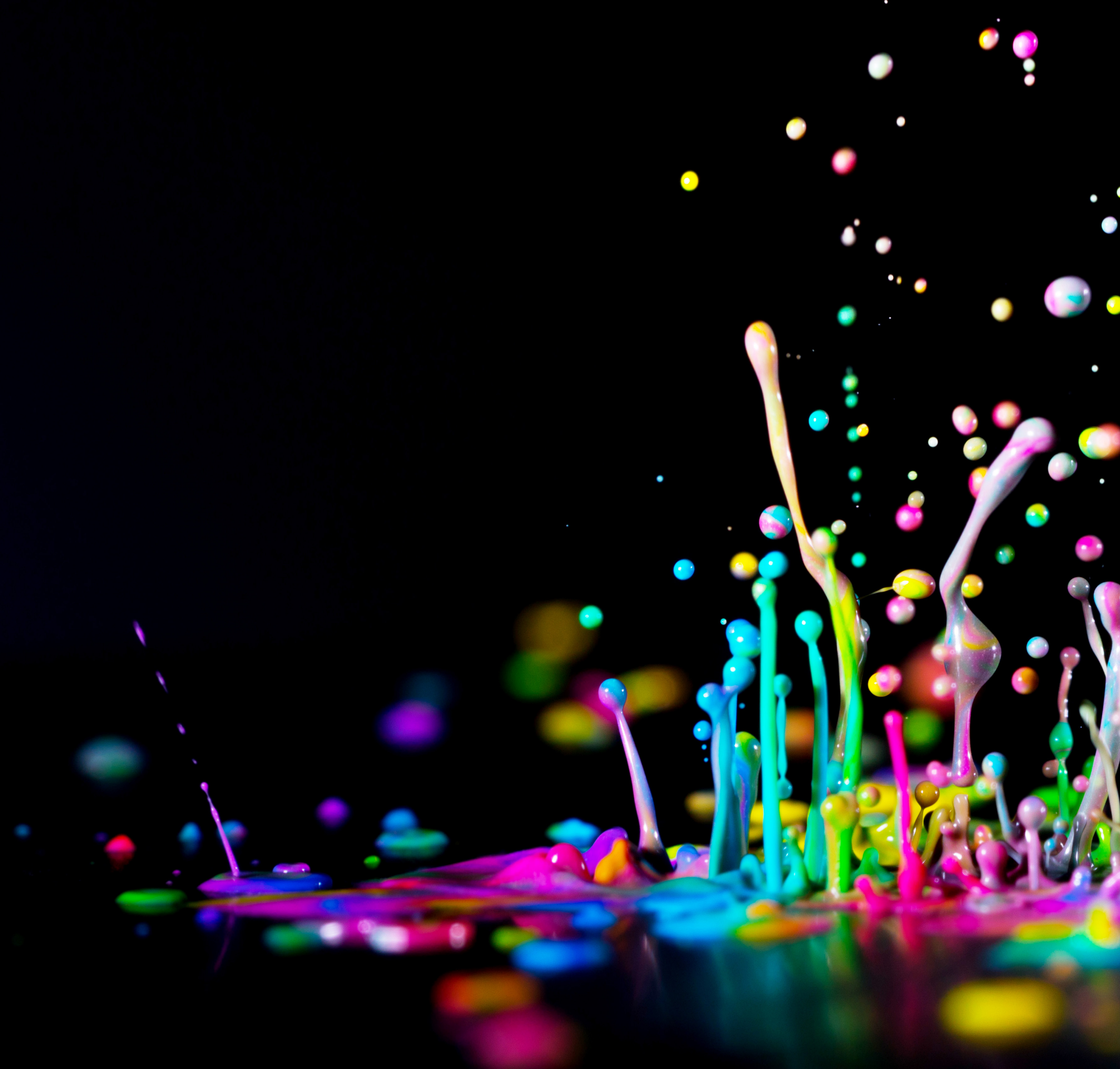
If you would like to discuss the topic further, please do not hesitate to get in touch with:

