UK EXECUTIVE COMPENSATION SERVICES

FIRST 50 DIRECTORS' REMUNERATION REPORTS

INITIAL TRENDS FROM THE 2024 AGM SEASON

MARCH 2024

ALVAREZ & MARSAL
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This report identifies the latest trends in executive remuneration from analysis of the first 50 Directors' Remuneration Reports (DRRs) published in the current AGM season.

This year's AGM season takes place against the backdrop of continued debate around the UK market's approach to executive pay. Some question whether the current approach to both the structure and quantum of executive packages is damaging the ability of UK listed companies to compete in global talent markets.

It is therefore interesting to note that a number of the trends we identify appear to chime with the key themes of that 'Big Tent' discussion. For example, over 20% of our sample intend to increase incentive opportunities this year. On structure, it is noticeable that over half of those submitting a new Remuneration Policy are softening their approach to annual bonus deferral.

The debate will continue during the year ahead. And while it is too early to tell how embedded these initial trends will become, it does suggest that the market may be evolving, and hence it is important that remuneration committees stay abreast of further developments.

Finally, it was interesting to note that the market is continuing to take a restrained approach to salary increases. Despite lower average all-employee increases this year in the context of falling inflation, around three quarters of our sample are continuing to apply a lower 'discounted' percentage increase for executive directors. However, as all-employee rates reduce further towards historic norms (of around 2% to 3%), we anticipate more companies returning to the practice of aligning executives with that rate.

As ever, our 'First 50' report is based on the sample of 50 companies that are first to report during the current (2024) AGM season. The group represents around one fifth of the FTSE 350 (excluding investment trusts), with a broadly even split between the FTSE 100 and FTSE 250. All companies in the sample have financial year-ends between September and December 2023 (with the majority being December) and were published in the period up to and including 11 March 2024.

Should you wish to discuss any aspect of the data shown, its implications for your business or to request more specific data cuts or analysis, please reach out to your A&M contact.

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EXECUTIVE SUMMARY KEY THEMES

Most companies continue to discount ED salary increase vs wider workforce

Average increases for the wider workforce are generally lower than last year, but remain above historical averages.

Around three quarters of the sample continue to discount executive director salary increases compared to the average increase for the wider workforce. However, where the level of workforce increase is towards the lower end of the market range (e.g. 4% or below), many companies have returned to aligning executive director increases with the workforce.

Median workforce rate 5.0% vs. median CEO increase 4.0%.

Significant reduction in one-off employee payments

Last year over 40% of the sample disclosed some form of one-off payment to employees in response to the prevailing high inflation and cost-of-living environment. This year, just 6% disclosed such payments.

Increases to incentive award opportunities in around a fifth of the sample

In our sample, around a fifth of companies are increasing incentive award opportunities for the year ahead, most commonly via an increase to the long-term incentive award level. Most increases are in the range of 25% to 50% of base salary, although some are larger.

Most companies are utilising existing ‘headroom’ within their Policy to deliver these increases, rather than requiring a new Policy.

PSP and overall single figure outcomes generally up year-on-year

Limited change in annual bonus payouts from last year (median c.75% of max, down from 81% last year). However, for performance share plans (PSP), over half the sample received higher vesting year-on-year (and the median vesting has increased from 56% to 75% of maximum).

Discretion was very rarely used to adjust the formulaic bonus, and there were no examples of discretion being used to adjust PSP outcome.

Driven by higher PSP values, CEO single figures are also generally higher this year, increasing in around two thirds of the sample (with a median increase of around 20%).

ESG metrics adoption continues

80% of the sample now include ESG metrics in the bonus while 50% include in the PSP.

Analysis of bonus and PSP payouts suggests ESG metrics are typically more achievable than non-ESG metrics, particularly for the PSP.

New Policies focused on structural change

Around a fifth of the sample (11 companies) proposed a new Remuneration Policy this AGM season.

In terms of incentive structure, one company has proposed a ‘hybrid’ which combines a PSP with Restricted Shares, but would only apply to US executive directors (with non-US remaining on a PSP only).

Three companies switched from a more unusual incentive structure into a conventional PSP, although we don’t expect this to represent a sustained trend.

More than half of the companies proposing new policies (six companies) softened their approach to bonus deferral, most commonly by linking the requirement to defer with whether shareholding guidelines have been met (that is, if the shareholding guideline has been met, a lower proportion of the bonus must be deferred into shares).

Chair/NED fee increases remain below employee average

Around four in every five companies increased the fees paid to the Chair or non-executive director (NED) fees.

It remains common practice for fee increases to be set in line, or below, the average workforce increase.

Median Chair increase 4.0% vs. median NED base fee increase 4.3%.

BASE SALARY INCREASES: EXECUTIVE DIRECTORS VS. WIDER WORKFORCE

The relativity between salary increases for executive directors and those of the company's wider workforce has been a key market theme in recent years.

For many years, it was established market practice for executive director increases to align with the average rate for the company's employees (which was typically c.2%–3%, reflecting generally modest levels of price inflation in the UK over a prolonged period).

During 2022 and 2023, the average employee increase in many companies trended higher in response to rising inflation and the cost-of-living crisis. In line with shareholder expectations for restraint in this environment, most companies adopted a "discounted" approach for executive director salaries last year (i.e. where their percentage increase was below the wider workforce average).

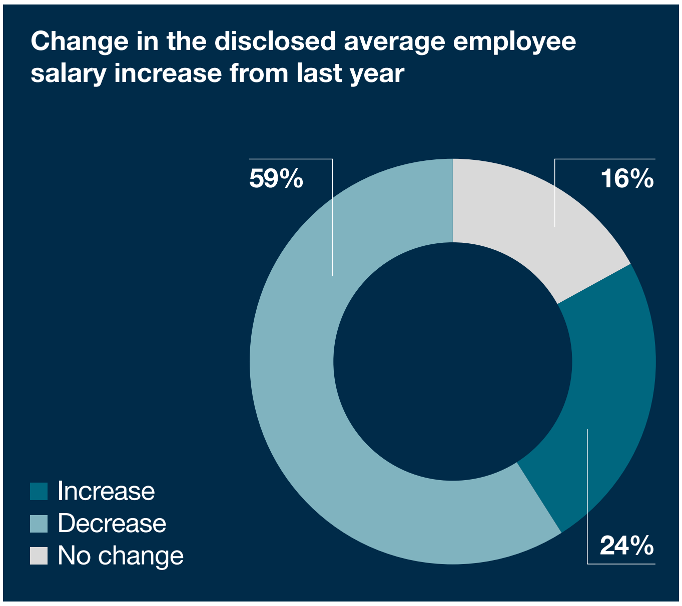
BASE SALARY INCREASES: EXECUTIVE DIRECTORS VS. WIDER WORKFORCE

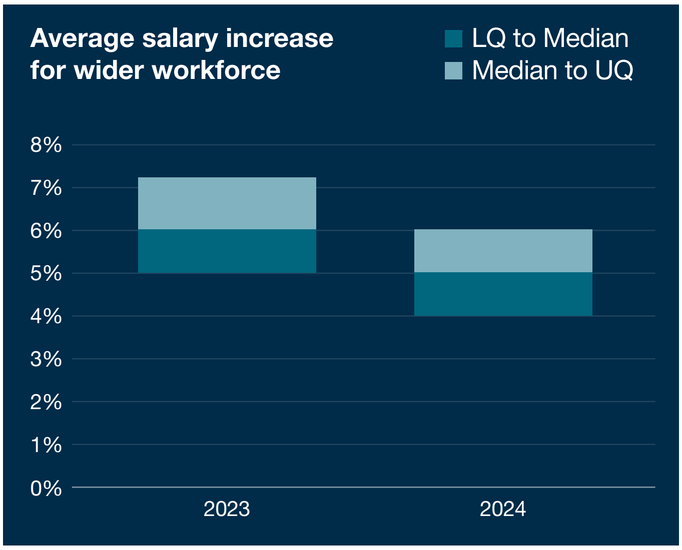
This year, for the majority of companies in our sample, the average all-employee increase is lower than last year, which is consistent with a lower inflation environment. However, despite the year-on-year reduction, the general range of all-employee rates in the sample (c.4%–6%) generally remain higher than the previous long-term average of c.2%–3%.

