

# Executive Pay in the UK

## The 'Big Tent' Discussion

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ALVAREZ & MARSAL



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# Executive Pay in the UK – The ‘Big Tent’ Discussion



**David Tuch**

Managing Director

[dtuch@alvarezandmarsal.com](mailto:dtuch@alvarezandmarsal.com)

+44 7949 169944



**James Harris**

Managing Director

[james.harris@alvarezandmarsal.com](mailto:james.harris@alvarezandmarsal.com)

+44 7861 294374



**Jeremy Orbell**

Managing Director

[jorbell@alvarezandmarsal.com](mailto:jorbell@alvarezandmarsal.com)

+44 7341 486140





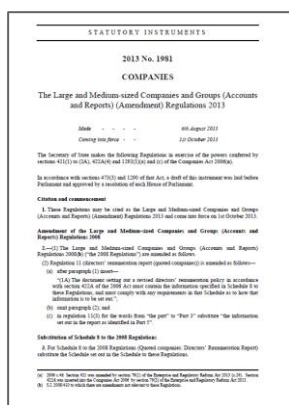
# The 'Big Tent' Discussion

## Background and context

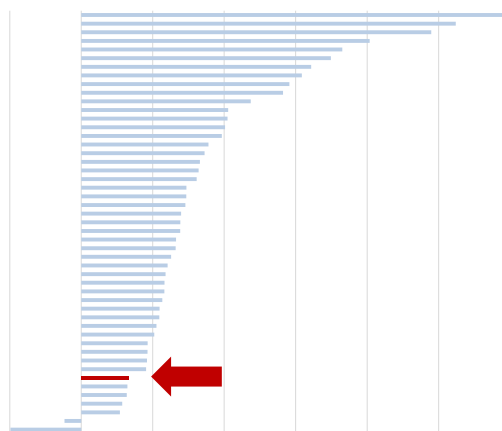
*"We need a constructive discussion on the UK's approach to executive compensation ... with all stakeholders about a topic that tends to generate emotion and strong views. This needs to be a **'big tent'** conversation, with listed company Chairs, Founders of potentially listed companies, Asset Managers and Owners, the Financial Reporting Council, the Investment Association, other investee groups and the proxy agencies."*

Julia Hoggett, CEO London Stock Exchange, May 2023

### 10 year anniversary of current Policy/DRR framework



### UK economic growth lagging peers



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Data and observations over the past 10 years

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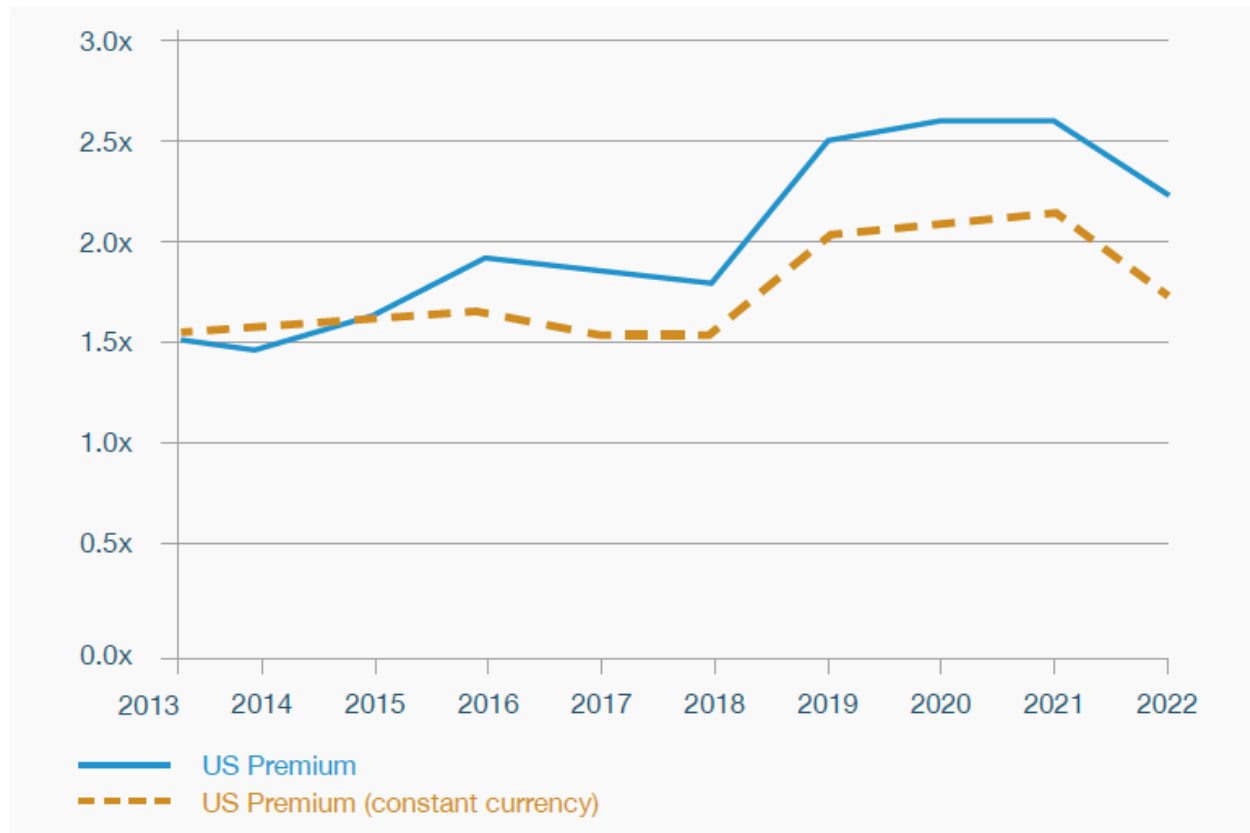
Evolving the UK – practical ideas for change

