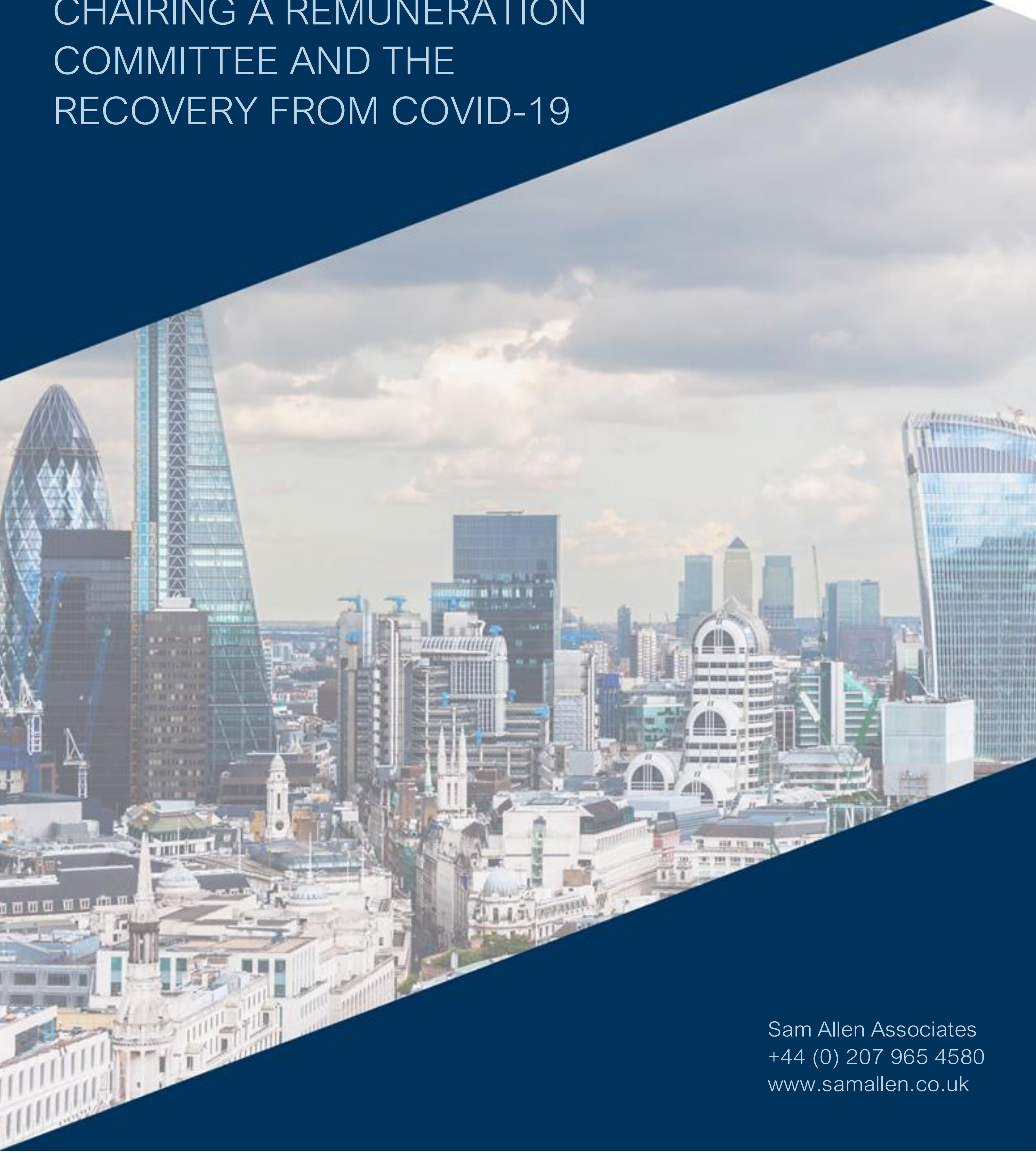
In Focus:

