EXECUTIVE COMPENSATION SERVICES

EXECUTIVE PAY IN THE UK

THE 'BIG TENT' DISCUSSION

June 2023

ALVAREZ & MARSAL

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EXECUTIVE SUMMARY

The issue of executive pay in the UK-listed market requires, as the CEO of the London Stock Exchange recently emphasized, a 'big tent' discussion. It remains a challenging and sensitive issue that requires a balanced consideration of perspectives. The recent uptick in concern from some quarters about the competitiveness of executive pay in the UK market takes place in the context of an ongoing cost-of-living crisis.

Our overall perspective is that the current model is not fundamentally broken, but there are opportunities for improvement. Any changes should aim to support the growth and performance of the UK-listed market, benefiting all stakeholders: shareholders, management teams, employees, as well as broader society.

EXECUTIVE PAY IN THE UK-LISTED MARKET: DATA AND OBSERVATIONS

As context for the debate, we first set out four main data-driven observations on the progression of UK executive director pay over the past decade:

- **CEO premium in the US vs the UK has grown:** Although the challenges that this creates for some companies should be acknowledged, it is important not to overplay this theme, which is by no means a new phenomenon and is not relevant for all companies. We think other trends and observations are more compelling for the UK market.
- **Over the past decade, the total 'realised' pay for the median FTSE 100 CEO is essentially unchanged:** This trend lags UK inflation, average UK worker pay growth, and the increase in the median market capitalisation of the index. Although this may surprise some market observers, there are several factors which have contributed to this. First, the median FTSE 100 CEO base salary has only marginally increased during this period. Additionally, there has been a notable decrease in executive pension provision over the period, resulting in a decline in fixed pay. While incentive opportunities have increased, the actual amounts received from share awards have been impacted by the recent environment of lower share price growth. Drawing conclusions may depend on one's perspective, but it is important to acknowledge the overall trend which, contrary to some narratives, suggests that executive pay in the UK is not 'out of control'.

- **Changes to the structure and operation of executive packages have reduced their perceived value for management:** For example, over the past decade, there has been an increased use of bonus deferral and holding periods, larger requirements for share ownership that now extend post-cessation, expanded clawback provisions, and a more frequent use of downward discretion to adjust incentive outcomes. In isolation, each of these changes has a rationale designed to improve alignment with shareholders. However, the cumulative impact has reduced the perceived value of packages by increasing complexity and uncertainty, extending the time period for receipt of reward, creating 'asymmetries' in the application of key principles, and increasing divergence from practice for management roles below board and in other key talent markets.

- **Limited variability in incentive structures:** Despite the market regularly acknowledging that 'one size does not fit all', the conventional Performance Share Plan (PSP) continues to dominate the UK market. The ability to combine different types of plans into a 'hybrid' structure, as commonly done in the US, is effectively precluded from the UK market. When companies introduce Restricted Share Plans (RSP) to enhance retention and shareholder alignment, they are usually compelled to do so at the expense of a PSP, which raises valid concerns about UK-listed companies' ability to incentivise and reward exceptional performance.

In light of the above, it is reasonable to conclude that remuneration packages for executive directors in UK-listed companies have become less attractive over the last ten years. This aligns with the experience of those companies that face increased challenges in securing top leadership talent.

If the market's objective is to support the growth and performance of UK-listed companies, then access to the highest quality of executive leadership is required.

However, we argue that change can be implemented in ways that align with stakeholder interests, without compromising the key principles that have contributed to the UK's longstanding reputation in corporate governance.

SHAPING THE FUTURE: PRACTICAL IDEAS FOR EVOLVING THE UK MARKET

There is no 'silver bullet' solution. Our preferred approach is to provide greater flexibility for remuneration committees, while maintaining adherence to clear principles and guidance. To foster discussion, we present four practical ideas for the potential evolution of UK policy and practice:

- **Foster greater variation in reward structure:** Companies should be encouraged to adopt incentive structures, or mix of structures, tailored to their needs and circumstances. For example, a simple 'hybrid' plan could combine the benefits of retention and long-term share ownership with greater incentive to drive performance. Alternatively, companies focused on exceptional growth and performance might adopt structures better aligned to that goal (such as share options or 'multiplier' plans).

- **Enhance flexibility on the operation of incentives:** The use of discretion to ensure incentive outcomes reflect underlying performance is a commendable principle, but currently applies 'asymmetrically' in practice – almost always to reduce outcomes and rarely to increase them. We argue that the market could foster greater acceptance of positive discretion. Additionally, and perhaps more contentiously, we would support a debate on whether the re-set of 'in-flight' targets could become more accepted, provided it was done within a set of clear guiding principles which reflect the shareholder perspective.

- **Simplify the framework to build executive shareholdings:** Ensuring that executive directors build and retain a material long-term shareholding, including into post-cessation, remains important. However, companies could be supported in adopting structures that uphold this key principle in a simplified way, for the benefit of all stakeholders. We present one alternative structure that replaces the conventional bonus deferral and long-term post-vesting holding periods with a streamlined approach to robustly build and maintain executive shareholdings.

- **Address the quantum issue – take the emotion out:** In some cases, changes to incentive structure will not be enough, and companies may need to offer higher pay to secure top talent. This is a sensitive issue in the broader societal context, presenting challenges for the UK market. An honest discussion is necessary to recognise the various risks and perspectives. We argue that the market would benefit from the development of a rational and less emotionally charged framework for the quantum discussion.

THE ENVIRONMENT FOR REMUNERATION COMMITTEES

Finally, we consider the environment in which remuneration committees operate, as it plays a crucial role in driving change.

- The UK-listed environment has evolved towards an increasingly 'rules-based' approach to executive pay, rather than one guided by fundamental principles. The development of a range of shareholder guidance, including the rigorous application of some 'red line' voting issues, has been a highly effective catalyst to drive UK market practice on some issues. For remuneration committees, it has also limited flexibility and created a fragmented landscape to navigate.

- When companies receive a 'low' vote on remuneration (i.e. 80 percent or less), it can lead to an unhelpful public perception that the remuneration committee has somehow acted improperly. We argue that such votes may simply reflect a reasonable degree of divergence in views on a subjective issue, which should be expected in an increasingly fragmented shareholder environment. Since the launch of the Investment Association's Public Register in 2017, over 220 companies have been included, and we question whether egregious remuneration practices have occurred in over 40 percent of the UK-listed market during that period. We also argue that the current requirement to re-engage with shareholders after such a vote often yields limited value for all stakeholders.

Both trends above are compounded by the growing influence of voting agencies, which are naturally and understandably more likely to rely on a rules-based assessment approach, but have an almost 'binary' impact from their recommendations on the probability of a low vote.

Looking forward, we would welcome an evolution of the UK shareholder environment based on four key concepts: greater flexibility, principles over rules, trust and collaboration, and honesty.

However, we anticipate that change will primarily be driven incrementally by remuneration committees themselves becoming increasingly 'risk tolerant'. The role will continue to involve making informed judgements that consider and balance various perspectives, while ensuring effective shareholder consultation and disclosure. Ultimately, if making decisions that serve the best interests of the company become increasingly divergent from what would be required to simply maximise the shareholder vote, this may require greater acceptance of lower voting outcomes. This may also involve a growing recognition that there is a qualitative distinction between a low vote influenced by voting agency recommendations and one stemming from opposition by major shareholders based on their independent assessments.

INTRODUCTION

In May 2023, Julia Hoggett, the CEO of the London Stock Exchange issued a statement calling for a "constructive discussion on the UK's approach to executive compensation" and indicated her intention to bring together a range of stakeholders for a 'big tent' discussion on the issue. We share the view that now is a good time to 'take a step back' and reflect on the current state of executive pay in the UK-listed market, for various reasons.

Firstly, we are approaching the ten-year mark of the current regulatory and disclosure framework, as well as the five-year anniversary of the most recent refresh of the UK Corporate Governance Code ("the Code"). Both have provided the foundation for UK-listed companies over recent years.

Additionally, the UK continues to face up to the consequences of Brexit on its economic prospects and positioning in the global economy. The growth levels achieved and expected by the UK lags most of its peers. There are ongoing concerns around the competitiveness of the London equity market compared with other financial centres. And, although rarely explicitly cited, the UK's approach to executive pay may be a relevant factor for companies that are considering listing or moving their listing overseas.

Based on our experience advising boards and remuneration committees across the UK-listed market, we sense a growing frustration with the limited flexibility to make decisions on executive pay necessary to secure the quality of leadership required.

At the same time, it is important to consider the current wider societal context of the ongoing cost-of living crisis in the UK. With inflationary pressures and salary constraints, most people are experiencing a significant reduction in real incomes.

Our view is that the UK market is not fundamentally 'broken', but that there are problems that should be acknowledged and addressed. This is not a zero-sum game, where changes benefit either shareholders or management teams. Instead, the objective should be to deliver changes that support the growth and performance of companies across the UK-listed market, benefitting all stakeholders, including shareholders, executives, employees, and the wider economy.