3

The environment in which remuneration committees operate

# Data and observations

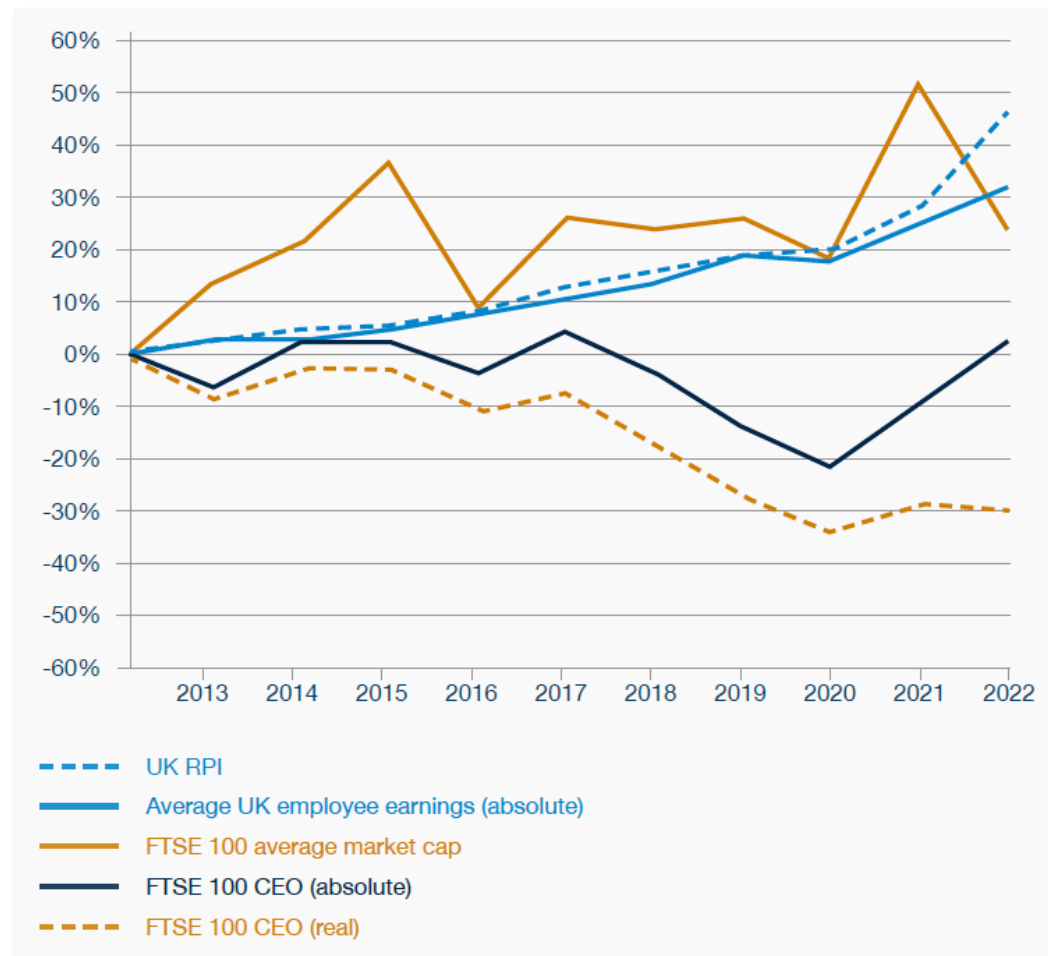
*US 'premium' vs the UK has grown*



- ▶ Key issue for those competing in the US talent market
- ▶ Less so for many UK-listed businesses
- ▶ Not a new issue

# Data and observations

*Realised pay for FTSE 100 CEOs has been flat for 10 years, lagging UK reference points*



How we do explain the CEO trend:



Salary restraint



Pensions



Incentive *opportunities* up...