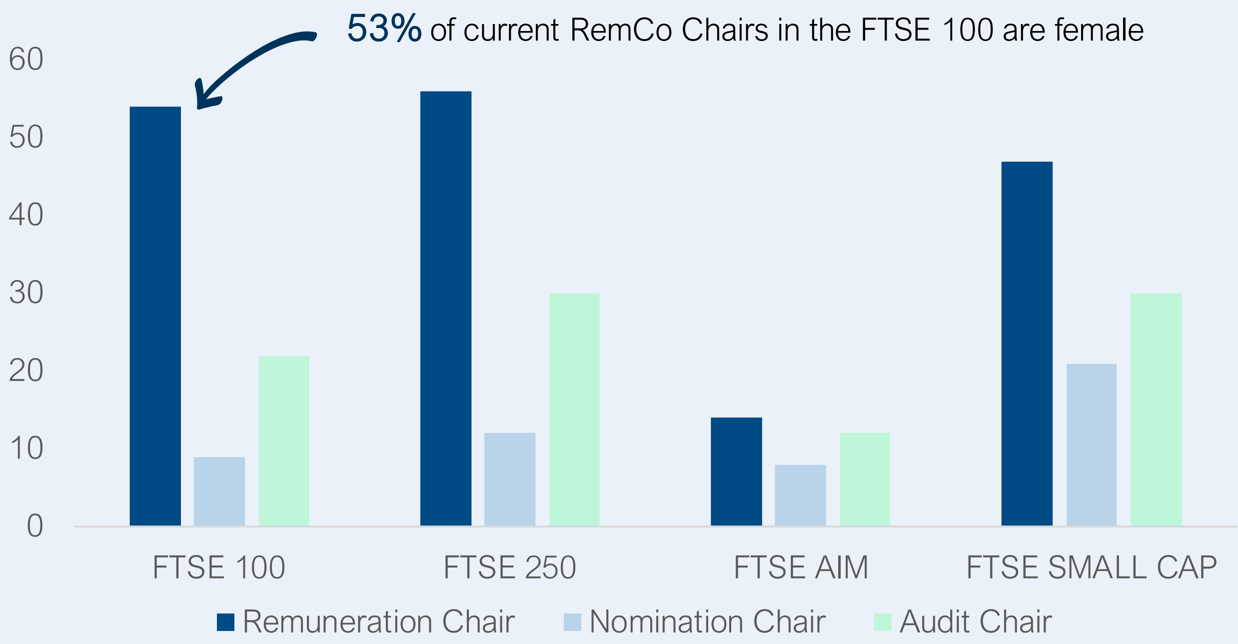
CHAIRING A REMUNERATION COMMITTEE AND THE RECOVERY FROM COVID-19



Sam Allen Associates
+44 (0) 207 965 4580
www.samallen.co.uk

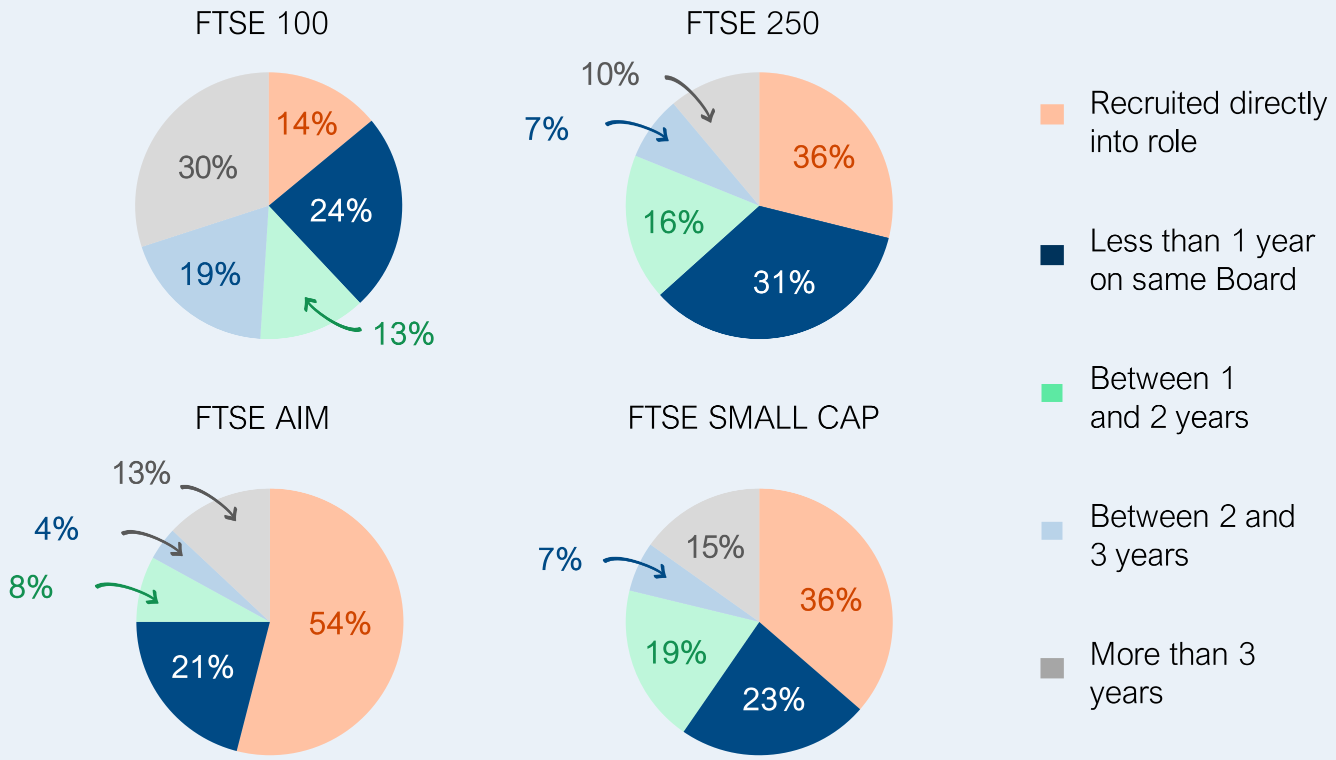
Gender Diversity