In this report, we contribute to the ongoing discussion on UK executive pay. We aim to engage all market stakeholders and encourage constructive dialogue. The report is divided into three sections:

A) **Executive pay in UK-listed companies: data and observations (pages 6-14).** This section presents an objective analysis of four key trends in the evolution of executive pay in the UK-listed market over the last ten years.

B) **Shaping the future: practical ideas for evolving the UK market. (pages 15-22).** Here we transition from factual analysis into presenting our own ideas for change in the UK market. We focus on areas such as incentive design and implementation, required shareholdings, and quantum.

C) **Implementing change: the environment for remuneration committees (pages 23-27).** In this final section, we discuss the regulatory and shareholder environment in which remuneration committees operate. We also provide observations and recommendations for areas of potential change.

A

EXECUTIVE PAY IN UK-LISTED COMPANIES: DATA AND OBSERVATIONS

1.CEO PREMIUM IN THE US VS THE UK HAS GROWN:

This is a good starting point for the discussion as it is commonly mentioned as a potential drawback of the UK's executive pay approach.

While this is true, it is not a recent development. Figure 1 shows the ratio for the total compensation of the median FTSE 100 CEO compared to the median CEO in a sample of 100 US-listed companies of broadly equivalent market capitalisation (see chart notes for details on methodology). While some of the trend over this period reflects a deterioration in the exchange rate (as shown), the chart clearly illustrates the continuing premium in the US for executive director talent.

Figure 1: US 'premium' to UK (median CEO total compensation)

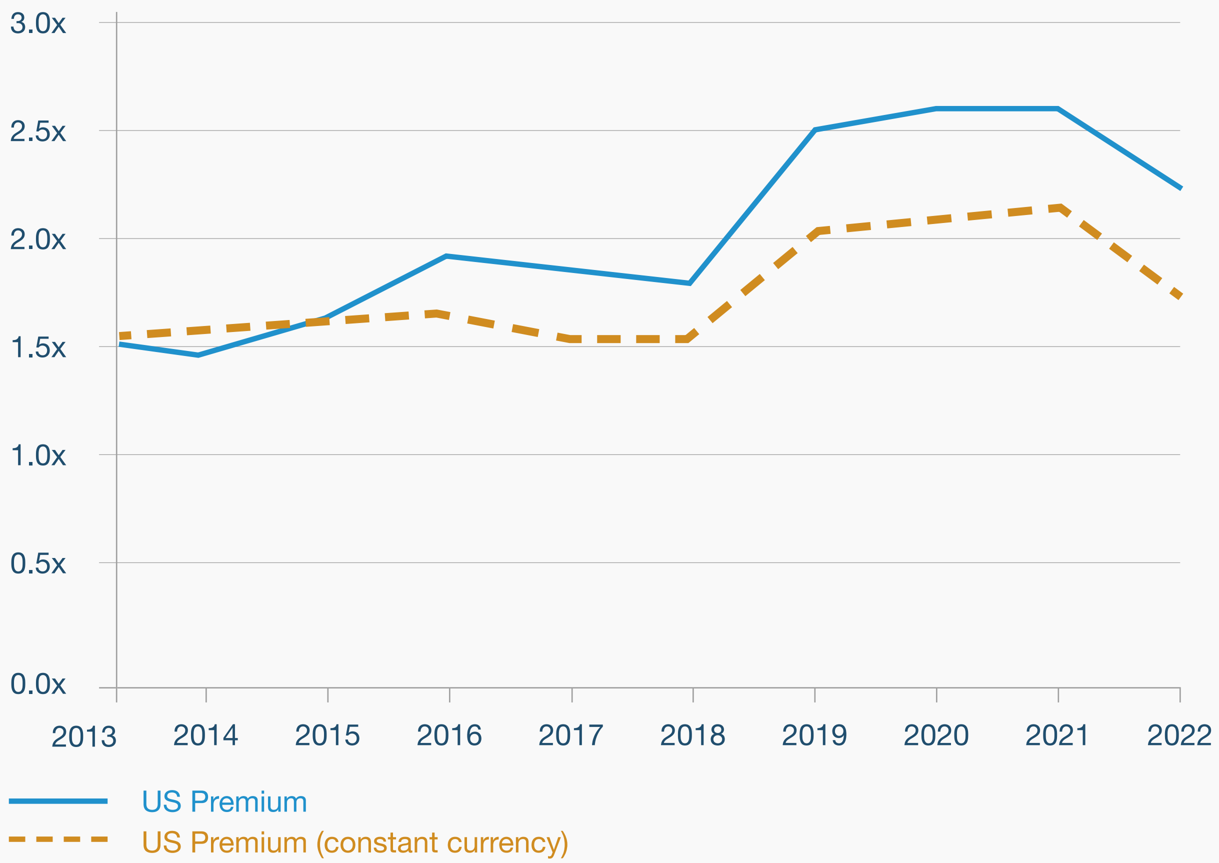


Chart represents the ratio in total compensation (in $) between the median CEO ('highest paid director') in a sample of 100 US-listed companies of broadly similar market capitalisation to the FTSE 100 and the median FTSE 100 CEO. The total compensation methodology differs for the UK (based on disclosed 'single figure' outcomes) and the US (based on the grant-date 'expected value' awarded), although given the large size of the data set, one might reasonably expect these to be broadly comparable, and has been consistently applied for each year in the period

The implications for the UK market should be acknowledged. For companies competing for talent in the US market (or, equally, in a global talent market which is shaped by US practice), it can be challenging to compete on quantum.

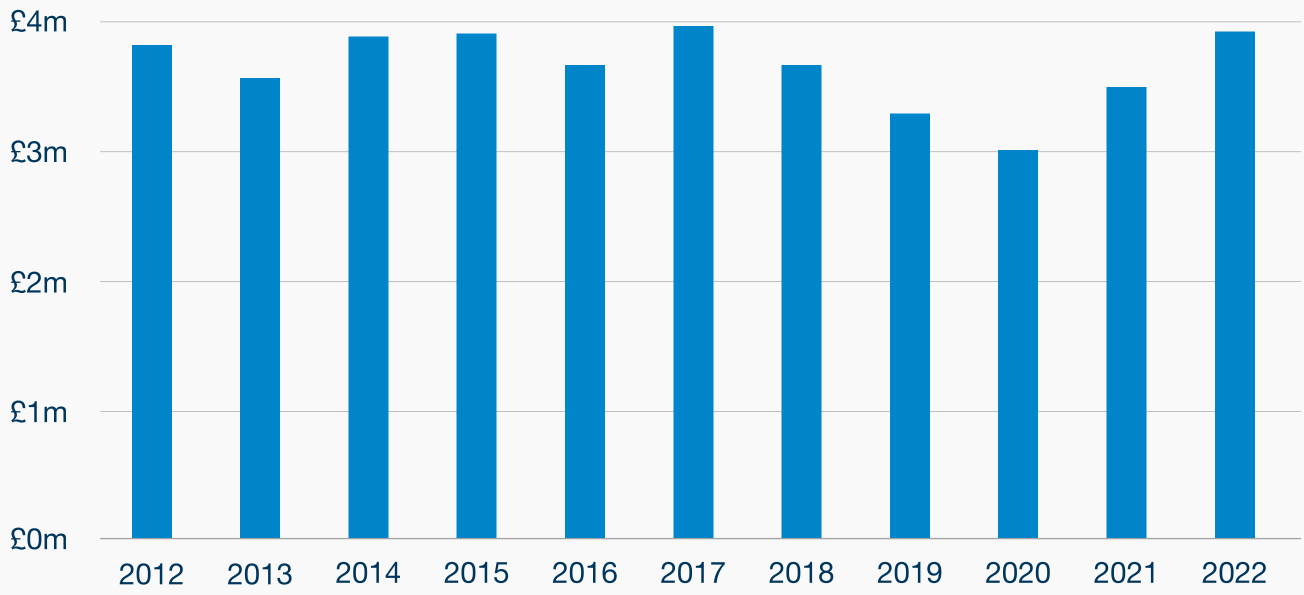
At the same time, it is important not to overplay this factor. First, most UK-listed companies do not typically compete for talent in the US (or global) talent market. Even when they do, the premium for US executives is not a new phenomenon and has been a consistent theme throughout our years of experience in the field. Although the premium may have increased in recent years (both with and without currency impact), the idea that this is now the key problem to solve is simply not compelling (for most companies). Additionally, one should also recognise the relatively common shareholder observation that "UK companies should pay UK rates", which emphasizes the importance of comparing UK executive pay to local reference points, a topic we will discuss next.

2. OVER THE PAST DECADE, THE TOTAL 'REALISED' PAY FOR THE MEDIAN FTSE 100 CEO IS ESSENTIALLY UNCHANGED, LAGGING A RANGE OF UK REFERENCE POINTS:

There are different ways to asses a CEO's total compensation, particularly when considering long-term share awards. One approach is to use the "single figure" of remuneration, which represents the total remuneration earned with respect to a specific year or performance period, as mandated by UK remuneration disclosure regulations.

Examining these data, we observe that the total remuneration received by the median FTSE 100 CEO has remained relatively unchanged over the past ten years, fluctuating within a range of approximately £3-4 million. This finding is depicted in Figure 2, highlighting the consistent flat trend during this ten year period.