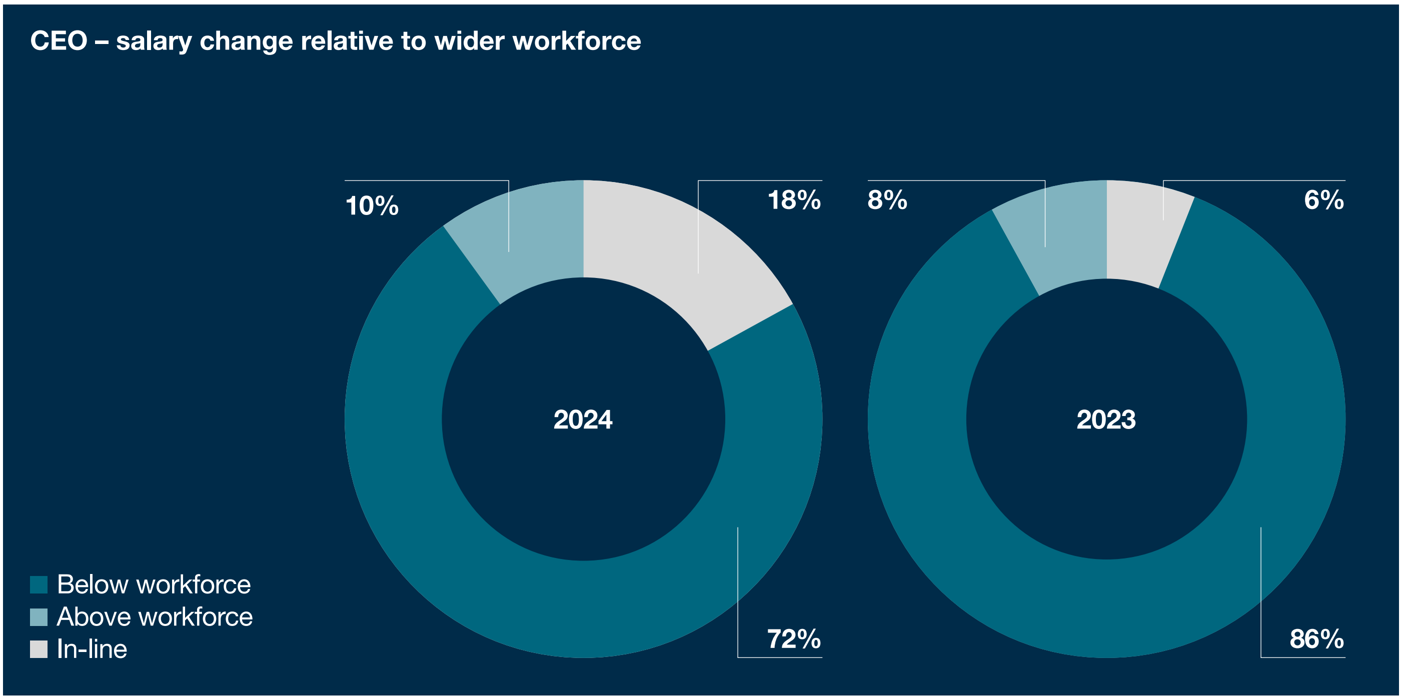
Interestingly, despite the downward trajectory of UK price inflation over the last six months, there is only a relatively minor reduction in the median all-employee rate from the companies with September year-ends (5.0%) to those with a subsequent year-end (4.4%).

Disclosure also suggests that a tiered approach to salary increases (with higher increases for more junior colleagues) remains relatively common.

For executive directors, although "discounting" remains the most common approach (in around three quarters of the sample), the proportion of the market aligning increases to the employee average has increased.







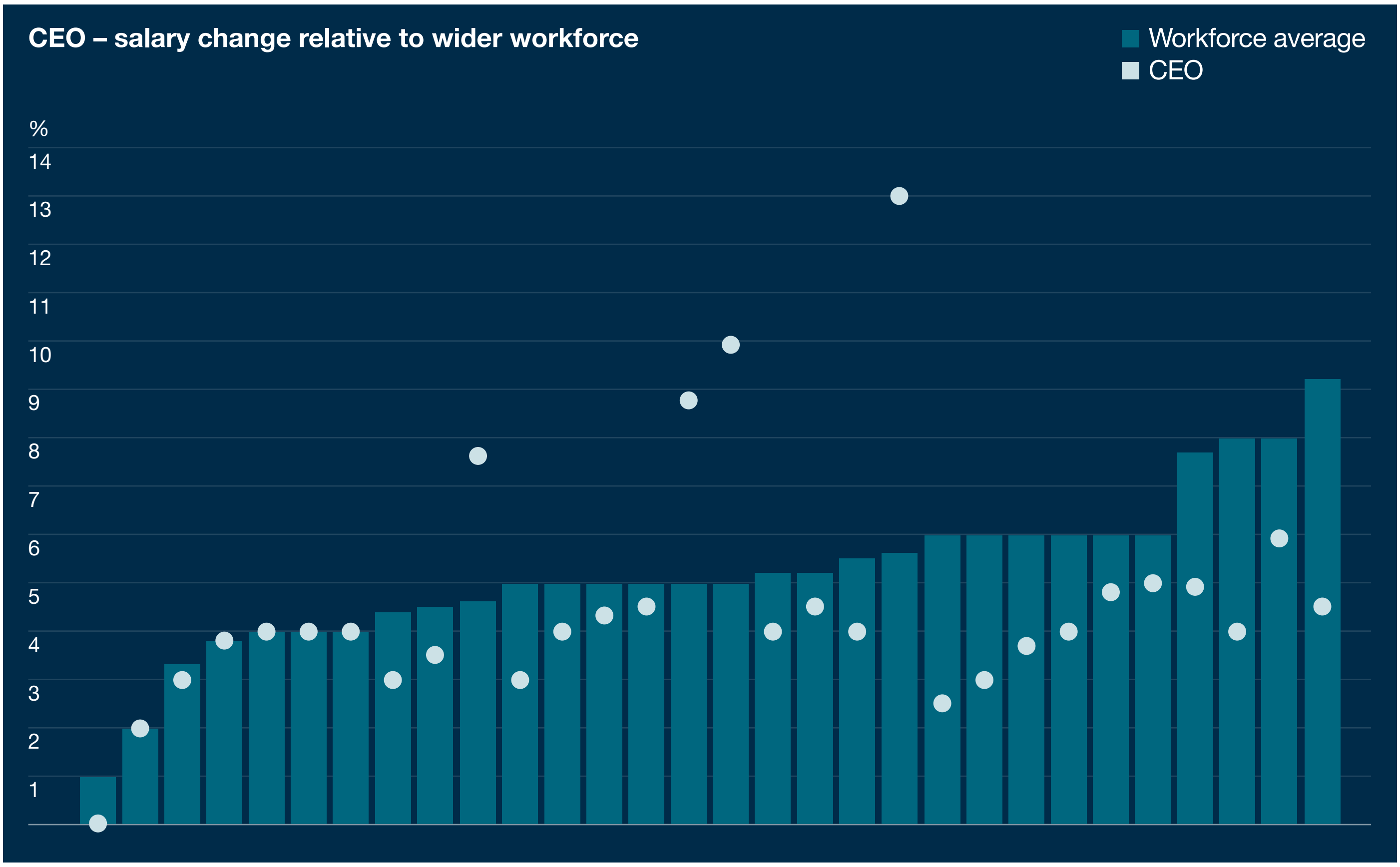
BASE SALARY INCREASES: EXECUTIVE DIRECTORS VS. WIDER WORKFORCE

The following chart illustrates market practice across the full sample, showing both the average employee increase and the CEO increase (with each bar and associated marker representing one company). It suggests that increasing the CEO salary in line with that of the workforce is more common in those companies where the increase in workforce pay is at the lower end of the market range (e.g. at or below 4%).

For the handful of companies increasing salaries above the workforce rate, the most commonly disclosed rationale was market competitiveness against a UK peer group (although two also referenced the relativity to the US talent market).In each case, no objections were raised by the main shareholder voting agencies and, for those where the AGM has taken place, strong support for the DRR was received.