Across the FTSE, 30% of RemCo Chairs are female. The proportion of female RemCo Chairs is significantly higher than the proportion of female NomCo or Audit Committee Chairs across all indexes.



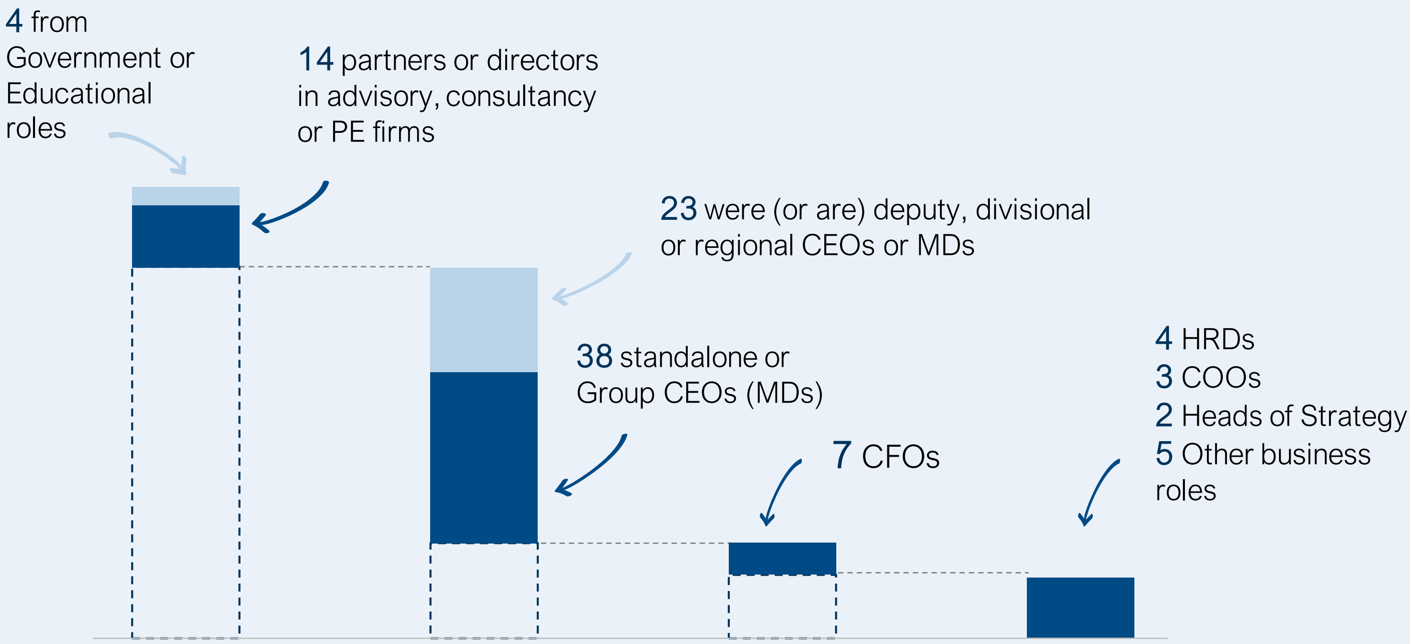
Experience on Company Board Before Moving into RemCo Chair Role