Figure 2: FTSE 100 median CEO total remuneration received

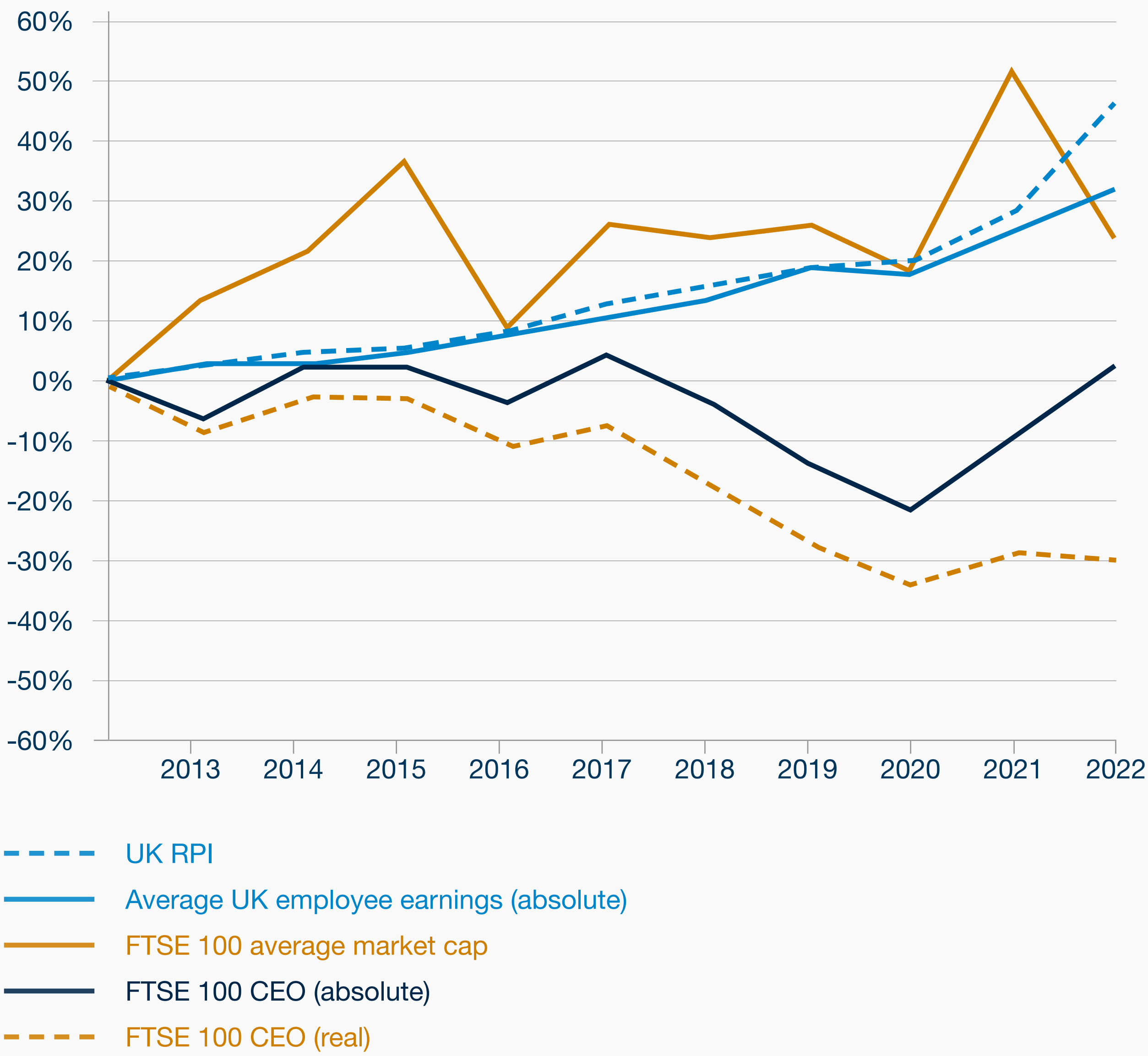


Source: Disclosed 'single figure' of remuneration for CEOs in post for the full financial year and which comprises all elements of remuneration in respect of the financial year (fixed pay, earned bonus, and the value of long-term incentive awards based on performance measured to that year) using the constituents of the FTSE 100 index at that time.

In Figure 3, this trajectory is compared against a number of UK reference points, including:

- UK inflation (RPI) of c.45 percent over the ten-year period;
- The pay of the average UK employee, which has broadly tracked RPI inflation over the period (until recently); and
- The increase in the median market cap of a FTSE 100 company

Figure 3: FTSE 100 median CEO total remuneration vs UK benchmarks (10-year growth)



Sources: ONS, DataStream, A&M database

These data points show that, due to the flat trajectory combined with UK inflation, the median realised total compensation for a FTSE 100 CEO has experienced a real-terms decline of around 30 percent over the past ten years. Initially, this may seem surprising and counter-intuitive. For this reason, it is important to understand the underlying factors:

- **Limited growth in median base salary.** The median FTSE 100 CEO salary has only seen a marginal increase over the period (by less than 1 percent per annum). At first, this may appear anomalous, seemingly at odds with salary increases for incumbent executive directors generally aligning with the percentage increase for the broader employee population (typically c.2-3 percent per annum over the period). This was the established market standard for much of this period (until the recent trend towards 'discounted' increases emerged). However, shareholder pressure for greater restraint has resulted in: (i) the relatively frequent use of salary 'freezes' during the period (typically applying to at least one-third of the FTSE 100 market each year, and sometimes higher such as during COVID); and (ii) CEO turnover, with many companies setting the salary for new appointments below that of the previous incumbent.

- **Significant decline in executive pensions.** The value of pension provisions for executive directors has significantly decreased during this period. This decline reflects the final stages of the phasing out of generous "defined benefit" arrangements during the earlier part of the period. More recently, shareholder pressure has resulted in a reduction in defined contribution pensions (or cash allowances in lieu) from around 20-30 percent of salary to approximately 10 percent for FTSE 100 CEOs.

- **Influence of share price performance.** As discussed above, the "single figure" includes the value earned from long-term share awards at vesting, incorporating any changes in share price over the performance period (typically three years). The average level of three-year share price growth was higher in the earlier part of the ten-year period compared to recent years (for example, over the first half of our ten-year period, the median three-year share price increase averaged over 30 percent, compared to an average of 10 percent in the second half of that period). This means that lower achieved share price growth in recent periods has moderated the total value received, reflecting the principle of 'pay for performance.'

- **Increase in incentive opportunities.** The flat trajectory of total realised pay may surprise market participants and observers who have witnessed a consistent upward drift in the level of incentive opportunities (i.e. the potential multiple of salary that can be earned if performance targets are met). For FTSE 100 CEOs, the median annual bonus opportunity has increased from 180 percent to 200 percent of salary. Similarly, the median long-term award opportunity has risen to over 275 percent of salary, compared to around 200 percent a decade ago.

The interpretation of these trends ultimately depends upon one's view of executive pay. On the one hand, although the total pay received has fallen in real terms, it is hard to argue that total compensation of c.£3-4m is something to be 'sniffed at', especially considering the ongoing cost-of-living crisis. It is also worth noting that prior to 2013, CEO total compensation had increased fourfold from approximately c.£1m at the turn of the century. On the other hand, company boards and shareholders, who are frustrated with their ability to compete for top global talent, will view this trend as further evidence of the challenges they face. We recognise both perspectives, but consider it is important for market stakeholders to acknowledge the data and its potential implications.

3. CHANGES TO THE STRUCTURE AND OPERATION OF EXECUTIVE DIRECTOR PACKAGES HAS REDUCED PERCEIVED VALUE, WHILST FURTHER INCREASING COMPLEXITY:

Over the past ten years, the structure of a typical executive director package, and how it is applied, has evolved to include new features and requirements. In most cases these have been intended to provide greater alignment between executive reward and the 'shareholder experience', through a combination of greater share ownership, performance alignment, and safeguards. Figure 4 shows a summary of how practice has evolved across a number of areas:

Figure 4: Changes to typical package structure (FTSE 100)

	2013	2022
Bonus deferral	Around two-thirds of companies used deferral. While being phased out, some deferral 'matching share' arrangements were still in place.	Deferral of annual bonus is almost universal and a required practice. Typically, half the earned annual bonus is deferred for a period of three years. Deferral 'matching' schemes no longer used.
LTIP post-vesting holding periods	In the early stages of adoption, operated by around half the market.	Almost universal adoption of the standard approach – vested shares must be held for a further two-year period, beyond three-year vesting period.
Malus and clawback	Adopted by less than half the market, typically narrowly focused only on misstatement and misconduct.	Comprehensively adopted across the market, typically with a much broader range of potentially subjective 'triggers' (such as reputational damage).
Shareholding requirements	Relatively wide adoption, with a median level of 200 percent of base salary.	Universal adoption, with the median level now 300 percent of base salary.
Post-cessation shareholding requirement	Not required	Widely adopted, with most companies now requiring executives to retain the 'in-employment' shareholding level for two years post-cessation.
Discretionary adjustments to incentive pay-outs	Rarely used	Relatively commonly used particularly on annual bonus (around one-third of the FTSE 100 in recent years) and almost always negatively to reduce outcomes. Positive discretion very rarely used.
'Windfall gains'	Not an area of focus	Adjustments to PSP awards (either at grant or vesting), but typically works asymmetrically to reduce for a 'windfall gain' but not increase for a 'windfall loss'.
Pensions	Most received a cash allowance in lieu of pension of c.20-30 percent of salary (and some still in generous defined benefit arrangements).	Generally reduced to align with the workforce rate, often around 10 percent of salary. This trend also included reducing the contractually agreed pension for incumbent roles.