CEO salary increase: unchanged year-on-year

	2024	2023
Upper quartile	4.5%	4.5%
Median	4.0%	4.0%
Lower quartile	3.0%	3.0%



One-off payments to employees

Last year, to help employees through the cost-of-living crisis, over 40% of the companies in our sample disclosed some form of one-off payment to their workers. This year, the number of companies disclosing such payments has fallen significantly to just 6% of our sample group.

REMUNERATION POLICIES

Around a fifth of our sample (11 companies) have proposed a new Remuneration Policy for shareholder approval during this AGM season. Notable themes from analysis of these new Remuneration Policies are summarised below.

This year's AGM season takes place against the backdrop of a fresh debate around the UK market's approach to executive pay. Although that debate is ongoing, and many of the decisions reflected in our sample of DRRs are likely to have been made months ago, it is interesting to note that some of the emerging trends we identify chime with the key themes of that ongoing debate.

Changes to incentive structure

One company has proposed to introduce a "hybrid" long-term incentive which will combine a PSP with Restricted Shares. This new structure will only apply to US executive directors, while directors "who are not normally resident in the US" will continue to participate in the PSP only.

Three companies have moved to adopt a traditional Performance Share Plan and away from less commonly used incentive structures (one from Restricted Shares, one from a Single Incentive Plan and one from a Value Creation Plan).

Relaxation of bonus deferral

Over half of those changing their Policy have relaxed their approach to bonus deferral.

The most common route is to reduce the amount that must be deferred in scenarios where the shareholding guideline has already been met.

In addition, one company changed the approach to deferred bonus awards, allowing those who resign to retain unvested awards rather than a default where awards are forfeited, and another removed its previous requirement, which was unusual in the market, of requiring an element of base salary to be delivered in deferred shares.

Increases to incentive quantum

One third of this sample (four companies) increased maximum incentive opportunities under the Policy.

Also see the analysis on page 10 which also includes those increasing incentive opportunities within existing Policy headroom.

INCREASES TO INCENTIVE OPPORTUNITIES

While companies continue to show restraint on base salary, around a fifth of the sample (11 companies) disclosed an increase to their incentive opportunities for 2024.

In most cases, this was an increase to their long-term incentive (LTI) award, although four companies increased bonus opportunities (two of which did so alongside increases to PSP awards).

Percentage of companies increasing incentive opportunities for 2024

22%

INCREASES TO INCENTIVE OPPORTUNITIES

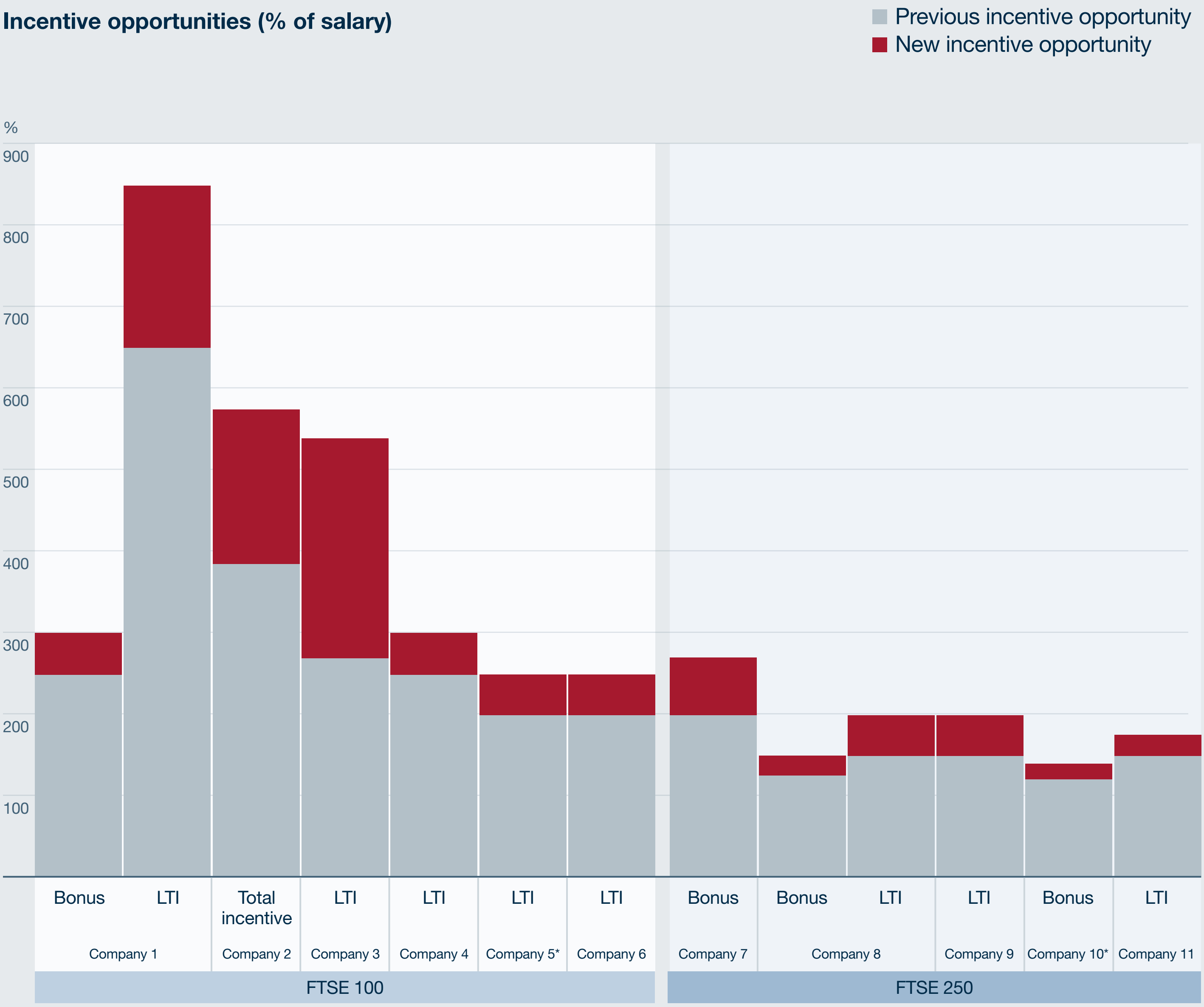
The chart below summarises the change for each of these companies. Most increases were in the range of 25% to 50% of base salary.

The majority of these companies made the increase within existing headroom in their existing Remuneration Policy (although four companies did require a new Policy – see page 9.)

In most cases, the disclosed rationale in support of the increase was strong performance of the business, strengthening alignment with strategy, and, in some cases, market positioning. Of those citing market positioning, some explicitly referenced the challenges faced when seeking to recruit or retain talent in the context of higher pay levels in the US market.

As at the date of this report, most of these companies had received no opposition from major voting agencies and, where the AGM has taken place, achieved strong shareholder support. However, of the three companies making the most significant increases, only one has received a published recommendation at the date of this report, and that recommended against. It will therefore be important to monitor how the shareholder receptiveness for these more material increases evolves over the remainder of the season.

Incentive opportunities (% of salary)



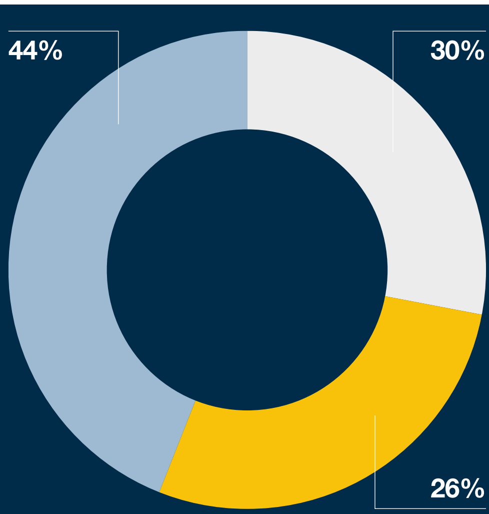
* Changes shown for CFO (no changes to CEO)
Within LTI, RSU awards are shown at a PSP-equivalent face value assuming a standard 50% haircut. One other company increased annual bonus opportunity by 25%. However, as this was part of their previously approved policy, it is not shown here.

