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The first 50 AGMs and Covid-19:

Did companies listen on executive pay?

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The first 50 annual general meetings (AGMs) of 2021 have now taken place, and stakeholders are closely watching how companies have addressed Covid-19 disruptions in making decisions on executive pay.

As organisations sought to find a path to recovery out of the pandemic in 2020, many furloughed employees or accepted other government support.

Was this first group of companies to hold general meetings sensitive to concerns by employees and investors for more moderate positions on executive pay? Were they aligned?

By and large, they were.

Half paid no bonuses to executive directors: this included three-quarters of the companies that accepted external support. In addition, many executives took a temporary 20% pay cut for part of 2020. Overall, therefore, this first 50 group generally followed the recommendations of voting agencies and the Investment Association (the IA).

The proxy voting agencies' guidance at the height of the pandemic was that executives should not be insulated from the impact of the pandemic and should "share the pain" with their employees and shareholders. In November, in its most recent Covid-19 guidance, the IA set out the following expectations:

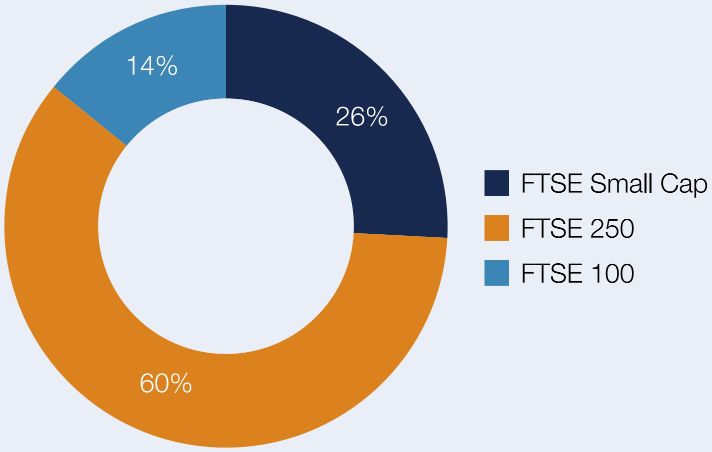
- When direct support was received through furloughing employees or raising capital, companies should pay no bonuses to executive directors other than in "exceptional circumstances";
- Companies should downward adjust bonus pay-outs when dividends are cancelled;
- Companies should consider deferring more bonus into shares;
- Companies should award no higher than workforce salary increases if increasing executive salaries; and
- Companies should not seek to compensate executives for lower remuneration in FY2020 when setting FY2021 variable pay opportunities.

This report shows how the first 50 companies to hold AGMs in 2021 responded to this guidance. For any other companies that have not yet decided how to respond to this guidance or have not yet reported, explaining the context for decisions and providing adequate justifications for actions that deviated from guidance will be key.

First 50 AGM snapshot: Company responses to Covid-19 a key issue

This group represents the first 50 AGMs held in 2021. These companies had financial years ending between 29th August 2020 and 31 December 2020. Many had finalised key pay decisions before the vaccination programme was rolled out or the UK roadmap out of the Covid-19 crisis was unveiled.

Index split of companies in the first 50 AGMs of 2021



2021 AGM

AGM Result

Average % of votes for

89.0%
Remuneration Report

90.7%
Remuneration Policy

Broadly a third (32%) of this first 50 took a new policy to shareholders at their 2021 AGM. Average shareholder support in this group is broadly similar to support among the first 50 AGMs held last year at 90.7% compared to 91.9% in 2020. Note that companies in the first 50 to hold AGMs each year appear to have slightly lower levels of support than companies generally, where the average vote for remuneration policies and remuneration reports tends to be in the mid-nineties. Only one of the companies taking a new policy to shareholders in this group received a significant (20% or more) vote against the proposed policy. This could be the result of companies continuing to take a cautious approach to policy changes in the context of the wider economic uncertainty.

Shareholder support for how these companies have operated and intend to operate, their policy was similar to last year, with the average advisory vote in favour of the Directors' Remuneration Report (DRR) at 89.0% compared to 90.8% for the first 50 in 2020.