While the underlying rationale for each of these changes has often been persuasive in isolation, they have collectively served to 'chip away' at the overall perceived value of remuneration packages in the eyes of executive directors (even before any assessment of quantum as discussed in the previous sections). This is because the various changes have:

- **Extended the time period to realise value.** Executives now have to wait significantly longer to realise the value of their earned rewards, reducing the perceived value of those awards.

- **Increased uncertainty, with a particular bias to the downside.** This extends not just to incentives (e.g. increased use of downward discretion, greater potential for clawback, etc.), but equally to fixed contractual entitlements. The investor pressure that led to the widespread reduction in pension provision under pre-existing contracts for incumbents (without compensation) eroded some of the trust and credibility in the UK-listed executive employment market.
We suggest that it would have been preferable to implement this change via the 'grandfathering' of existing arrangements to uphold the integrity of contracts, in line with established precedent of UK corporate governance.

- **Constructed a complex tapestry of rules.** This applies particularly with respect to the various obligations around the deferral, holding and release of shares. Navigating these rules has become increasingly challenging, particularly for executives unfamiliar with the UK-listed environment.

- **Created an environment of 'asymmetric' governance.** There is a common perception in UK-listed company boardrooms of an increasingly 'asymmetric', and arguably inconsistent, approach to governing executive director remuneration in the UK. By asymmetric, we mean that some underlying principles are typically applied in one 'direction', typically to the detriment of executives. For example, in practice, the exercise of discretion on incentive outcomes is usually only applied on a downward basis to reduce outcomes, whereas the use of upward discretion is rarely applied or viewed as acceptable by some shareholders and voting agencies.

- **Increased divergence with other senior executives in the same company.** Remuneration committees will typically choose to apply fewer of the features outlined in Figure 4 to management roles below the main board. If they are applied, it is often not to the same extent as for executive directors (for example, bonus deferral or PSP holding periods may cover a lower proportion of the award or use a shorter period). This is indicative of the greater flexibility available for below-board roles allowing remuneration committees to tailor the structures they think are right for their business, rather than being effectively compelled to adopt them all, as at the executive director level.

- **Increased divergence with other talent markets.** For example, while some of the features set out in Figure 4 have gained traction in other geographies, many have not (for example, the use of annual bonus deferral is still unusual in the US, Europe and Asia, other than in financial services in some geographies). Equally, within the UK market, it has created further divergence between the listed environment and the significantly greater level of flexibility on the structure of executive reward and incentives in private companies and the Private Equity-backed market.

It is important to state that we do not think the solution is to simply 'roll back' all the best practice features described in Figure 4. Each has merit in helping to foster a responsible framework for executive pay, for which the UK market has been held in high regard.
At the same time, we think it is important for the impact on the executive perspective to be understood, and for all stakeholders to consider a more balanced, flexible, and simplified approach in practice, which we will discuss in more detail in Section B.

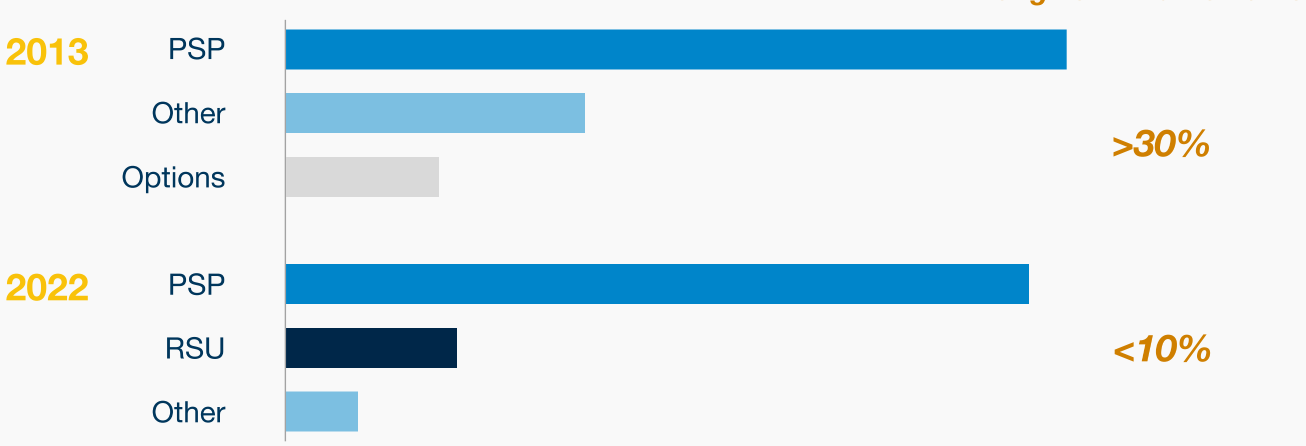
4. LIMITED VARIABILITY IN LONG-TERM INCENTIVE STRUCTURES:

In 2016, the Investment Association 'Executive Remuneration Working Group' was established as an independent panel to address a concern that executive remuneration had become too complex and was not fulfilling its purpose. The first conclusion in the Working Group's final report was that "there should be more flexibility afforded to remuneration committees to choose a remuneration structure which is most appropriate for the company's strategy and business needs".

At that time, we considered that this might have heralded a new dawn for innovation in remuneration and incentive frameworks in the UK, with companies having more flexibility to tailor their arrangements to their specific business need or talent market.

This has not occurred; if anything, the level of homogeneity in the UK market has increased, with the conventional PSP model remaining the dominant market practice and the use of other types of incentive (including a so-called 'hybrid' where more than one long-term incentive vehicle is used) lower than it used to be, as shown in Figure 5.

Figure 5: Types of long-term incentive used (FTSE 100)



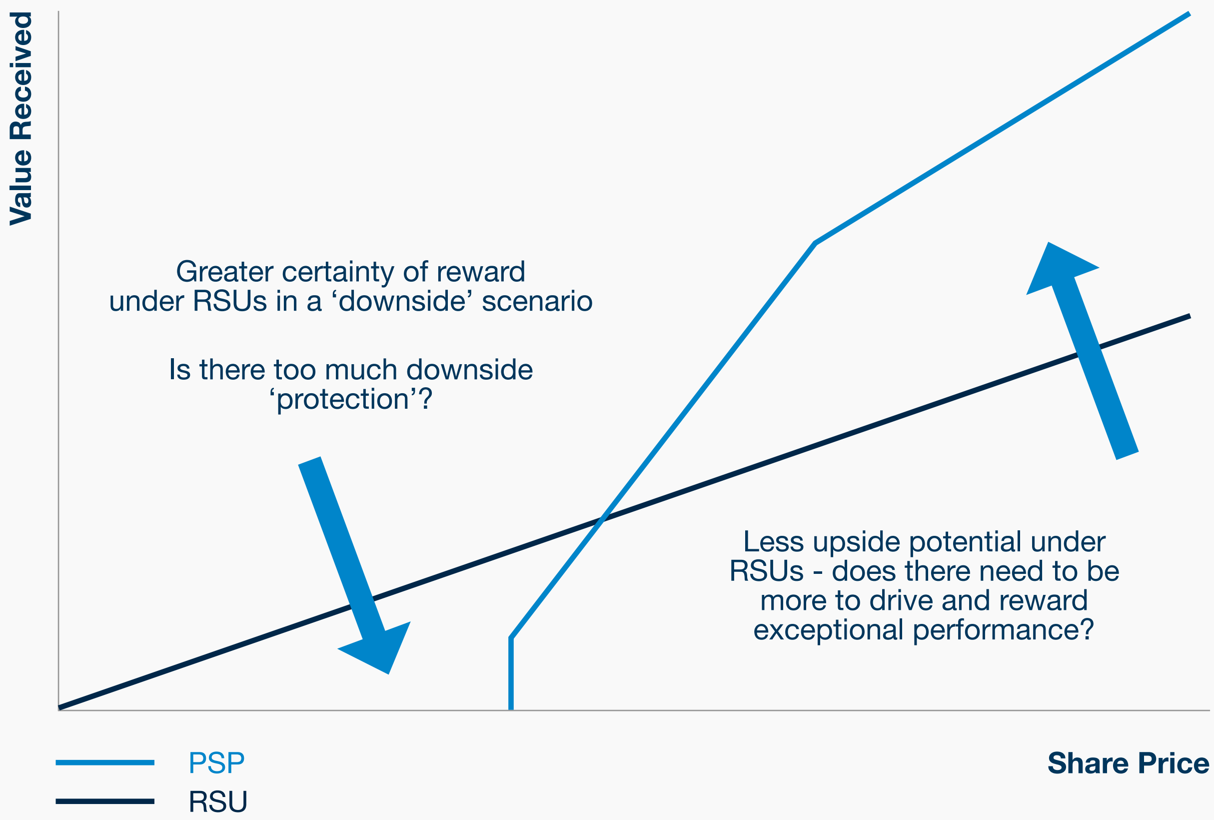
One notable trend in recent years has been increased adoption of Restricted Shares (or RSUs), which are now in place in over 10 percent of the UK-listed market, often replacing a conventional PSP. These awards are generally structured in broadly the same way as a PSP, with the major difference being that they are not subject to stretching performance conditions (only 'underpins', which are generally expected to be met). As a trade-off, the award size is normally around half that of a PSP.