INCENTIVES AND SINGLE-FIGURE OUTCOMES

Annual bonus pay-outs

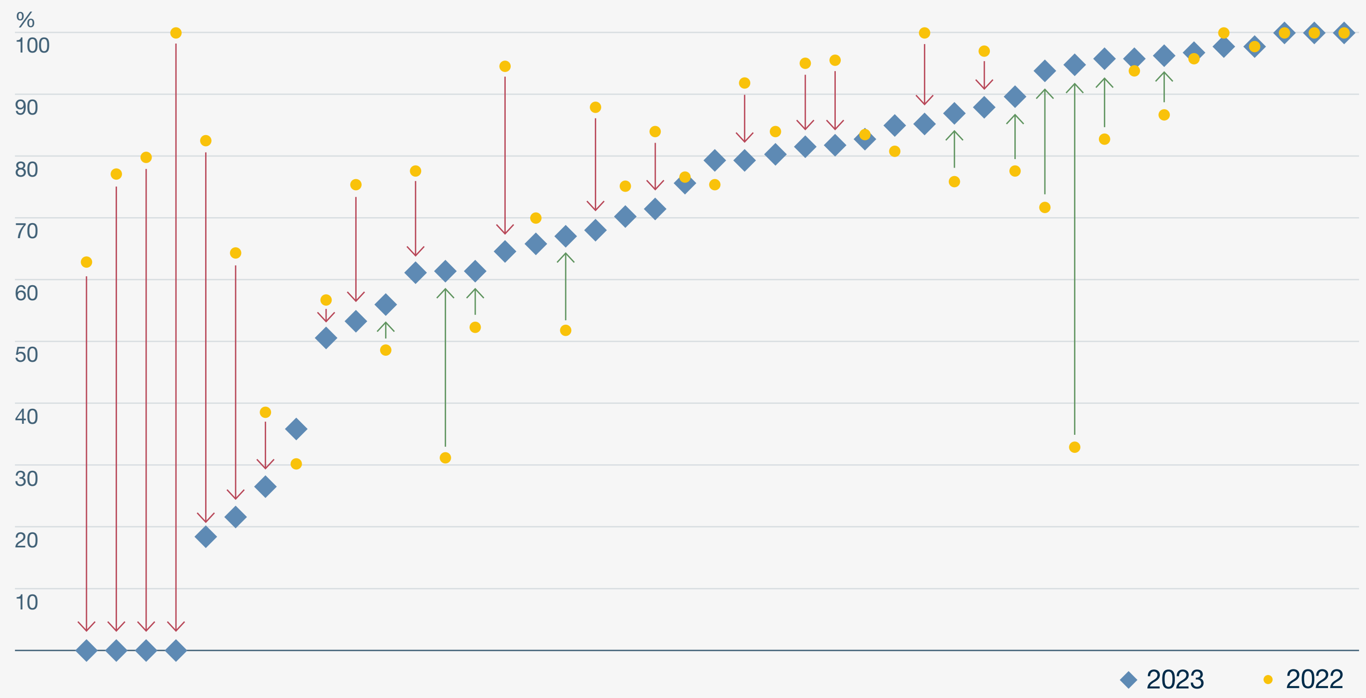
In our sample, bonus outcomes for the year were generally down year-on-year. Just less than half received a lower outcome in 2023 vs. 2022, and the median pay-out across the group was down. Changes for each company in the sample are shown in the lower chart.

Change in CEO bonus outcome vs prior year



CEO bonus outcome (% of maximum)

	2023	2022
UQ	91%	95%
M	75%	81%
LQ	53%	71%

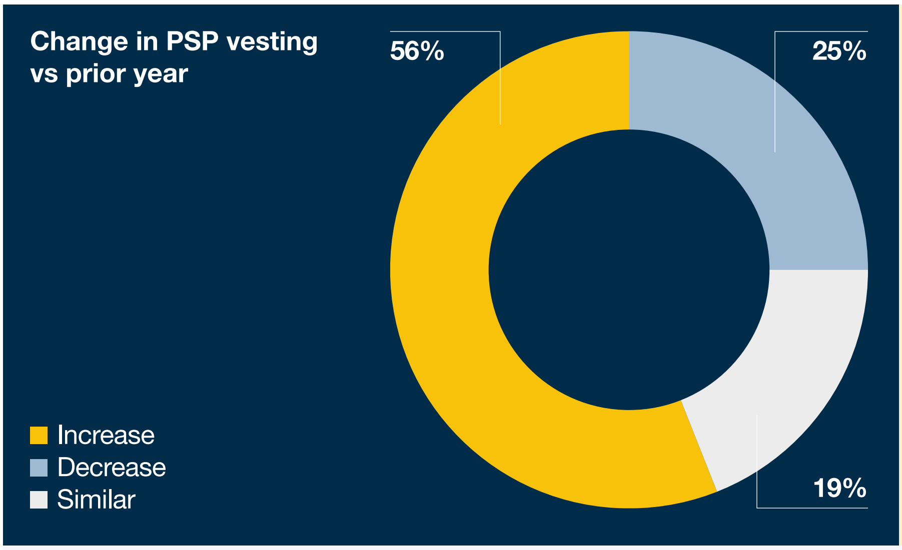


INCENTIVES AND SINGLE-FIGURE OUTCOMES

PSP vesting

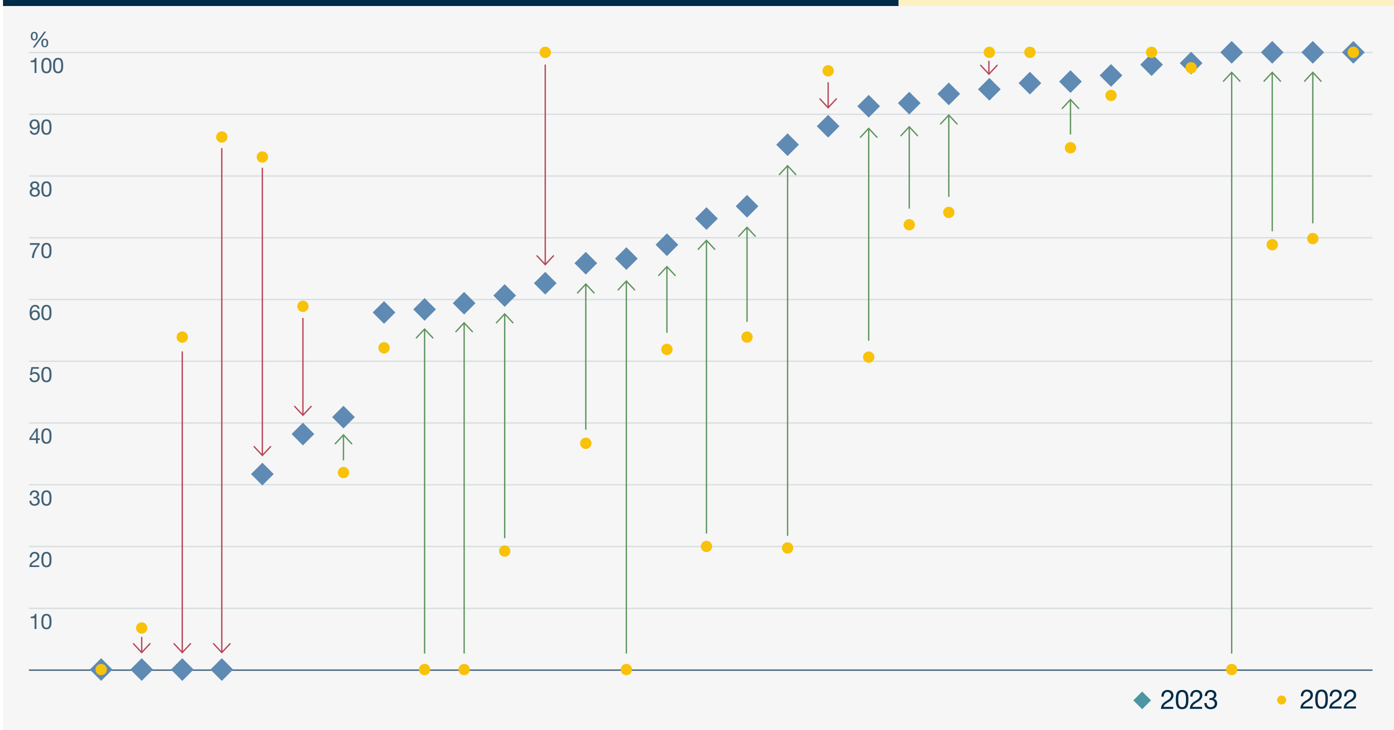
The story was different for PSP outcomes, with over half of the sample receiving a higher vesting than last year, and only around a quarter receiving less. As this captures the outcome for awards granted in 2021, higher vesting across the market may reflect strong levels of performance since 2020, which was a relatively low 'base year' due to the impact of COVID-19.