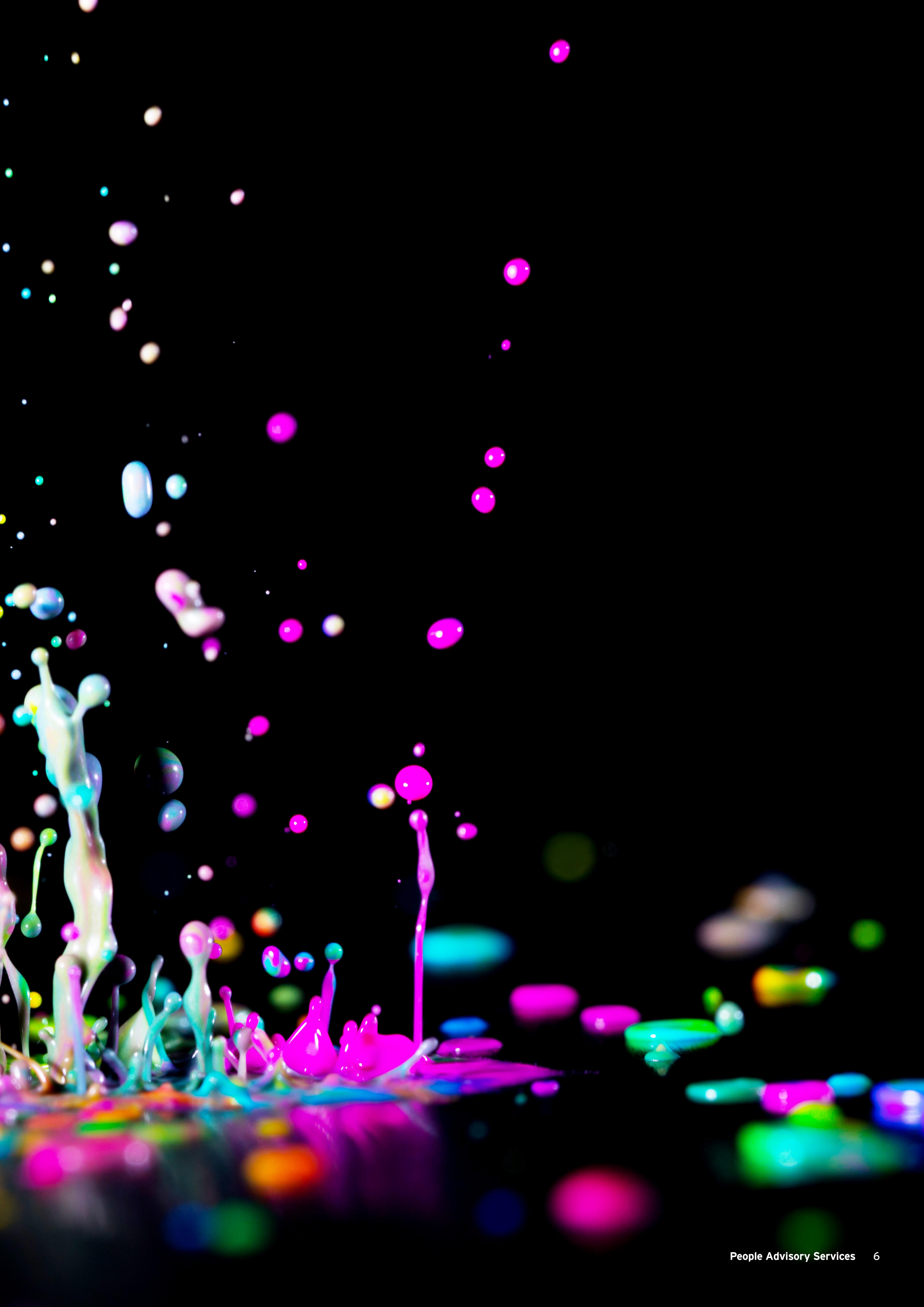
Martin Reynolds
Senior Manager,
People Advisory Services

+ 44 7717 274568
martin.reynolds@uk.ey.com

Caroline Johnson
Director,
People Advisory Services

+ 44 7717 447665
caroline.johnson@uk.ey.com





EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EYUK-000140287.indd (UK) 07/21. Artwork by Creative London.
ED None

ey.com/uk