In our experience, RSUs tend to elicit a range of views. On the one hand, supporters point to the benefits of fostering a long-term, stewardship-based culture and improving the retention of key talent due to the greater certainty of vesting.

There are also practical advantages from not having to set performance targets, which can be challenging for companies operating with very limited long-term visibility.

On the other hand, there can be legitimate concerns around the impact of removing performance targets on a company's 'performance culture'. These concerns arise from both the potential to reduce accountability for poor or mediocre performance and from the removal of the greater upside opportunity that encourages and rewards exceptional performance. This is illustrated in Figure 6, which compares the 'flatter' nature of the RSU vesting outcome with the more 'performance-geared' PSP.

Figure 6: Illustration of the relative value proposition of PSP vs RSU for different share prices



For simplicity, the PSP pay-out curve assumes a performance target directly correlated with share price performance.

Part of the problem in the UK market is that companies are essentially forced to make a binary choice between using either a PSP or using RSUs. As Figure 5 shows, 'hybrid' arrangements (where more than one long-term incentive award vehicle is used) have effectively been eradicated in the UK over the last ten years. While this has the obvious advantage of reducing the complexity of executive incentives, it has also limited the flexibility for remuneration committees to meet the needs of the business by combining the characteristics and benefits from different types of long-term award structure.

It also creates a divergence with other talent markets. Whilst again recognising that the global talent market extends beyond just the US, it is interesting to note that around nine in every ten large US-listed companies operate at least two long-term award vehicles for executives (with many operating three). The use of some form of 'hybrid' arrangement is also found for some executives below the main board in UK-listed companies.

The lack of interest in exploring more unusual or innovative incentive structures, or a combination into a 'hybrid' arrangement, is not the problem in the UK. In our experience, most remuneration committees have been keen to understand and test the range of potential alternatives, but many have ultimately chosen not to proceed, even just to the point of initially sounding out their investors, because of the perceived lack of flexibility afforded by the voting agencies and wider shareholder environment (see Section C).

CONCLUSION

Based on the data and observations presented, it is reasonable to conclude that remuneration packages for executive directors in UK-listed companies have become less attractive over the past decade. This aligns with anecdotal evidence suggesting that it has become more challenging to compete for top leadership talent against other destinations, including companies outside the UK and in the Private Equity-backed sector. However, the implications depend on one's perspective.

Some may question the significance of this issue, arguing that CEO roles are still filled by capable individuals who are well-compensated compared to employees in general. Given ongoing crises in cost-of-living, growth, and productivity, one might query whether 'fixing' the pay for a relatively small number of senior executive roles should be a top priority. However, if the goal is to support the growth and performance of the UK-listed market for the benefit of all stakeholders, including investors, management teams, employees, and the broader economy and society, it is crucial to have access to the highest quality of executive leadership.

Importantly, addressing this issue does not imply a "zero sum" game. Making remuneration packages for executive directors more attractive can be achieved in ways that align with stakeholder interests and do not compromise the key principles that have shaped the UK's international reputation in corporate governance.

B

SHAPING THE FUTURE: PRACTICAL IDEAS FOR EVOLVING THE UK MARKET

To achieve the objective of supporting the growth and performance of UK-listed companies, several options can be considered.

It is important to note that there is no ‘silver bullet’ solution that will solve all the challenges. Our preferred approach is to provide remuneration committees with greater flexibility, guided by clear principles and guidelines, as we will explore in Section C. However, for the purpose of discussion, we present four practical ideas for the potential evolution of UK policy and practice.

1. GREATER VARIATION IN INCENTIVE STRUCTURES, INCLUDING ‘HYBRIDS’:

The conventional approach of using an annual bonus combined with a PSP continues to dominate the UK market, as shown in Figure 5. While this framework may be suitable for many companies, we consider that embracing alternative approaches would enable companies to design arrangements that better suit their specific needs. There is no ‘one-size-fits-all’ solution.

It is important to note that we do not think the answer is to ‘innovate’ some new complex incentive structure. Keeping things simple and aligned with underlying principles and guidance is crucial. Many potential incentive structures are already widely understood, and the key is to allow their implementation or combination in ways that are most suitable for each company. Two potential areas where we think the UK market could be more amenable are discussed below: ‘hybrids’ and incentives to drive exceptional performance.

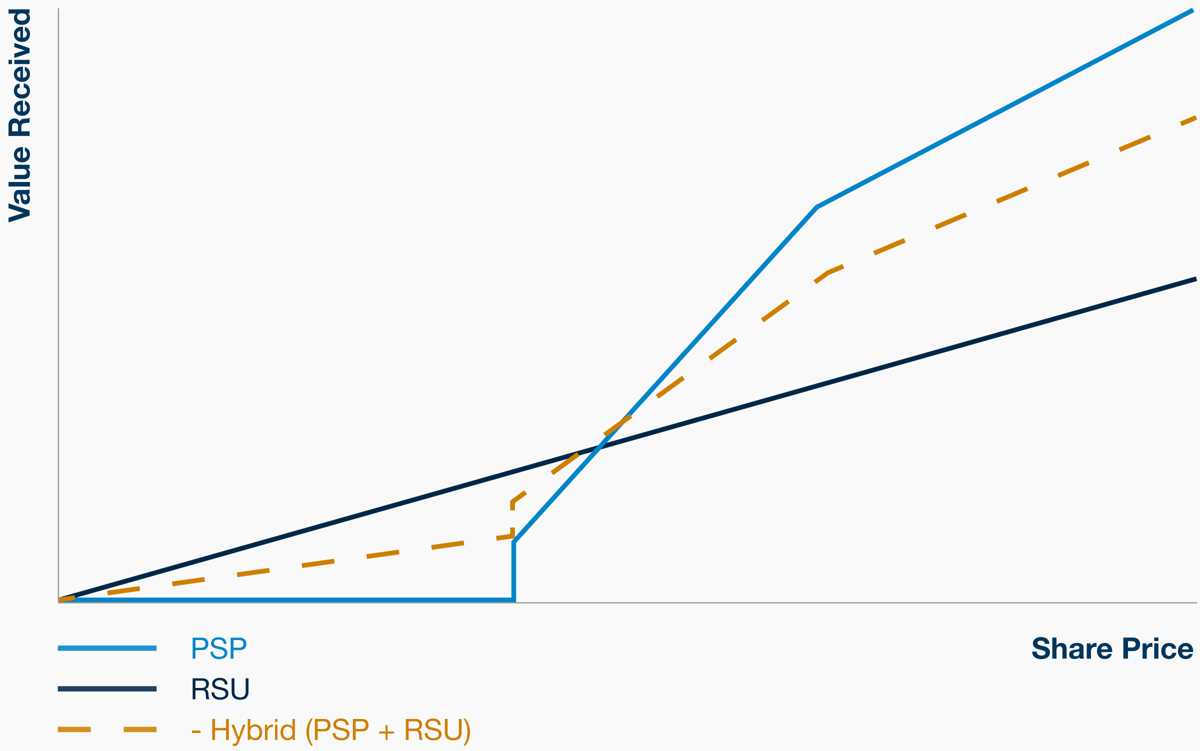
The ideas discussed below typically face a set of well rehearsed counter-arguments from some UK shareholders and investor bodies. While their concerns are valid, it is important to recognise that every type of incentive arrangement has drawbacks and carries some degree of risk. In the UK, the problem lies in the rigid application of these counter-arguments, which forces most remuneration committees to follow the standard approach merely to ‘tick a box’, rather than assessing the benefits and risks based on their company’s specific circumstances.

PSP+RSU ‘hybrid’ – combine to balance the benefits of each award type

By combining different types of long-term incentive vehicle, a hybrid allows the company to balance the benefits and risks of each. In theory, any mix is possible, but one of the most compelling combinations might involve pairing the advantages of PSPs and RSUs.

This allows the company to avoid the stark contrast in potential payout curves that comes with being forced to choose only one type of award structure. As illustrated in Figure 7 below, the combination provides a certain level of retention value and downside protection (though not as much as with RSUs alone), while also offering some potential for greater reward in case of stronger performance (though less than in a sole PSP). Many companies would likely appreciate the opportunity to select the most suitable balance between downside protection and upside potential based on their specific circumstances.