Changes for each company are shown in the lower chart.



PSP vesting (% of maximum)

	2023	2022
UQ	95%	88%
M	75%	56%
LQ	58%	20%



Discretion on incentive outcomes

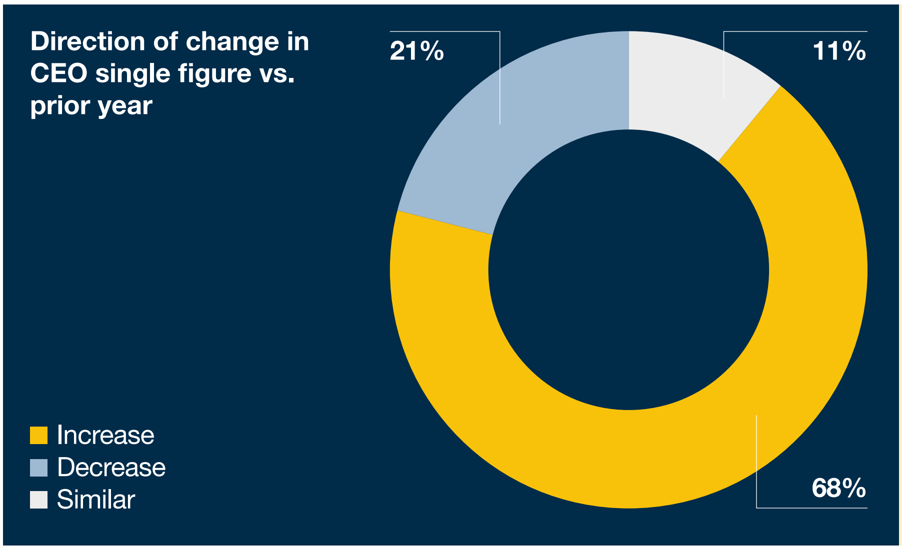
The use of discretion to adjust the "formulaic" performance outcomes downwards has generally become more prevalent in recent years. However, in our sample this year, it was only used by one in every ten companies for the annual bonus, and not at all for PSP vesting.

% using discretion to adjust overall bonus outcome	% using discretion to adjust PSP vesting
10%	0%

INCENTIVES AND SINGLE-FIGURE OUTCOMES

Single figure

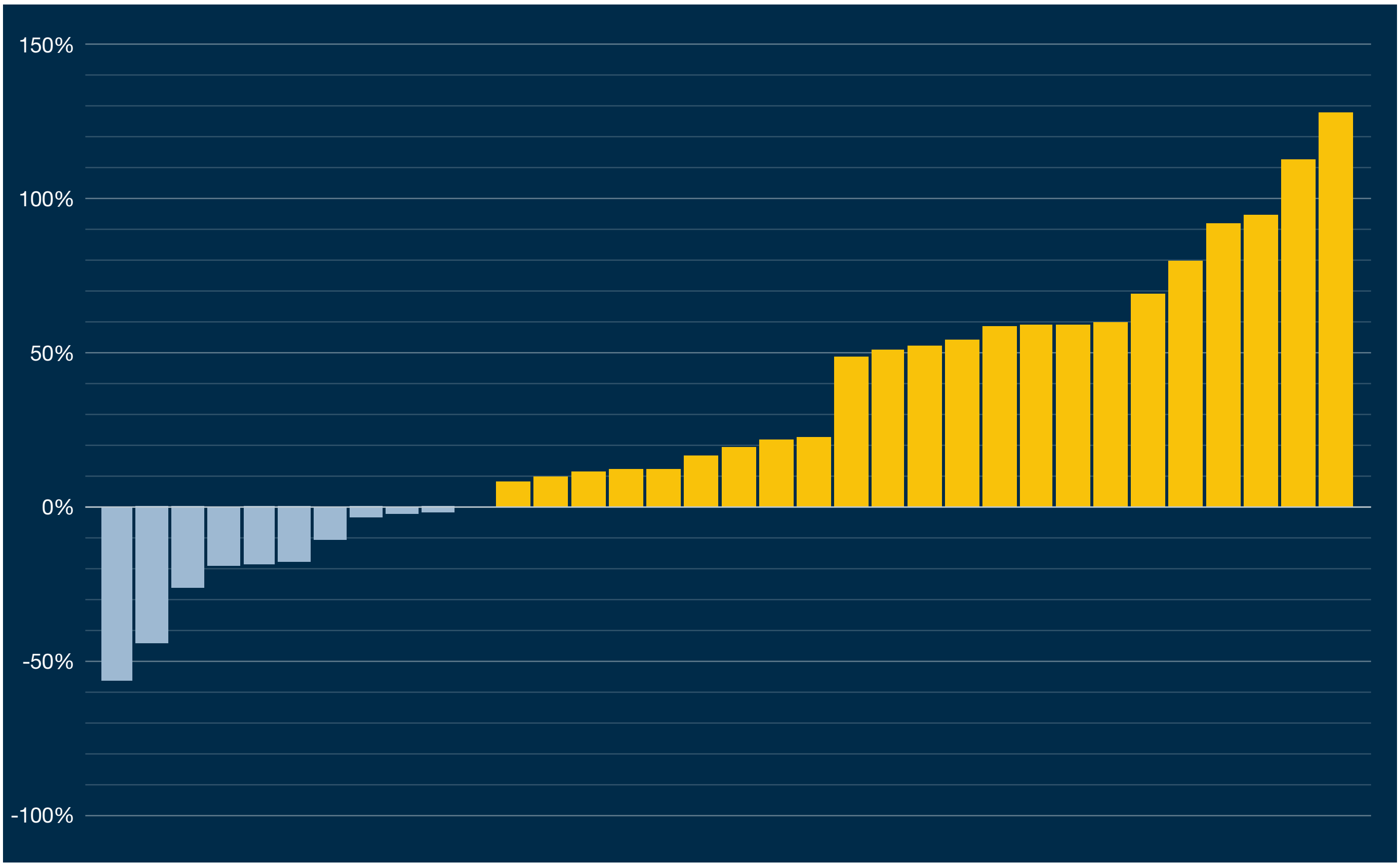
Overall, total compensation (as per the disclosed single figure) increased year-on-year in around two thirds of the sample, largely reflecting the higher PSP vesting described above.



% change in CEO single figure

	CEO single figure change
UQ	58%
M	18%
LQ	-2%

The percentage change for the CEO in each company is shown below:

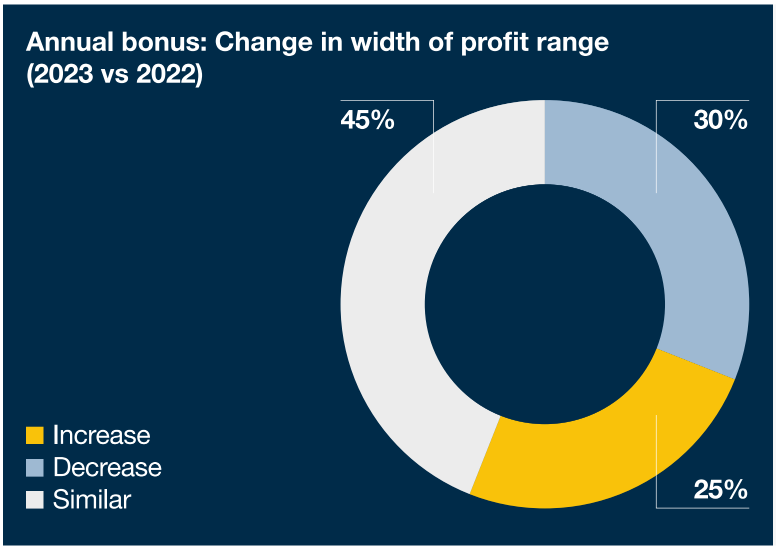


For year-on-year changes, companies with a change in incumbent are excluded, as are companies where a year-on-year comparison is not possible, for example where the first LTIP award vested this year and there were no LTIP awards eligible to vest in prior years. Where a year-on-year change is described as 'similar', this is typically within a margin of +/-5%, on a relative basis to the prior year.