Across the FTSE, 45% of RemCo Chairs were recruited directly into the role. This was lowest in the FTSE 100 (14%) and highest in the AIM (54%). On average 23% of RemCo Chairs spent less than a year on the same Board before taking up their current role.



Latest Executive Positions held by FTSE 100 RemCo Chairs

Only 6 of the FTSE 100 RemCo Chairs are currently in an executive role. The remaining 94 are all in plural careers or have a single Non-Executive Role. For all RemCo Chairs, we looked at the last (or current) executive position they occupied:



Sector Backgrounds of RemCo Chairs

Lack of experience as an executive in a particular sector is not a barrier to becoming a RemCo Chair: Financial Services, Consultancy and Asset Management experience is valued highly.

Executive Experience of RemCo Chairs (Top 6)

- Consultancy/Advisory 14%
- Banking 12%
- Asset Management 10%
- Food producers and Processors 5%
- Insurance 5%
- Business Services 5%

FTSE 100 Sector (Top 6)

- Leisure & Hotels 7%
- Media & Entertainment 7%
- Mining 7%
- Construction and Building materials 6%
- Business Services 6%
- Speciality Finance 6%

Data taken from BoardEx, analysis conducted by Sam Allen Associates

Introduction

Now is a difficult time to chair a Remuneration Committee (RemCo). On top of the normal complexities involved in determining the structure and scale of executive remuneration packages and ensuring pay is both performance related and proportionate, they must also navigate the sharpest recession on record. Differences in public sentiment around furlough arrangements and government bailouts only compound these difficulties.

The recent history of executive remuneration is one of increased scrutiny from the public, regulatory organisations or from shareholders. In the wake of COVID-19 there will also be increased scrutiny from employees, many of whom may have been furloughed on less than 100% or made redundant. With many, including the Government, closely watching the actions of big businesses in the wake of COVID-19, never has the pressure been higher to 'get decisions right' regarding executive remuneration.

To force the issue, a few large companies have publicly stated their aim to hand back some, or all, of the government handout they have been given, especially furlough support. Whilst many of these companies deny the move has anything to do with public perception, they cannot argue it will resonate well with the public and shine a spotlight on those competitors not doing the same. It will undoubtedly be easier for these companies to justify executive bonuses than those who have relied on Government support.

Investment Association – *Principles of Remuneration*

"Shareholders discourage the payment of variable remuneration to executive directors if the business has suffered an exceptional negative event, even if some specific targets have been met, in particular ones that impact on stakeholders including the company's workforce."

The decision to stick with, or review, an existing remuneration policy in the face of significant economic upheaval is a difficult one. With a number of prominent executives declaring their intention to take reduced salaries or bonuses in the wake of the pandemic it can feel like many RemCo chairs are being backed into a corner.

However, to make the right decision for the company, and to avoid a knee-jerk reaction to public opinion, it may be useful to revisit two of principles laid out in the Corporate Governance Code: risk and proportionality.