...but amounts being *received* down

# Data and observations

*Changes to the structure and operation of packages have reduced perceived value*

	2013	2022
Bonus deferral	c.2/3 of market	Universal
LTIP holding periods	c.50% of market	Universal
Malus and clawback	<50% market	Universal
Shareholding requirements	c.2x salary	c.3x salary
Post-cessation	N/A	2 years @ 100%
Discretionary adjustments	Rare	c.30% of market, often downwards
'Windfall Gains'	N/A	Shareholder focus
Pensions	DB or 20-30% DC	c.10% DC

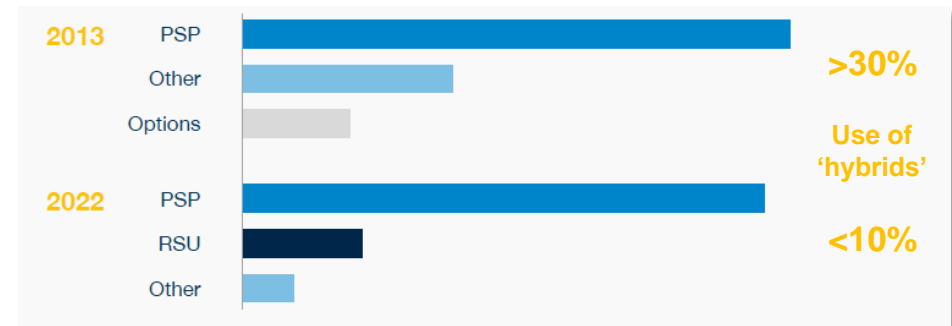
Each has a rationale in isolation, but collectively have served to 'chip away' at the overall perceived value of remuneration packages:

- Extended time horizons
- Increased uncertainty
- Increased complexity
- Perceived 'asymmetry'
- Divergence with below board executives and other talent markets

# Data and observations

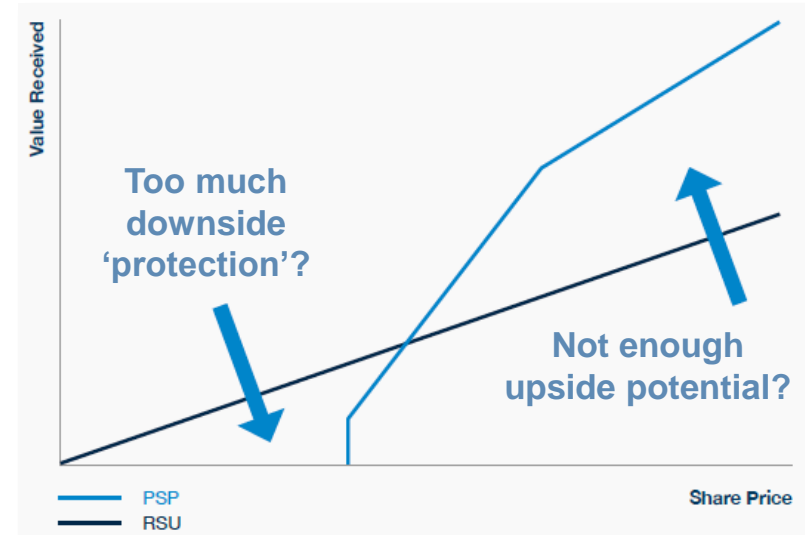
## Limited variability in long-term incentive structures

- Often recognised that ‘one size does not fit all’
- Yet homogeneity has increased over the last 10 years



### Focus on Restricted Shares

- Elicit a range of views
- Can foster a long-term stewardship culture, support retention, and avoid practical challenge of target-setting
- Legitimate concerns around impact on performance
- *Key problem in the UK is having to make a **binary choice** between either PSP or Restricted Shares*



# Data and observations

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## *Conclusion*

*It is reasonable to conclude that remuneration packages for executive directors in UK-listed companies have become less attractive over the past decade*

- ▶ Is it a priority?
- ▶ How can we address the issue in ways which align with stakeholder interests?