ANNUAL BONUS AND LONG-TERM INCENTIVE PROFIT RANGES – LATEST TRENDS

Setting performance targets for both short and long-term incentives remains one of the most important, and most challenging, activities in the remuneration committee's annual cycle.

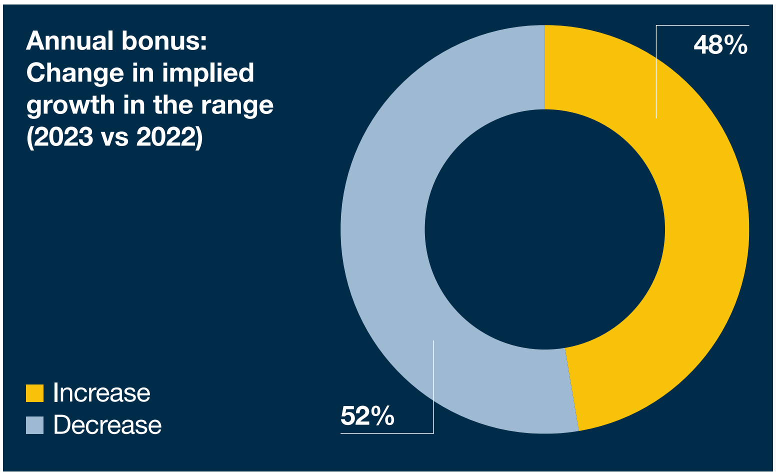
Based on the disclosure in our sample, we can make the following observations on the latest market practice (also see our recent study on target setting for profit metrics across the FTSE market):



Width of annual bonus ranges

The width of the bonus range refers to the extent to which the maximum and threshold points in the performance range deviate from the target point.

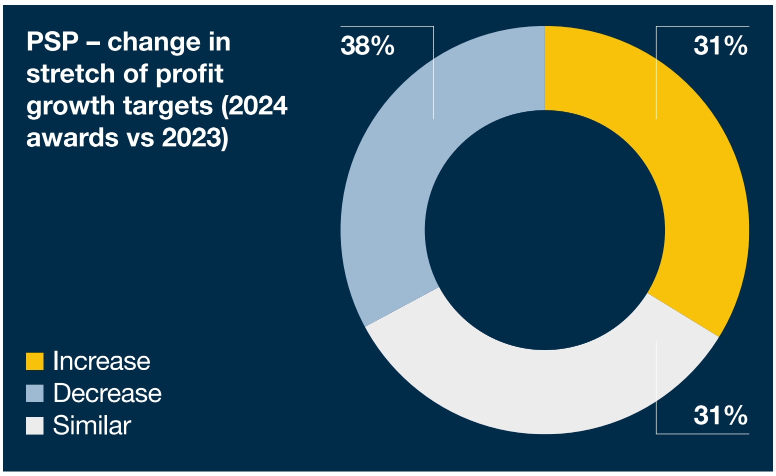
The most common approach in our sample was for the 2023 ranges to remain unchanged from 2022. Where changes were made, there was a broadly equal split between those narrowing and those widening the range. This contrasts with last year, when there was a clear trend towards narrowing ranges.



Implied growth in annual bonus profit ranges

Most annual bonus profit targets are disclosed as monetary values, but they can be converted into an implied growth rate from the prior year's actual.

For 52% of our sample, that level of implied growth (from the prior outcome) in the 2023 profit target range was lower than the level of implied growth in their 2022 bonus target range.



PSP targets

The level of growth in the profit ranges disclosed for 2024 PSP awards can be compared to that of awards made during 2023.

This shows a broadly even split between those making no changes, those increasing the stretch, and those reducing the stretch.

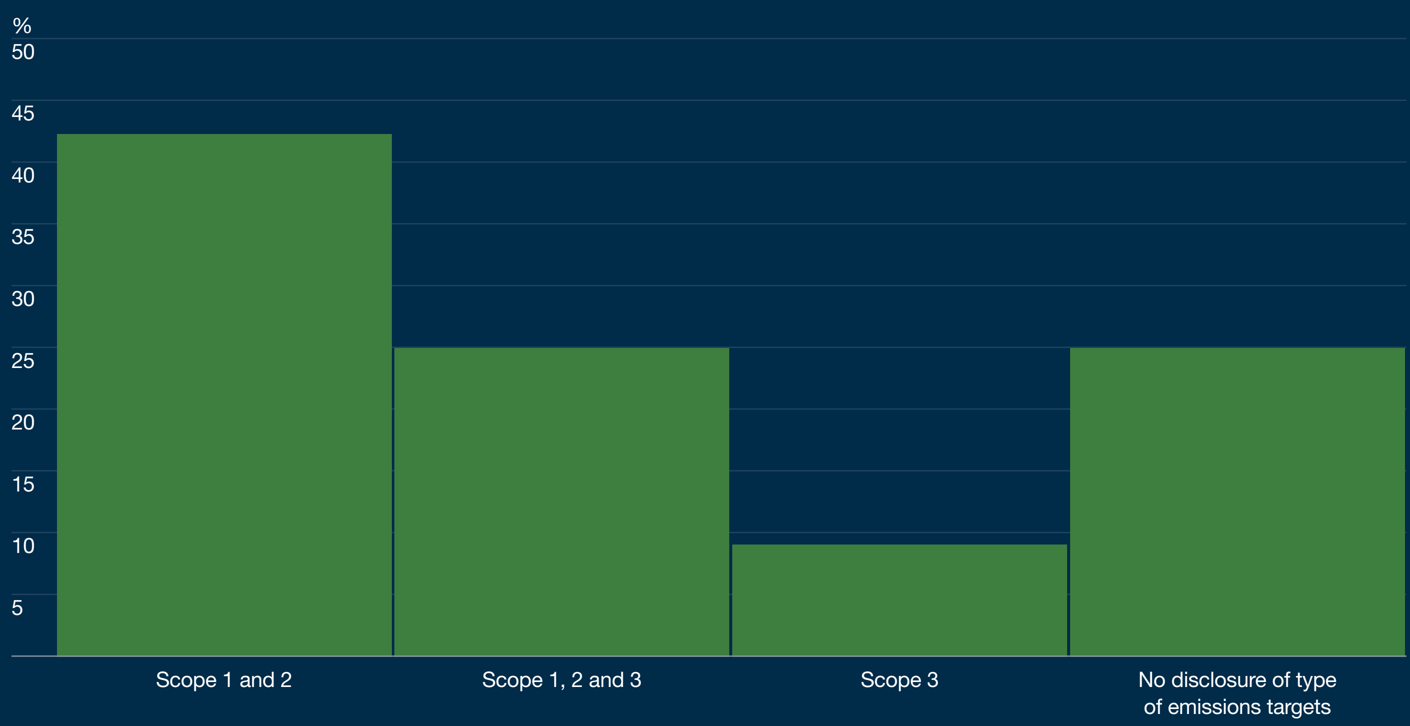
ESG

The use of ESG measures in annual bonuses has increased rapidly over the last few years and around four of every five companies in our sample now use an ESG measure within the annual bonus.

The introduction of ESG measures in PSPs has been slower, but is continuing steadily upwards. 60% of the sample will be using a long-term ESG measure in their upcoming LTIP grant, which is up from around 40% last year, and from around 20% three years ago.

With ESG measures now being very common, some investors have started to focus on ESG targets, in particular emissions targets and whether companies are disclosing the use of Scope 1, 2, or 3 emissions targets in their long-term incentives. Whilst most companies do not have an emissions target in their LTIP, 70% of those with an emissions target disclose the type of measure they are using (i.e. Scope 1, 2 or 3).