Eighteen percent of these companies received a significant (20% or more) advisory vote against their DRR and have been placed on the IA register. One company has so far failed to get more than 50% in favour.

Average % of votes for

62.1%
ISS "Against"

76.8%
IVIS "Red-top"

The influence of the investor and voting agencies on negative voting outcomes remains strong. The average vote for remuneration reports was 62.1%, where ISS gave an AGAINST voting recommendation, and 76.8% where the IA gave a RED Top.

The key reasons why IVIS and ISS have issued negative reports have been where they have felt that the impact of Covid-19 on the wider business, employees and shareholders has not been adequately reflected in the executive directors' remuneration or where remuneration committees have exercised their discretion in such a way as to allow awards to vest that would otherwise have not.

Overall Trends in FY2020

Addressing the impact of the ongoing pandemic required hard choices for some remuneration committees in FY2020. Many companies have had to factor in the impact of furloughs and other government support, and capital raises or dividend cancellations - actions that directly affected the workforce, taxpayers or investors. For example:

- About one quarter (26%) of the first 50 companies furloughed employees under the UK Government's Coronavirus Job Retention Scheme (CJRS);
- Roughly one-third (34%) cancelled at least one dividend; and
- Ninety-four percent of companies that furloughed staff introduced a temporary reduction in fixed pay for executive directors, typically by 20% of salary over a three-month period.

A closer look: Bonuses and LTIPs

Annual bonus and deferral

Remuneration committees' approach to bonuses in 2020 shows that a great majority of companies demonstrated restraint:

- Three quarters (76%) of companies that received Government or shareholder support (through dividend cancellation or capital raising) did not pay a bonus to executive directors;
- In total, roughly half (46%) of all CEOs and executive directors did not receive a bonus. In half of these cases it was because minimum performance thresholds were missed;
- In the remainder, no bonus was paid due to the bonus being waived, the bonus plan being suspended, or the remuneration committee exercising discretion to reduce bonus payment to zero;
- However, four companies paid a bonus despite using CJRS, resulting in two of these companies receiving significant votes against their remuneration report at their AGM;
- One company decided to deliver the bonus entirely in shares, deferred for three years; the other companies paying the bonus as a mix of cash and shares as normal;
- Annual bonus deferral is well established in all companies of this group — only four had no formal deferral in place. This is an area of focus for the IA, and investors generally expect the annual bonus deferral to be more meaningful and are becoming more focused as to how the deferral is structured;
- In its updated guidance (November 2020) the IA recommended that bonus deferral should apply to all the bonus, not just the proportion above 100%;

LTIP

- In 36% of the first 50, no long-term incentive award vested due to performance thresholds not being met;
- Of the two thirds (64%) of companies that had LTIPs vesting, only one company's remuneration committee exercised positive discretion where targets were missed as a consequence of the pandemic to increase the level of vesting. The response from the voting agencies was a RED Top (IA) and an AGAINST recommendation from ISS and ultimately shareholders responded with a significant vote against;
- One company applied a malus adjustment, reducing the CEO's vesting quantum by £1m, however this was as a result of a governance issue and not as a result of the impact of Covid-19.

As a result of salary waivers and lower bonus and LTIP outturns, the average CEO single figure of remuneration has fallen materially for FY2020 compared to FY2019, in 58% of companies in this group (where the incumbent CEO was unchanged). Where it fell, the average reduction in the single figure was 36%. Overall the single figure fell by about 10%.

2021 remuneration

In making decisions for 2021, remuneration committees have generally demonstrated a desire to take into account the pandemic's impact on their stakeholders. Significantly more companies than usual have applied pay freezes for their executive directors for FY2021 in light of the ongoing pandemic, and almost none sought increases in variable pay opportunity in new policies submitted to shareholders at the 2021 AGM.

CEO salary increases

- For 2021, more than half (54%) of companies have frozen pay for the CEO, and the CFO;
- In companies that awarded executive directors a salary increase, 92% did so in line with or below the increases applied to the larger workforce; and
- The average CEO salary increase across all companies in the first 50 was 2.4% (including zeros) and 6% (excluding zeros). These salary increase figures are skewed by a small number of significant increases to reflect changes in role, scope or pre-agreed increases for recruits brought in below market until their performance is proven.