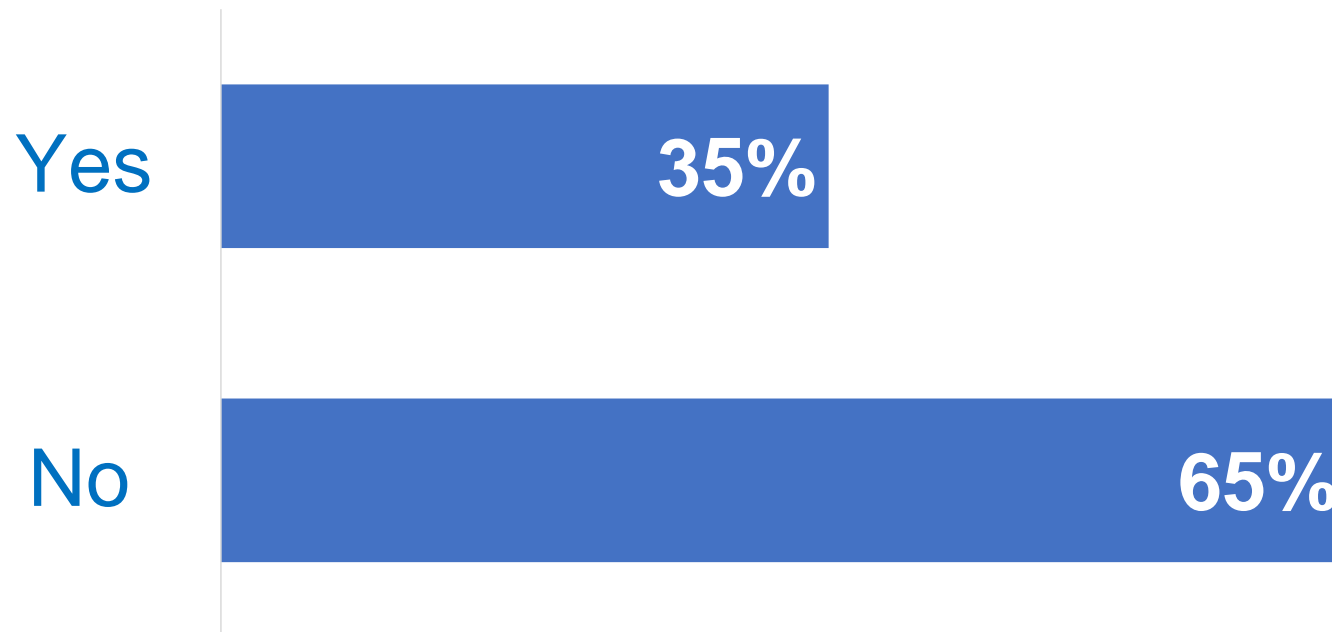


## Poll question #1

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*Polling questions were asked during the webinar and the audience response is below*

*Has the UK market's approach to executive pay caused, in practice, a material issue in the recruitment or retention of executive director talent in your business?*

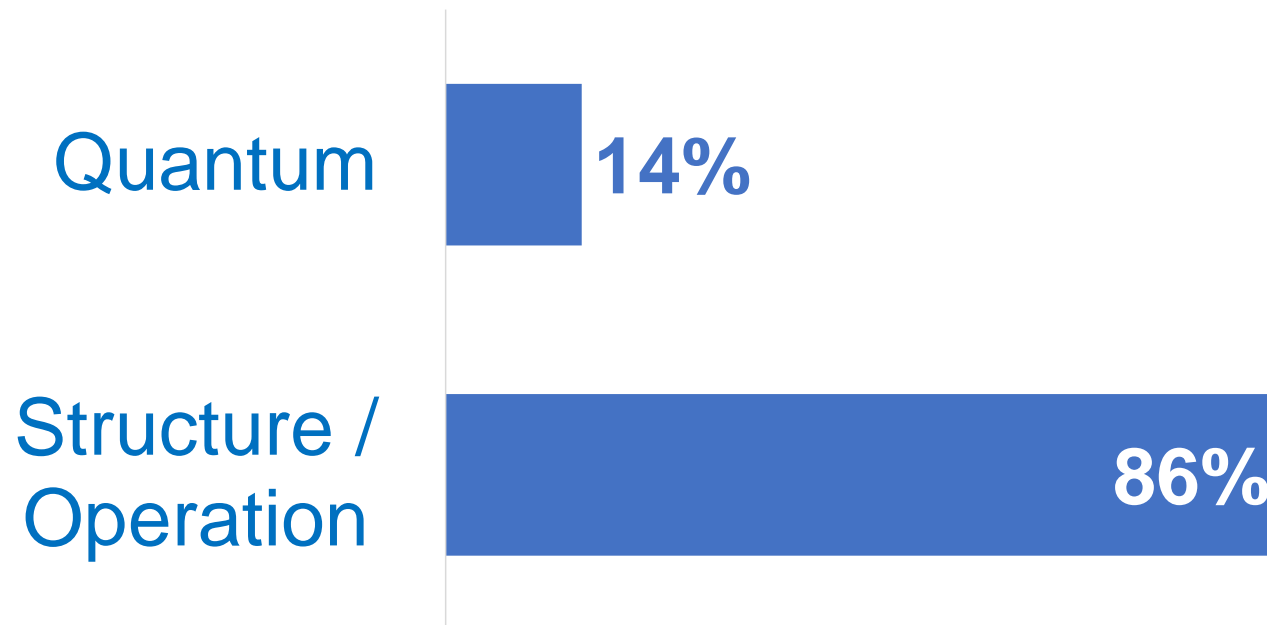


## Poll question #2

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*Polling questions were asked during the webinar and the audience response is below*

*We have discussed issues related to both quantum and the structure / operation of packages. Which would you prioritize as the key problem for the UK market to address?*