Type of emissions target in LTIP

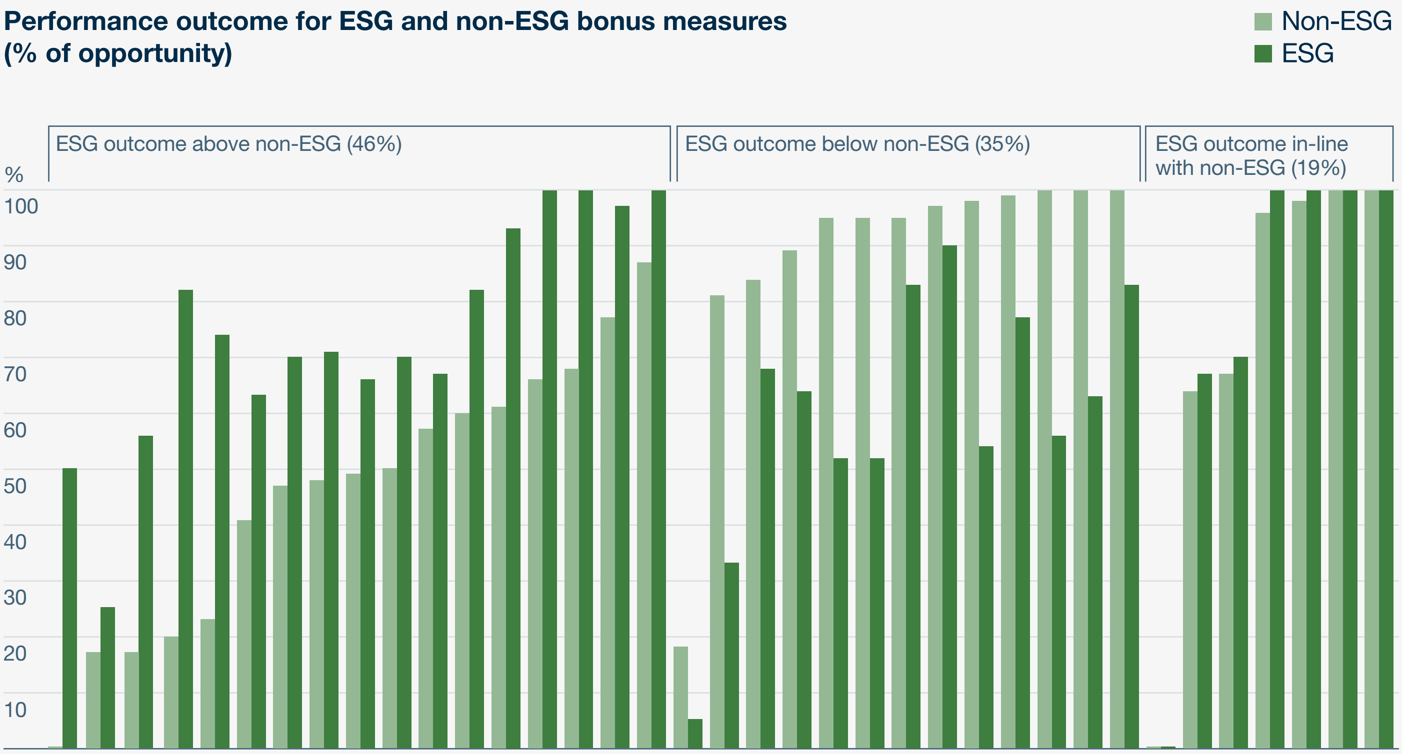


ESG metrics – analysing payouts

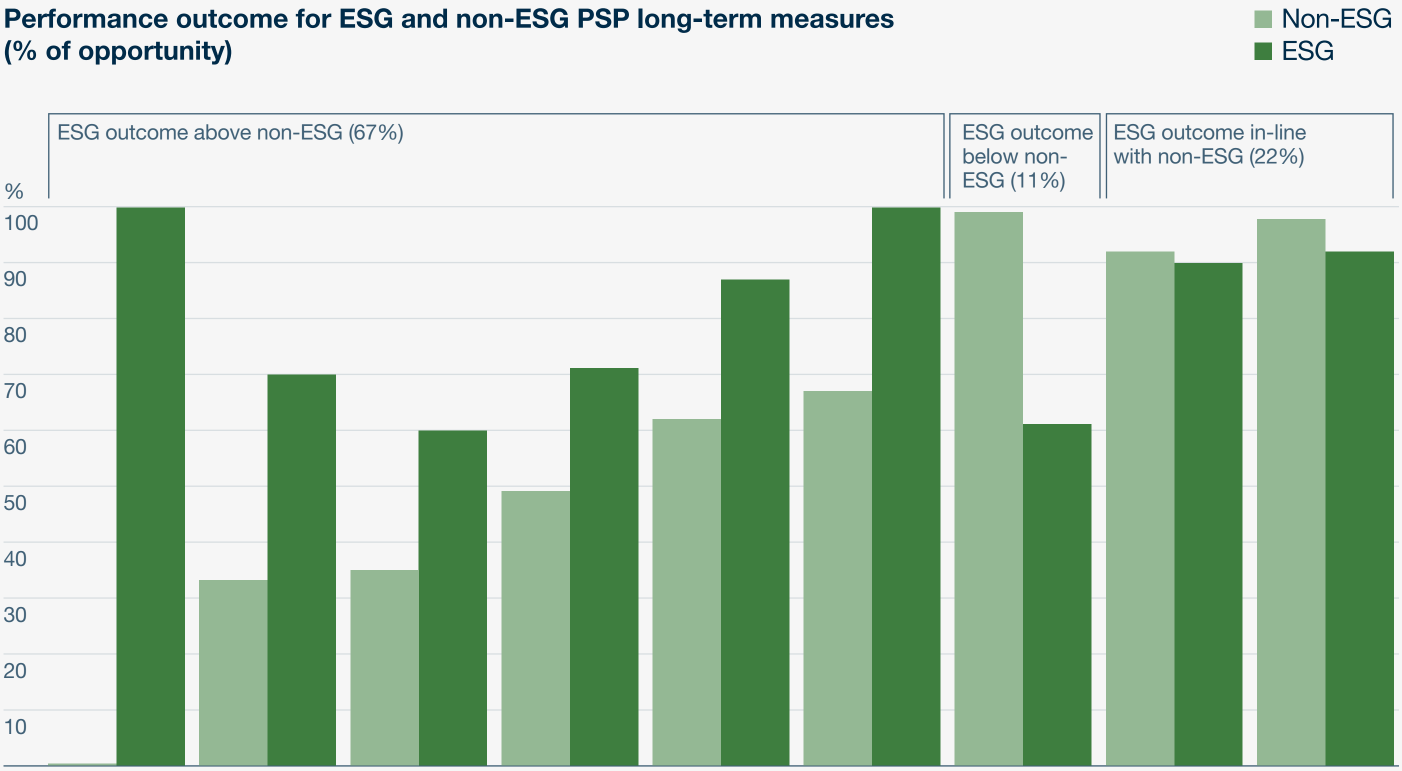
As ESG metrics are different from the more traditional financial and operational metrics, it can be challenging to set incentive targets that strike the right balance between achievability and stretch.

With wider market adoption, it becomes increasingly feasible to conduct a more robust analysis of ESG metric outcomes. One approach is to consider how the outcome of the ESG element compares to that of the non-ESG elements in the incentive payout. This analysis is shown for our sample in the charts below, which demonstrates that it is more likely for the ESG payout to exceed the non-ESG payout, particularly in the PSP.

Performance outcome for ESG and non-ESG bonus measures (% of opportunity)



Performance outcome for ESG and non-ESG PSP long-term measures (% of opportunity)



In the above charts, each set of bars represents the outcome of the ESG and the non-ESG component of the incentive at one company.

WINDFALL GAINS

During the 2023 AGM season, the subject of so-called 'windfall gains' was a prominent area of focus.