Figure 7: Comparison of 'hybrid' pay-out curve with PSP and RSU



The risk of complexity is clearly the downside trade-off when adopting a hybrid, although this can often be overplayed. For example, one common concern around a PSP+RSU hybrid structure is that it requires the 'complexity' of two separate share awards (one PSP and one RSU).

However, this does not need to be the case. The same underlying value from this combination (i.e. reduced upside but an element guaranteed) could instead be delivered using a single share award with a simple change to the vesting schedule, as shown in the illustrative example below.

Conventional PSP	Vesting
Maximum	100%
Threshold	25%
Below Threshold	0%

Combined award	Vesting
Maximum	75%
Threshold or below	25%

Vesting schedules shown as percent of salary

Other hybrid combinations, or different weightings between the two award types, would be possible. As an example, a combination of RSUs and share options might be applicable for a company where a PSP was not considered feasible as a result of a difficulty in setting robust long-term performance targets, but simply using RSUs alone created a concern around a lack of sufficient upside potential to drive performance.

Incentives structures to drive exceptional performance

For companies seeking to encourage and reward outstanding growth or performance, there are incentive structures that can support this. Although not applicable to all companies, the following ideas could support this objective:

Share options	By allowing participants to receive value based on the increase in share price only, share options perfectly reflect the simple concepts of 'gain sharing' and shareholder alignment, and continue to be operated by over half of the US-listed market. They are most likely to appeal to those companies looking to introduce greater upside potential, specifically linked to driving share price performance. In the UK market, there are now ways to structure share options to address concerns traditionally levelled against this type of award. These include addressing issues of excessive dilution, avoiding unexpected windfalls, and using 'underpins' instead of stretching performance targets.
'Multiplier' plans	For companies that are looking to drive a 'step change' in performance, building in additional upside which is incremental to the normal award opportunity (sometimes called a 'kicker' or a 'multiplier') can be a way to support the delivery of 'super stretch' performance in excess of the 'business as usual' maximum. The challenge for this type of incentive structure is to ensure that the targets for that additional opportunity represent a genuine premium on 'normal' levels of out-performance, but without encouraging excessive risk-taking.
One-off awards	Another practice that is seen in the private sector but less accepted in the listed space is the use of one-off long-term equity awards instead of granting awards on the conventional 'rolling' annual basis. One-off awards can be calibrated in various ways, from plans which allow participants to share in some proportion of the shareholder value created over the period to simpler structures which are conceptually no more than a 'super PSP' that consolidates the opportunity from several annual awards into one award. What unites any such arrangement is the ability to attract and engage participants in scale of ambition and the accelerated wealth creation opportunity. They can be suitable for companies in a 'turnaround' situation, or simply for those looking to execute a particular strategy over a defined future period.

2. GREATER FLEXIBILITY IN THE OPERATION OF INCENTIVES:

In practice, remuneration committees of UK-listed companies have relatively limited flexibility when making decisions around incentive outcomes for executive directors. The level of flexibility is significantly lower than for executives below the main board, and indeed in most businesses across the privately-owned sector. Although the use of discretion to amend the 'formulaic' outcome has become more common in recent years, this is almost always operated to reduce outcomes, and never to provide additional reward, such as for outstanding performance. The recognition that, in practice, discretion can only operate in one direction can also negatively impact the target setting process itself. Greater flexibility, operated robustly, consistently, and in accordance with agreed principles, would be beneficial for the UK-listed environment. We flag two key areas:

- **Greater acceptance of positive discretion to get to the right overall outcome.** The principle that a formulaic outcome may not appropriately reflect underlying performance should apply, in theory, in both directions – positively and negatively. For this to apply in practice, both shareholders and remuneration committees have a role to play. Simply applauding downward discretion and being sceptical of upward discretion should be replaced by consideration of what the right overall outcome is, based on a rounded and holistic assessment. Equally, remuneration committees need to take a robust and responsible approach to using discretion. Those that can establish their credibility for doing so (e.g. by demonstrating a track record of downward discretion first, before using on an upward basis and/or by ensuring that a compelling explanation is disclosed) may be better placed to secure support.

- **Ability to reset 'in-flight' PSP targets within agreed guidelines.** The well-established principle in the UK market that in-flight PSP targets should not be adjusted was severely tested in the aftermath of the COVID-19 pandemic. Only a handful of UK companies sought to amend targets and tended to receive significant shareholder opposition.
Our experience in UK-listed companies' boardrooms at the time was that this felt draconian for many executive directors, particularly when many were under unprecedented levels of pressure as they navigated the pandemic and were also seeing their direct reports having incentive targets reset (or replacement awards issued). We think that it should be possible for the UK market to establish agreed principles, which would allow such adjustments in a way that is considered fair and reasonable for both management teams and shareholders (for example, as shown in the following table).

Key principles for re-setting PSP performance targets	
Only applicable in circumstances where an exogenous event has caused a material impact	Amending in-flight targets should not be a regular occurrence. The 'threshold' for the type of event should be high and based on events that are outside of management's control. For example, COVID would qualify, but a downturn in business performance would not.
Awards in the final year of the performance period cannot be adjusted	For these awards, stakeholders should accept that 'the outcome is the outcome' and the alignment with the shareholder experience should take precedence.
Material 'haircut' to award sizes on re-set	In recognition that targets are being reset, award sizes should be subject to a material 'haircut'. Investors could argue for some 'rule of thumb', perhaps a discount of at least 50 percent?
New targets need to be demonstrably as stretching as when originally set, with clear disclosure	The probability of meeting the new targets should be the same as it was when targets were originally set, a principle already commonly embedded within most PSP rules. Companies need to provide clear disclosure to support this, and shareholders then have the opportunity to express their views via the AGM vote (as with any PSP target).
Consistent application – upwards and downwards	In circumstances where the company is subject to a positive exogenous event that materially improves the vesting outlook, remuneration committees should look to reset targets upwards in the same way.

Technical adjustments to targets (e.g. to reflect a change in accounting standards) are not captured by this framework.

3. EXECUTIVE SHAREHOLDING: SIMPLIFICATION FOR THE BENEFIT OF ALL STAKEHOLDERS:

As discussed in Section A, UK shareholder guidance has incrementally evolved to create a complex patchwork of rules and requirements that are all designed to encourage long-term executive shareholding. This includes bonus deferral, PSP 'holding periods', and requiring executives to meet shareholding guidelines, which also now extend into a post-employment period.

It is of course right to require executive directors to build a meaningful long-term shareholding and should be maintained as a key principle in the UK market.

However, the mechanisms for robustly achieving this objective could be simplified from current required practice, benefitting both management teams and shareholders.

In Figure 8, we set out one illustrative example of a basic framework, which would ensure executives could build up and retain the agreed level of required shareholding from the pay-out of their incentives, but in a simplified way without rigid bonus deferral or PSP holding periods as conventionally operated.

Figure 8: Illustrative example of simplified structure for delivering long-term share ownership

Set a level of 'Required Shareholding' applicable to in and post-employment periods.

This must be held in an 'Executive Share Account' ("ESA")

If Required Shareholding is not met

X% of the pay-out would be transferred (in shares) to the ESA.

Company controls release of shares from ESA:

- *Until **two years post-cessation**, ensuring that the relevant Required Shareholding is maintained*
- *Ability to reclaim shares to **enforce clawback** (based on the normal policy, including timelines)*

Y% released to the executive

If Required Shareholding is met

100% released to the executive

No restrictions

(For example, released shares can be either sold or retained at the discretion of the executive)

Parameters for the company to determine would include, for example: the percentage of the incentives to be transferred on pay-out (signified as X% above, and could be different for short and long-term incentives), the mechanics for assessing Required Shareholding (e.g. which salary and share price to use), whether the transfer of shares to the ESA can and should be made on gross or net of tax basis, whether any forfeiture provisions should apply, the calibration of malus and clawback provisions, and any 'exceptional circumstances' provisions to provide flexibility on the ESA administration. The ESA would be controlled by the company (e.g. a nominee account).

Within this overall framework, companies would retain flexibility on the exact calibration of the parameters, and these could be set to follow existing company policies and precedent (see the notes to Figure 8). Companies with specific regulatory obligations, for example in financial services, would need to ensure these were met. The key point is that the basic framework can achieve the underlying objective of robustly creating long-term executive shareholding but with less complexity (e.g. removing bonus deferral and PSP holding periods as they conventionally apply).

There are range of variations that could also be considered; for example, packages could be constructed so that a small percentage of base salary is also transferred into the ESA, ensuring that meaningful shareholdings can be built over time irrespective of the outcome of incentive awards.

4. QUANTUM – TAKING THE EMOTION OUT OF THE ISSUE:

The potential changes outlined above, aimed at structuring and operating incentives in a more balanced, flexible, and simplified manner, could help overcome many of the challenges faced by the UK-listed market. However, it is important to acknowledge that, in some cases, these changes may not solve everything. Some UK-listed companies may need to offer higher pay to attract and retain the calibre of talent required for challenging and complex leadership roles.