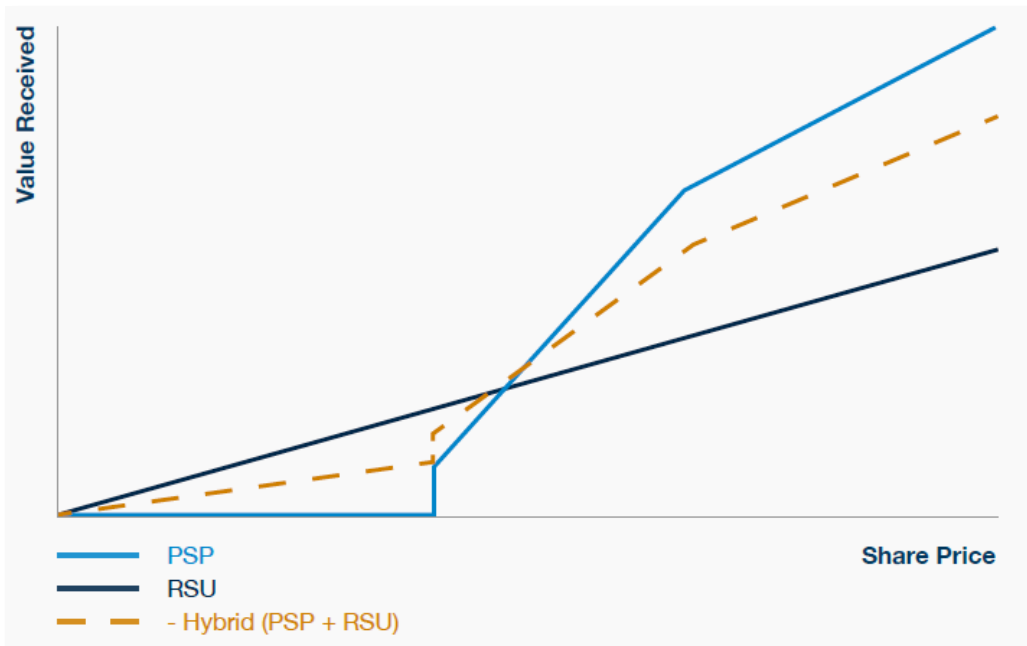


# Shaping the future: Ideas for the UK market

## *Greater variation in incentive structures, including hybrids*

Combine the benefits of different types of plans, for example Performance Shares and RSUs....

..... or plans to drive performance



Share options	Alignment to share price growth
Multiplier plans	Additional upside for exceptional performance
One-off awards	Energise strategic delivery over specific period

# Shaping the future: Ideas for the UK market

## *Greater flexibility in the operation of incentives*



*“Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes”*

*UK Corporate Governance Code*

Greater market acceptance to apply the principle of discretion in both directions....

.... could the market agree robust principles to govern re-setting ‘in-flight’ PSP targets?