Risk

The UK Corporate Governance Code - 2018

“Remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated”

What has really changed here as a result of COVID-19 is the likelihood of reputational damage. For companies who have furloughed staff and received tax-payer money to stay afloat any form of bonus could be deemed by some members of the public to be ‘excessive’. Recent press coverage has not been favourable in these cases. What’s more, for businesses offering financial services the government advice has been clear:

> “The PRA also expects banks not to pay any cash bonuses to senior staff, including all material risk takers, and is confident that bank boards are already considering and will take any appropriate further actions with regard to the accrual, payment and vesting of variable remuneration over coming months.”
>
> *PRA Statement – 31 March 2020*

Whilst in the unique case of financial services, this can be explained as “a sensible precautionary step given the unique role that banks need to play in supporting the wider economy”, the wider messaging around bonuses is clear. In addition, there is pressure from shareholders. In early April the Investment Association published its ‘shareholder expectation during the COVID-19 pandemic’ – an extract of which can be found on the next page.

Investment Association: Executive Remuneration in UK Listed Companies
Shareholder Expectations during the COVID-19 Pandemic

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.

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.

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.

However, the need to avoid reputational damage and appease shareholders must be balanced with the need to attract and retain the talent necessary for the business to survive the current economic crisis and position for the future. A fundamental factor when considering an appropriate package is proportionality.

Proportionality

The difficulties for RemCo Chairs in balancing risk and proportionality are compounded by the apparent disparity between the relative buoyancy of the stock market and the 'economic mood' of the country. Where an executive's pay is closely linked to share price or shareholder returns there may be some justification for a pay out in line with pre-COVID expectations.

However, for those companies whose share price has been depressed, another difficulty raises its head. Many long-term incentive structures are calculated using the prevailing share price at the time of the award, and the number of awards is calculated by dividing the executive's salary (or a fixed ratio of it) by the share price. Hence, if the share price is artificially depressed, the executive gets a bigger quantum of rewards. If the share price then returns to 'normal levels' it can be argued that the executive has benefitted from a windfall gain, without any real creation of shareholder value.

"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."

IA – Shareholder Expectations during the COVID-19 Pandemic

Moreover, what constitutes a 'job well done' in times of crisis is difficult to quantify. For many businesses (e.g. hospitality) merely surviving has been a heroic effort requiring ingenuity, decisive action and leadership – well deserving of a reward. However, set against redundancies, furlough of employees and cost savings, successes may have come at a heavy cost.

Changing a remuneration policy suddenly from previously agreed-upon terms will, in many cases, be a bitter pill to swallow, especially if the share price has remained strong. The flight risk of a senior executive must be carefully weighed up against the reputational risk of 'excessive bonuses'. Moreover, the internal damage to staff and partners done by an ill-timed or excessive payout could undo years of hard work.

In some sectors there is further pressure to avoid flight risk. In the digital, biochemistry and technology sectors especially (many of whom will have been performing well as a result of COVID-19) much of the top leadership is international. In these cases the RemCo Chair must structure remuneration packages to compete with Private Equity firms and talent from geographies where average pay is higher and scrutiny is less. In many cases there will be understanding from the shareholders, but wider reputational damage is still a risk as executives could be seen to be profiting from the pandemic.

Conclusion

RemCo Chairs have always had a complicated balancing act to manage; COVID-19 has only made this more difficult. On the one hand, in times of crisis businesses turn to their leaders for decisive action and experienced decision making. When the pressure is on, good leaders step up and really earn their money. On the other hand, success for a business in weathering a crisis may not, in many cases, feel like a success for the workforce. Where tax-payers money is concerned, it is vital that businesses understand the sensitivities involved to avoid a similar public backlash to the one caused by ‘banker’s bonuses’ following the 2008 financial crisis.

In addition, we must also acknowledge that predictability is also a key principle of any remuneration strategy. The Remuneration Committee’s job is not simply to appease shareholders and the public. As members of the Board they have a duty to ensure that actions are taken in the best interest of the company and that the best executives are attracted.