The issue of quantum is, and is likely to continue to be, highly sensitive from a broader societal perspective in the UK, often more so than it is in other countries. Indeed, for some, even if material *reductions* to levels of executive pay were made, it would still be considered too high.

How can the UK market navigate this challenge? There needs to be an honest discussion among all stakeholders involved, acknowledging the potential risks of the current environment limiting access to the best leadership talent, while also considering the broader societal perspective. Although there is no one solution, developing a rational and less emotionally charged framework for discussing pay levels would benefit the market. In this regard, we identify several key themes to consider:

Ability to address identified market shortfalls based on robust data

Where a remuneration committee identifies a genuine and material market shortfall for high quality executive talent, it should be able to address it, to the benefit of all the company's stakeholders.

In the overriding pursuit of 'restraint', the shareholder and voting agency environment has evolved to explicitly discourage 'benchmarking-related' increases (whilst at the same time making their own market assessments for a company using, in some cases, proprietary peer group construction which can be crude and misleading).

This broad aversion to benchmarking is not sustainable or credible in the face of the commercial reality of talent markets. For a role at any level in the business, companies will look to ensure they set pay in the context of the market environment, so why should this be different for executive directors?

At the same time, we do not support a return to the old approach where benchmarking was undertaken too frequently, and often interpreted and applied on a highly 'formulaic' basis. We would therefore welcome a shift in market focus from one which appears sceptical of any benchmarking to one which is supportive where it is used in a robust, measured and responsible way.

Strengthening alignment with performance and shareholder value

To address a market shortfall, the remuneration committee can choose which component of the package to increase, which will depend on the market data, the reward philosophy of the company, and shareholder preferences. In the current environment, shareholders have tended to urge restraint on all components of pay. Would a more rational approach involve the market establishing a more explicitly stated preference increases to be in forms which are most directly linked to performance and shareholder value?

Increases to performance-linked award opportunities (whether short or long term) would allow shareholders to make a commercial judgement about whether the potential uplift in remuneration is reasonable in the context of the performance required for those incentives to pay-out. For example, shareholders could be more open to proposals which create greater upside opportunity in exchange for exceptional performance (although a strict requirement that any increase to award levels is always matched with an increase in stretch is too formulaic). Although investors can sometimes be sceptical about the level of stretch in incentive plan targets, data on outcomes generally suggest a relatively robust approach across the market.

In addition, shareholders have a regular opportunity to opine on the target levels via AGM voting, and the typical engagement activity around this. If the emphasis of that engagement was to shift from the level of opportunity itself and more towards (i) the stretch of the target range and (ii) whether the ultimate outcome from the award was acceptable, would that be a bad thing for the UK market?

Increases which are also delivered in the form of long-term equity awards create even further alignment with shareholder interests. Such an approach is also likely to be particularly compelling for those companies looking to improve competitiveness against the US talent market, where equity award levels rather than base salaries are typically much higher.

A preference for performance-linked long-term equity is not new to the UK market and its shareholder community. But could a more explicitly stated preference for this route help the market to establish greater clarity and rationality on the issue of quantum increases?

The wider employee perspective – 'gain sharing' and consistency

Demonstrating that remuneration decisions and outcomes at the executive level are consistent with those applicable across the wider employee population is also an important part of taking the emotion out of the quantum issue for stakeholders, including employees. Significant progress has been made on this in the UK and should remain an area of focus.

For incentives, it is helpful for companies to illustrate that in situations where strong performance is delivered for shareholders, and large pay-outs are received by executives, these gains are also cascaded, or 'shared', with the wider workforce. This includes using all-employee share plans and cascading incentive plan participation into the business. This way, positive outcomes at the top translate to positive outcomes for employees too, even though the absolute levels will vary based on seniority.

On salary, the general shareholder expectation that increases for executive directors should not exceed the percentage increase for the wider employee population has driven market practice for much of the past decade. In the past year, in the context of higher-than-normal workforce increases in response to inflation, the vast majority of increases for executive directors were set at a 'discount' to the employee average. Neither of these approaches should become embedded in market guidance on a formulaic basis. The key is to ensure that executive directors are subject to the same principles and review process which applies throughout the business.

Compelling and comprehensive disclosure

As with anything related to executive remuneration, higher quality company disclosure will help. Where companies are increasing executive quantum, they could do more to ensure they set out a compelling case for change in their remuneration report, recognising that communication needs to meet the needs of a broader stakeholder audience than just shareholders.

This may include being more transparent on all the areas raised above, such as providing more information on the market benchmarks or other relevant context that supports the case for increased quantum. Alternatively, companies could more explicitly explain how increases to incentives opportunities are designed to strengthen alignment with company performance for the benefit of all its stakeholders.

C

THE ENVIRONMENT FOR REMUNERATION COMMITTEES

Remuneration committees face a complex external landscape that includes legal and regulatory requirements, ever-changing best practice guidelines and the potentially diverse range of views from their own investor base.

In the UK there is a well-established remuneration voting regime. Shareholders have had the ability to provide an advisory vote on the company's Directors' Remuneration Report at each Annual General Meeting (AGM) for over twenty years. Since 2013, companies have also been required to seek binding shareholder approval for their Directors' Remuneration Policy at least every three years. Most companies actively engage and consult with their major investors and shareholder bodies to discuss executive pay, providing a further route for shareholders to express their views.

Over this same twenty-year period, the proportion of the UK-listed market held by traditional UK institutional investors (insurance companies and pension funds) has been in consistent decline, going from around a third of the market to less than five percent. At the same time, the proportion held by those more likely to utilize voting agencies (e.g. overseas investors, non-traditional funds, etc.) has risen to over half of the market. The voting agencies have therefore come to play an increasingly important role in the UK's corporate governance 'eco-system'.

While the basic voting framework remains robust, we have two key observations about how the overall system, including the influence of the voting agencies, currently works in practice.

An increasingly 'rules-based' environment

We argue that the approach to executive pay in the UK-listed environment has gradually shifted towards a 'rules-based' approach. This means that the frameworks for managing executive pay rely less on a set of principles with flexibility in their application, and more on strict rules and guidelines.

This shift began with the regulatory framework itself. Since 2013, companies have been required to operate within the terms of a Remuneration Policy that has been approved by shareholders. Prior to that, remuneration committees had significantly more flexibility on how to pay their executives which, whilst not always used responsibly, should be acknowledged.

A greater impact comes from what we perceive to be an increasingly rules-based approach within the shareholder environment:

- **Institutional shareholders and 'red line' voting issues.** Institutional shareholders will often develop their own policies on executive remuneration. Some have chosen to rigorously apply aspects of their guidance in their voting decisions (i.e. by classifying some positions as non-negotiable 'red line' issues where failure to comply will result in a vote against, with no exceptions). On some issues (including some of those set out in Figure 4 above), this approach has been a highly effective catalyst to drive UK market practice. For remuneration committees, however, it can lead to a lack of flexibility to respond to the specific circumstances of their business. Furthermore, because the policies of each shareholder reflect the specific thinking and preferences of that institution, when taken together across the market they have created an increasingly fragmented landscape to navigate.

- **Amplified by influence of voting agencies.** The trend towards a more rules-based approach is further amplified by the growing influence of voting agencies. The major agencies need to opine on proposals being made across the full market, encompassing a spectrum of size, sector, and characteristics, without having the same insights and access to those companies that a shareholder may have. This naturally lends itself to the adoption of a rules-based assessment approach. In collaboration with their clients, agencies will develop a set of guidelines for a market and assess company proposals against these guidelines. Making exceptions to these agreed 'boundaries' is understandably very challenging for them. It can be frustrating for companies when a voting agency applies different guidelines and standards in different markets, prompting them to question the rationale behind such inconsistency.

Although by definition, a rules-based approach brings greater clarity and consistency to the market, it also makes it more challenging to be different, potentially stifling innovation. It begs the question: Has the 'pendulum' swung too far, and are the remuneration rules now hindering the UK's standing as an effective capital market, particularly with those companies that want to take a bold and differentiated approach?

The impact of a 'low' voting outcome – is it proportionate and constructive?