*In practice, currently  
downward only*

*Principle should apply  
both ways*

*Material exogenous event*

*Not applicable in final year*

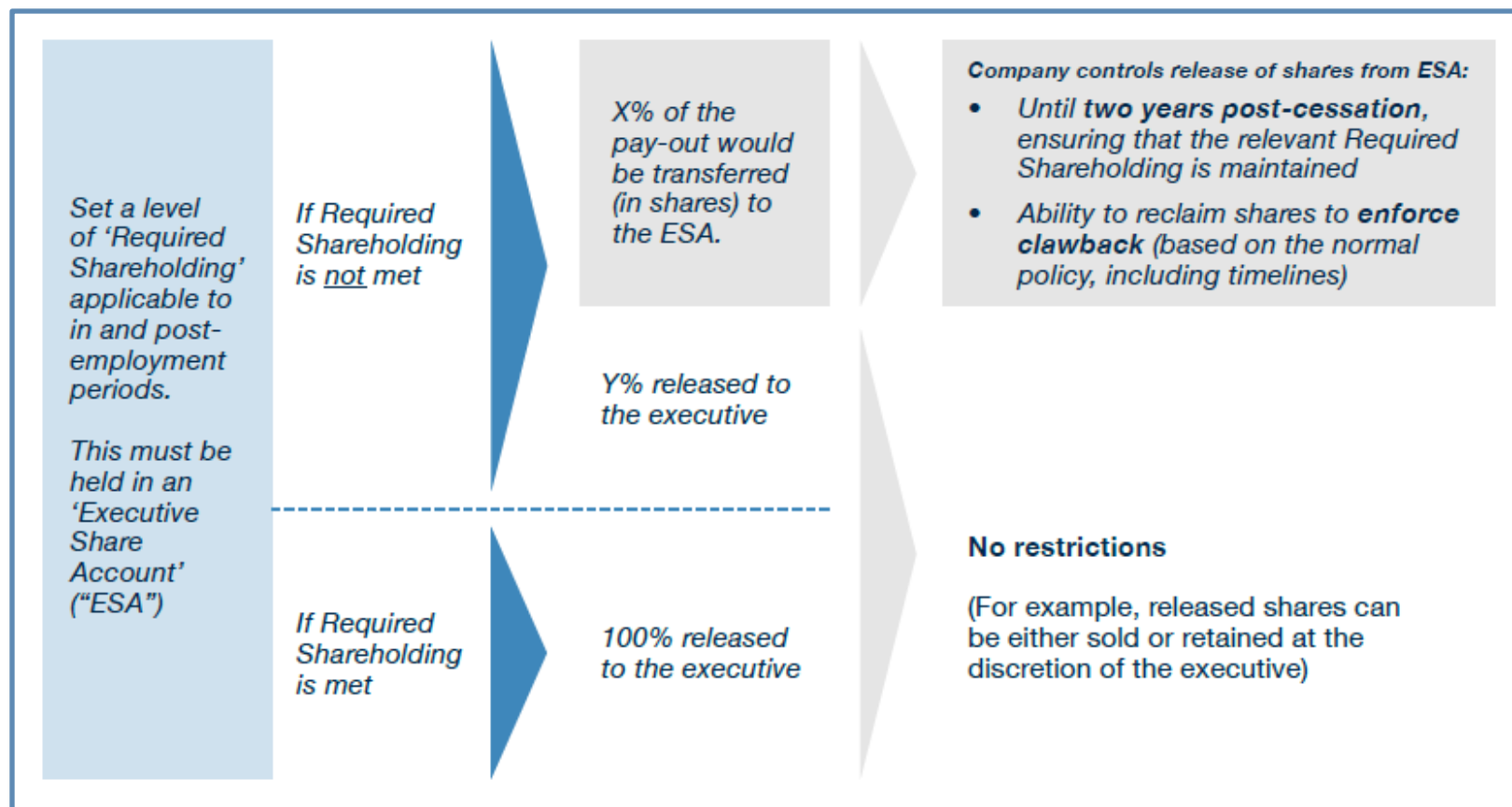
*Material ‘haircut’ to award*

*New targets retain level of stretch*

*Consistent application – up and down*

# Shaping the future: Ideas for the UK market

## Simplify executive shareholdings



### Simplified and robust framework:

- ✓ No conventional bonus deferral
- ✓ No PSP holding periods
- ✓ No required time period
- ✓ Robust mechanism for building shareholding
- ✓ ...and maintaining it through post-cessation period



# Shaping the future: Ideas for the UK market

## *Quantum – taking the emotion out of the issue*

### **Ability to address shortfalls based on robust data**

- Aversion to benchmarking not sustainable or credible
- Focus on robust and responsible approaches

### **Strengthening alignment with performance and shareholder value**

- Embed preference for long-term equity
- Shift engagement dialogue from quantum of opportunity to the performance required

### **Wider employee perspective – ‘gain sharing’**

- Compelling narrative for how performance feeds through to team
- Consistent salary increase framework

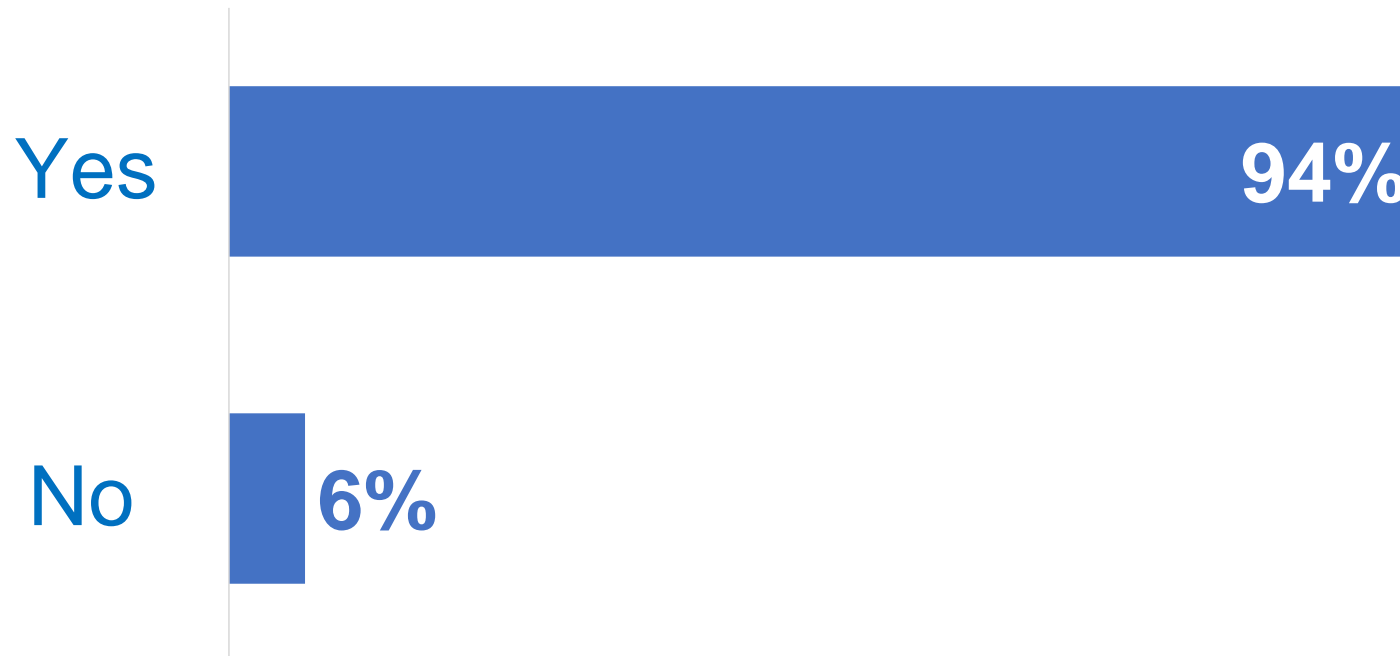
## **Compelling and comprehensive disclosure**