Annual bonus

- About a third (32%) of the first 50 presented new policies to shareholders at the AGM, of which only one company proposed increasing the maximum annual bonus opportunity permitted under the policy; and
- Two companies have reduced maximum bonus opportunities for the forthcoming year and two have increased them.

LTIP awards

- Many companies saw their share price fall as a result of the pandemic, with 8% of companies scaling back the size of grants made in 2020. Going into 2021, while many companies' share prices have recovered, a third (32%) of the first 50 had significantly lower share prices compared to the beginning of the pandemic. 18% of companies scaled back LTIP grant levels for 2021 or maintained reduced award levels under their Performance Share Plan (PSP) for FY2021
- However, most of the first 50 have kept LTIP award levels flat. Three companies have increased grant levels in FY2021, of which two were within existing policy limits and the third increased the LTIP opportunity in their new policy. In addition to these companies, two companies who had reduced award levels in FY2020, returned to FY2019 levels for their FY2021 grants
- How did companies that did not reduce award levels, despite depressed share prices address shareholder concerns? All but one committed to monitoring company performance and share prices over the vesting period to explicitly ensure windfall gains are not realised on vesting;
- Making this commitment appears to have been sufficient to avoid criticism but will be an area that is closely monitored by investors and voting agencies in future years and companies should think about their ongoing disclosures for these awards;
- Whilst PSPs continue to predominate, there is further evidence that restricted stock units (RSU), value creation plans (VCP) and single incentive plan models are becoming more popular. Four companies in the first 50 (8%)have moved from PSP to RSU models, each with a 50% reduction in grant levels; and
- One company has moved from traditional PSP to a VCP.

Other areas of focus

Pension

Voting agencies and shareholders continue to focus on whether the pension allowance levels of executive directors are aligned with those available to the wider workforce. For new executive director appointments, this is now market practice and in place for all of the companies in this first 50 group.

The focus is now on the alignment of pensions for incumbent executive directors. In the first 50 group:

- Two thirds (66%) were not aligned at the start of their FY2021;
- However, three quarters (76%) of these companies disclosed a plan and timeline to achieve alignment;
- Nearly all companies taking a new policy to a shareholder vote at the 2021 AGM were either aligned for incumbents or disclosed a plan to align.

The IA updated guidance is that where there is no credible plan to align incumbent directors' pension levels to the workforce by the end of 2022, it will "Red Top" those with a pension allowance set at or above 15% of base salary. Previously this threshold was 25% of base salary. The new guideline applies to companies with year ends falling on or after 31 December 2020.

In-employment and post-cessation shareholding requirements

All the companies in the first 50 have an in-employment shareholding requirement of at least 200% of salary, with a third of companies setting their requirement higher (the highest was 450% in this group of companies). Only one company had no formal in-employment shareholding requirement in place, but the executive directors already hold very significant shareholdings.

Every company in this group that took a new policy to a shareholder vote disclosed a formal post-cessation shareholding policy. In the first 50:

- Nearly nine out of ten (88%) disclosed a formal post-cessation shareholding requirement;
- A small majority (55%) of companies with a formal policy on post-cessation shareholdings were IA compliant in that the policy requires the full in-employment holding to be retained for two years post-cessation.

What companies can do going forward

Companies that have yet to finalise their DRRs should identify any pay issues that run contrary to the voting agency guidance or Corporate Governance Code requirements and consider their disclosures. It is important to explain the context of decisions and to detail any underlying rationale for actions taken. Being prepared will help organisations put the best case to shareholders for any decisions that could be controversial.

Over the next year, we expect more companies to review executive pay policies and begin to think about making more radical changes to LTIPs. In addition, as was the case after previous crises, if there is significant shareholder dissent on remuneration resolutions in 2021, we may see voting agencies, regulators or legislators respond with tighter guidance or rules, which may further reduce remuneration committees' scope for judgement and discretion.

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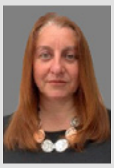

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