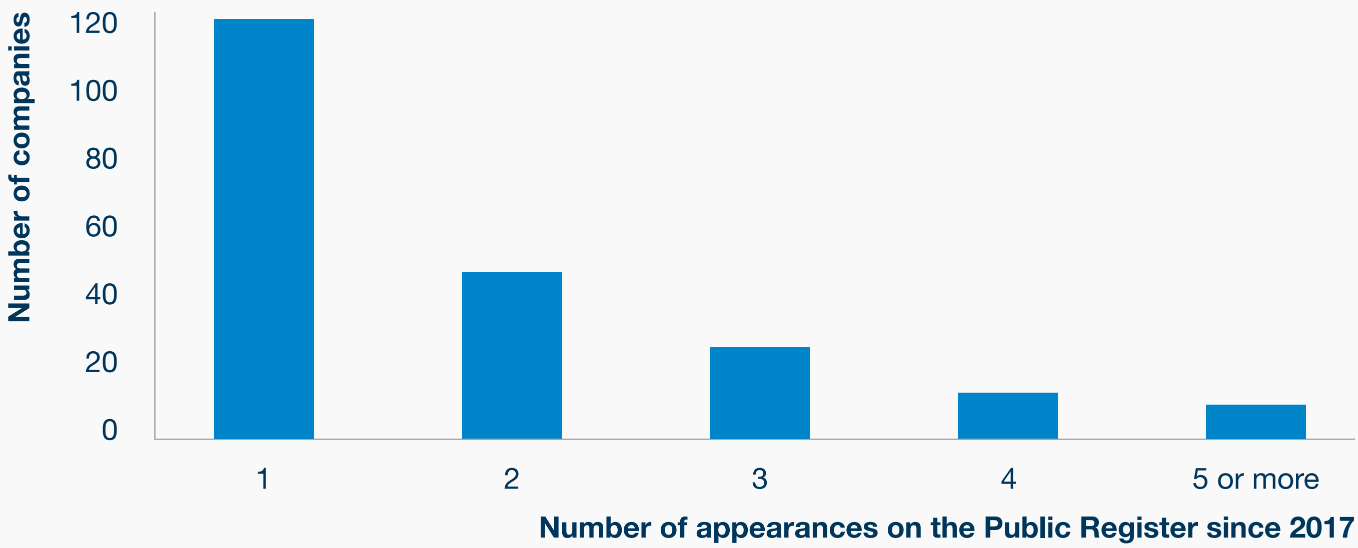
When it comes to shareholder voting on remuneration, most UK-listed companies consistently receive support in excess of 95 percent, a fact often ignored in popular narratives.

At the other end of the spectrum, in the rare circumstances where a company loses a remuneration-related vote (less than 1 percent of the market each year, on average), the consequences are rightly material. A failed Remuneration Policy vote means that Policy cannot be implemented, while a lost advisory vote on the ARR triggers a requirement to seek a new shareholder vote on the Policy itself.

More important to consider is what occurs when a resolution is passed, but with votes against amounting to at least 20 percent. In such cases of a 'low' voting outcome, the Code requires the company to explain *"what actions it intends to take to consult shareholders in order to understand the reasons behind the result",* make a number of subsequent disclosures, and be captured on the Investment Association's 'Public Register', an online repository that tracks all instances of low voting outcomes. Here, we can make three observations:

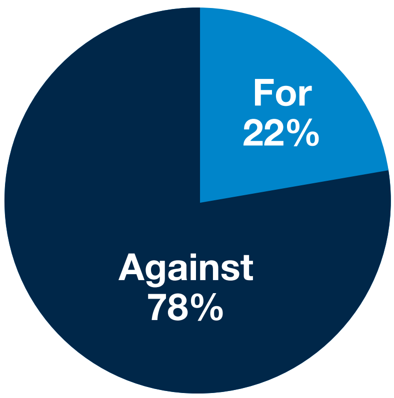
- **Feeds an unhelpful public narrative, disconnected from the scale of the 'offence'.** For example, it can be accompanied by a narrative suggesting that the remuneration committee has acted improperly, resulting in a shareholder 'revolt' or 'mutiny' on executive pay. In reality, is it not more often simply a reflection of a reasonable degree of divergence in opinion on a subjective matter, which we should naturally expect in an increasingly fragmented shareholder environment, without concluding that there is some 'problem' to address? Since the launch of the IA Public Register in 2017, more than 220 different companies have been captured. We question whether it really is the case that egregious remuneration practices have occurred in over 40 percent of the UK-listed market over that period. As shown in Figure 9, most of these companies have only ever been included once and 'repeat offending' is relatively unusual.

Figure 9: Appearances on the IA Public Register in respect of remuneration (since 2017)



Companies included in the IA Public Register since inception in respect of votes on the ARR and Remuneration Policy (source: IA Public Register website)

Figure 10: Recommendation from largest UK voting agency for companies receiving a 'low' remuneration-related vote



Includes data from AGMs from the start of 2022

- **Almost 'binary' impact of voting agency recommendation on the probability of a low vote.** Voting agencies' clients are often highly likely, or mandated, to vote in accordance with the agency recommendation. The typical impact on the voting outcome from an "against" recommendation from the most influential UK agency is around 20-40 percent and is therefore highly likely to trigger a low vote. Figure 10 shows that only around one in five companies receives a low vote without opposition from the leading voting agency.

  This situation creates a challenging and frustrating environment for remuneration committees.

  It is not uncommon for a company to undertake an extensive engagement with major shareholders to develop and refine a proposal that receives support from those institutions but ultimately receive a 'low' vote as a result of the voting agency influence. The implication from the AGM result that there has been widespread investor opposition can often seem disconnected from the reality of the feedback received from shareholders consulted.

- **Limited value-add from the requirement to re-engage with shareholders.** In our experience, for the majority of companies that take a responsible approach to executive pay governance, the Code requirement to re-engage with shareholders after a low vote adds little additional value for any stakeholder. Most companies will typically have already engaged with a large proportion of their register and will therefore often already understand the rationale for their voting decision. This explains why, in our experience, many shareholders choose not to participate in the required follow up exercise (on the very reasonable grounds that "we've told you our views already") and why the follow up disclosure appears to adopt a 'boilerplate' approach (because there is no new information to include).

Moving forward: a key role for remuneration committees

If the concern of companies about their ability to successfully compete for top talent in a global market becomes an increasingly credible factor in their decision to list or move their listing outside the UK, it might encourage institutional investors and shareholder bodies to be more open to change. In such a scenario, our preference would be to adapt the UK shareholder environment to better embody the following interconnected concepts:

Greater flexibility

In all aspects of design and implementation, companies need more flexibility to reflect the needs and circumstances of their business and its stakeholders.

Companies looking to be bold and innovative, within agreed principles, should not be discouraged from doing so.

Prioritising principles over rules

Greater flexibility does not mean abandoning the progress that has been made, it means embracing a return to a more ‘principles-based’ underlying framework of guidance – a smaller number of high-level objectives.

Principles should be applied fairly and consistently, whether to the benefit or detriment of management.

Pay proposals and outcomes should be viewed holistically, not on a ‘tick box’ basis.

Fostering trust and collaboration

There should be more trust in non-executives serving on remuneration committees to use their judgment in managing executive pay for the benefit of all stakeholders, in keeping with the role they are appointed to do.

Improved levels of trust would support a more collaborative, and less adversarial, approach to decision-making and engagement, for the benefit of all.

Honesty about talent

Leading a UK-listed company is a challenging and complex task that requires high quality executive talent. Those who hold a stake in the success of these companies – shareholders, employees, and the wider UK economy and society – need to acknowledge the risks from failing to secure the right leadership talent.

Equally, a more flexible system requires management teams to support the alignment of pay outcomes with performance.

Regarding the voting regime, we think that the UK market should consider how to facilitate a shift in the narrative around ‘low’ voting outcomes to recognise that a reasonable degree of divergence in views does not necessarily indicate a major concern or a governance failure. By doing so, we can encourage a more constructive environment for all stakeholders.

In practice, this could include sharpening the focus of the Public Register, for example by changing the threshold for inclusion, so that only the most meaningful and notable events are caught (e.g. lost votes, an absence of any consultation, and ‘repeat offenders’).

We also argue that finding ways to facilitate and encourage better engagement ahead of the AGM (including involving a larger proportion of the market) is preferable to the current obligation to re-consult after the vote which adds little value for most stakeholders.

Ultimately, however, we think that change is most likely to be driven incrementally by remuneration committees becoming more ‘risk tolerant’; that is, willing to accept lower voting outcomes to do what they believe is right for the business. We have witnessed evidence of this emerging shift in recent years.

This is not an easy task for non-executive directors. It takes a certain type of principled and resilient character in the face of the unhelpful public narratives and reputational risk which can arise when companies receive a ‘low’ vote. Remuneration committees can address this challenge as follows:

- **Informed judgements and balancing perspectives.** Remuneration committees must be able to make informed judgements, considering a range of different perspectives including the market landscape, the commercial realities of the business, broad investor guidance, and the specific views of their shareholder base. This requires judgement, and an ability to fairly balance those different perspectives.

- **Returning focus to core duties.** In addition to continuing to address some of the emerging key issues for remuneration committees in recent years (such as the incorporation of ESG metrics and wider workforce considerations), we expect the focus of the agenda for some may return to what might be described as the ‘core duties’ of a remuneration committee – attracting and retaining high calibre talent to deliver performance.

- **Consultation, disclosure, and transparency.** High quality and timely consultation with shareholders and voting agencies, combined with transparent and compelling disclosure in the DRR, particularly on material or potentially contentious issues, is more important than ever.

- **Decision-making in the best interests.** Ultimately, remuneration committees need to make decisions that they believe are in the best interests of the company and its stakeholders, which may become increasingly divergent from what would be required to simply maximise the DRR vote. Committees should be comfortable with accepting lower voting outcomes, if they consider it is the right course of action.

- **Differentiating low votes: agency influence vs. independent opposition.** We expect to see remuneration committees increasingly recognise a qualitative difference between a low vote which can be reasonably attributed to the influence of voting agency recommendations and one caused by opposition from major shareholders based on an independently derived view.

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