## Poll question #3

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*Polling questions were asked during the webinar and the audience response is below*

*Would you be interested in exploring adoption of a 'hybrid' in your company, IF the UK market was more amenable?*

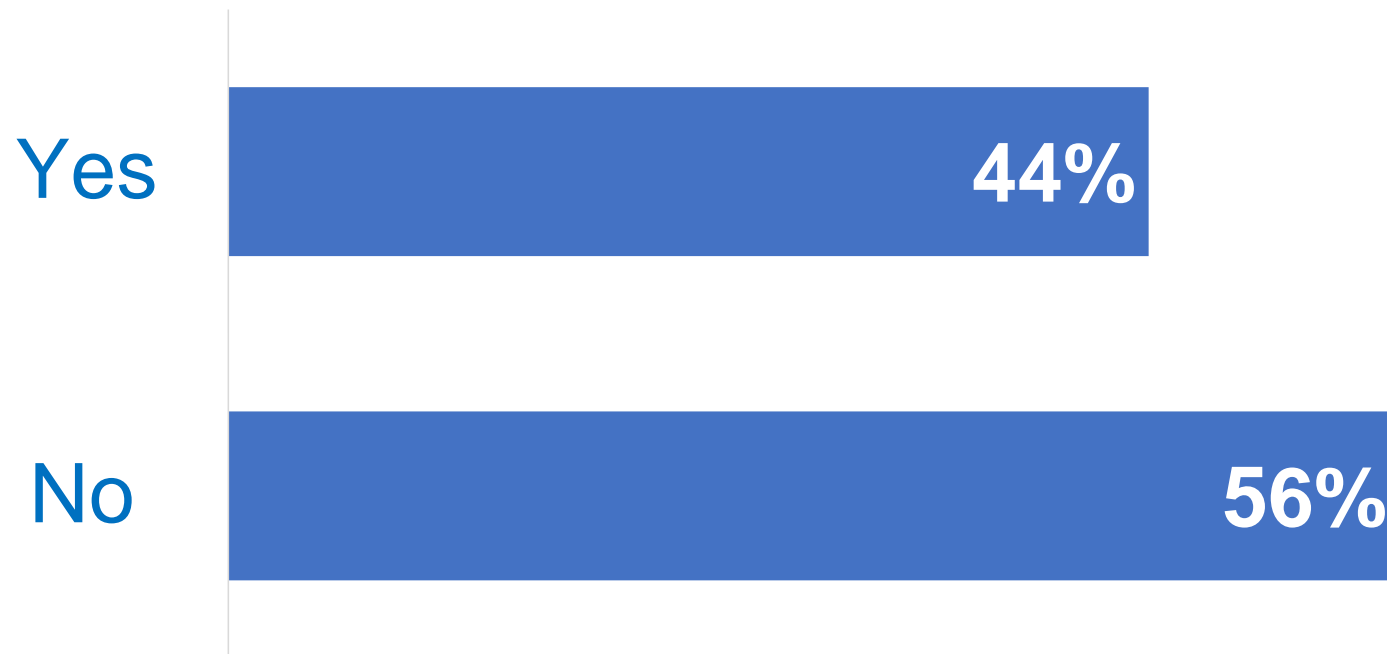


## Poll question #4

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*Polling questions were asked during the webinar and the audience response is below*

*In your business, has the remuneration committee ever wanted to exercise **POSITIVE** discretion, but felt unable to because of the potential investor response?*

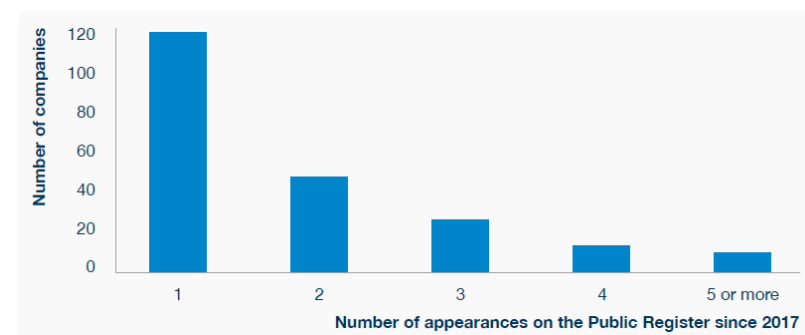


# The environment for remuneration committees

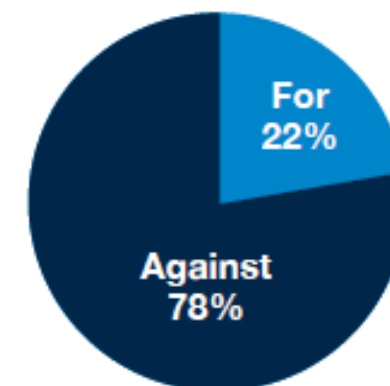
## Observations

'rules-based' shareholder environment	Impact of a 'low vote' – proportionate and constructive?
<ul style="list-style-type: none"> <li>• Voting policies increasingly 'rule-based' vs principles-based</li> <li>• 'Red line' voting issues</li> <li>• Increasingly fragmented environment</li> </ul>	<ul style="list-style-type: none"> <li>• Can feed an unhelpful narrative of shareholder 'revolt'...</li> <li>• ... compared to simply reflecting a reasonable degree of divergence in opinion on a subjective matter</li> <li>• Limited value in 're-engagement' provision</li> </ul>
<p style="text-align: center;"><b>Amplified by influence of voting agencies</b></p> <div> <div data-bbox="107 1157 701 1335">Naturally inclined to adopt a rules-based assessment approach</div> <div data-bbox="701 1157 1283 1335">Almost 'binary' impact of ISS recommendation on probability of a low vote.</div> </div>	

40% of UK market on IA Register since 2017



ISS recommendation for all 'low' DRR votes



# The environment for remuneration committees

## *Moving forward: a key role for remuneration committees*

*Evolve the UK shareholder environment to better reflect the following concepts:*

<b>Greater flexibility</b>	<b>Prioritising principles over rules</b>
<b>Fostering trust and collaboration</b>	<b>Honesty about talent</b>

Shift the narrative around 'low' voting outcomes:

- Sharpen the focus of the IA Register
- Focus requirement to re-engage?

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.

- ▶ Informed judgments, balancing perspectives
- ▶ Return focus to 'core duties'
- ▶ Consultation, disclosure and transparency
- ▶ Accepting of lower voting outcomes
- ▶ Differentiating types of low vote



# Q&A

*Follow the link to sign up to receive our future executive compensation updates and thoughtpieces*

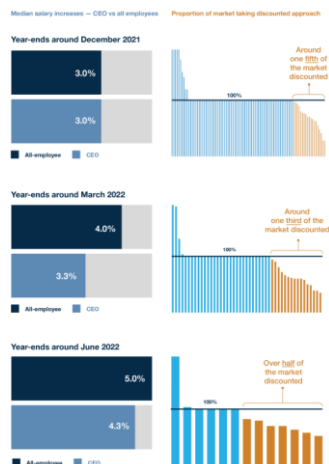


# About A&M

## Differentiated thought leadership – recent publications

### Salary vs wider workforce

In November 2022, we illustrated the emerging trend towards ‘discounted’ increases in the context of shareholder guidance and the external environment.



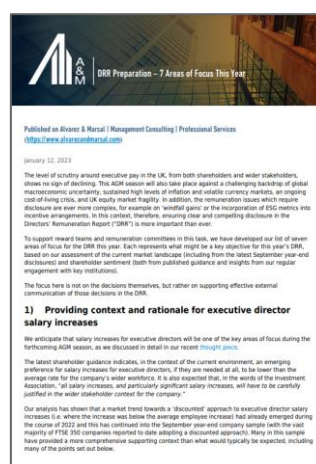
### Windfall gains

In early 2023, we published our guide on ‘windfall gains’, looking at the perspective of all stakeholders and setting out an assessment framework.



### DRR preparation this year

We set out our thoughts and practical tips in respect of the preparation of the DRR in the context of key issues for the forthcoming AGM season.



### 2023 target setting toolkit

Comprehensive study of profit targets in bonus and LTIPs across the FTSE market, to support committees and reward teams in target setting



### ‘Big Tent’ discussion

Our contribution to the ‘big tent’ debate on executive pay in the UK – analysis of key trends over the last ten years, and ideas for potential change