Companies that had granted PSP awards in 2020 using share prices that had been significantly reduced due to the impact of the Covid-19 pandemic faced pressure to reduce vesting if subsequent share price performance had resulted in a windfall gain. Our analysis showed that in most cases where this was a relevant consideration, companies either made an adjustment at vesting (commonly 10%) or received opposition from major voting agencies.

Since 2020, investor guidance has evolved to generally prefer that companies make an adjustment in award size at the point of grant following a material share price fall, rather than wait to consider whether an adjustment is needed at the time of vesting.

Based on analysis of our sample, windfall gains appears to have been a much less prominent issue this season.

Adjustment at grant

No companies disclosed an adjustment to PSP awards granted during 2023 to reflect windfall gains risk.

This includes nine companies in the sample where the share price ahead of the 2023 grant was more than 20% below the share price a year before.

However, two companies in the group have disclosed that they intend to reduce the size of the 2024 PSP award, citing the share price trajectory as a factor.

Companies reducing 2023 PSP award at grant to reflect windfall gains risk

0%

CHAIR AND NON-EXECUTIVE DIRECTOR (NED) FEES

This section looks at practice for Chair and NED fee increases as disclosed for the year ahead.

As we noted in our 2023 Non-Executive Director Fees report, the market has been gradually shifting towards more frequent reviews of non-executive fees.
It is more common now to review them on an annual basis (compared to a decade ago, where it was customary to review NED fees on a biennial or triennial basis).
The data from our sample shows that around four in five companies increased Chair or NED fees for 2024.

Percentage of companies increasing Chair or NED fees for 2024

78%

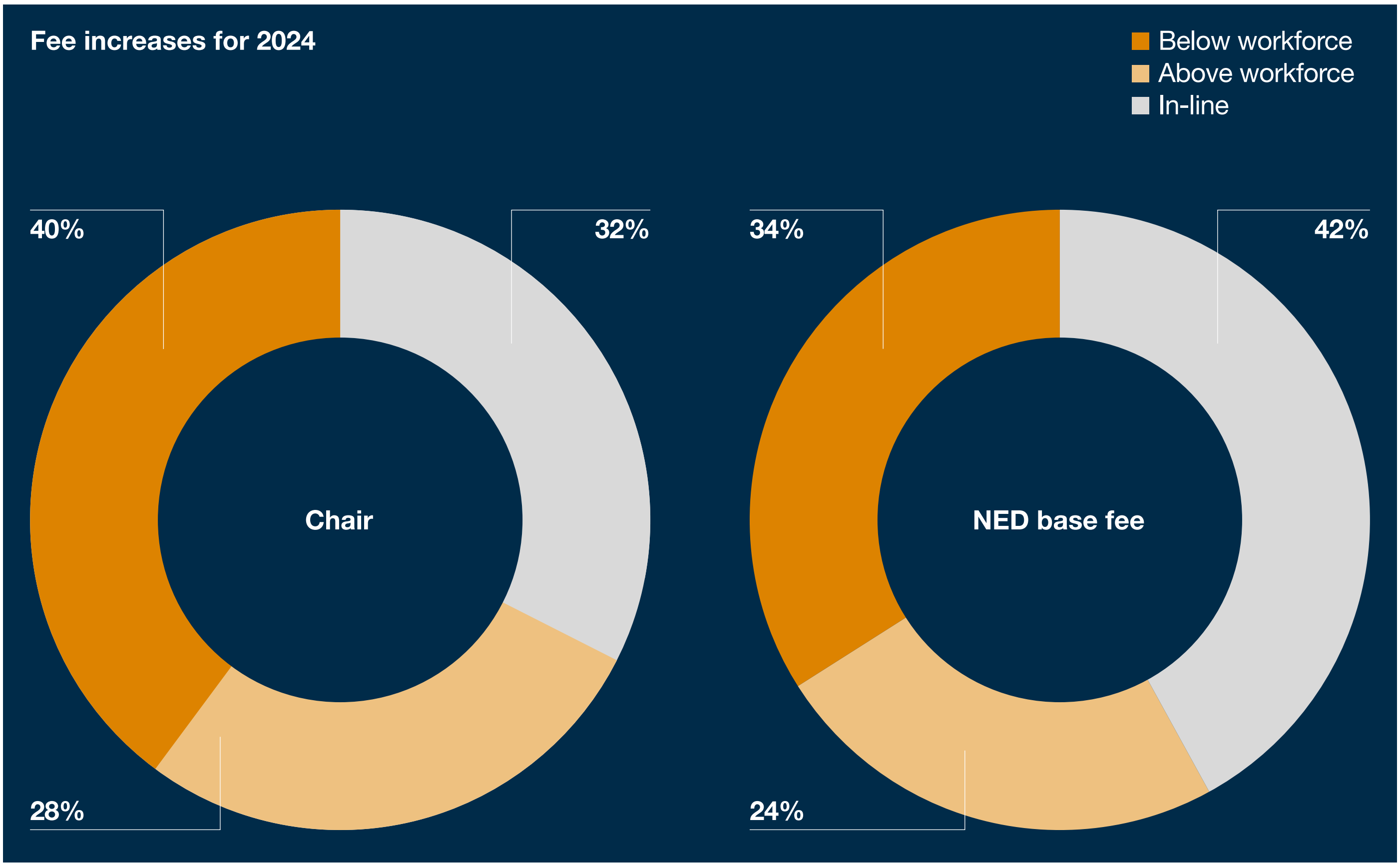
Alignment to workforce

Disclosed increases to fees for the year ahead are most commonly in line with or below the average employee salary increase.

Fee increases for 2024 (%)

	Board Chair	NED base fee
Upper quartile	6.6%	5.5%
Median	4.0%	4.3%
Lower quartile	3.9%	4.0%

Note – the table only includes those companies where an increase was made.



Note – the chart only includes those companies where an increase was made.

FINANCIAL SERVICES

BANKS: REMOVAL OF THE VARIABLE PAY CAP

Our sample contains seven banks—all of which potentially will be impacted by the removal of the variable pay cap for Material Risk Taker roles. The removal of the cap will be a key issue for banks over the coming years both for executive director and below-board remuneration. If a bank removes the cap, can it offset the increase in variable pay by reducing fixed remuneration costs?

By way of background, the variable pay cap was introduced following the financial crisis as part of a range of EU measures to better control risk-taking in financial markets. The cap was set at a ratio of 1:1 between variable and fixed pay, but could be increased to 2:1 with shareholder approval.

When introduced, many banks operated variable pay opportunities for Material Risk Takers far in excess of 1:1, and most gained shareholder approval to use the maximum cap of 2:1. At the same time, large increases were made to fixed pay, either through increases to base salary or through role-based allowances, which were sometimes paid in shares.

In October 2023, the FCA/PRA announced that the variable pay cap would cease to apply in the UK with effect for remuneration in respect of performance years that were ongoing on 31 October 2023, and banks have already started to react to this. In our sample of seven banks, all but one, which had a September year-end, addressed this regulatory change in their Directors' Remuneration Reports.

One immediate action taken by two banks, which operate a 2:1 cap, was to submit a shareholder resolution at the 2024 AGM to ensure their pay practices remain aligned with this new development. One of these banks plans to remove the obligation to abide by a cap, whilst the other is yet to disclose their approach in detail. If approved, variable pay caps may be relaxed for employees, but not for executive directors who are also bound by the Directors' Remuneration Policy.

One other immediate action was taken by another bank operating a 1:1 ratio. This bank has increased the variable pay cap for employees to 2:1 without asking for shareholder approval, but this will not apply to executive directors who will have to await the result of the Remuneration Policy review, and will be used on a "gradual and targeted basis".

Based on the disclosures, most banks will await the next Policy review to make any changes to executive director pay. For most of the banks in our sample, that review will occur in 2024 and be submitted for shareholder approval in 2025, although one bank with a later scheduled review have disclosed that they are considering bringing it forward to 2024.

For those wishing to disapply the cap, a key consideration will be how to reduce fixed pay when increasing variable, to ensure that costs are controlled, and total remuneration is more performance-linked. This is likely to be challenging as existing employees may be reluctant to accept reductions in guaranteed fixed remuneration in exchange for a higher discretionary variable pay element.

ABOUT A&M

YOUR STRATEGIC PARTNER FOR EXECUTIVE COMPENSATION

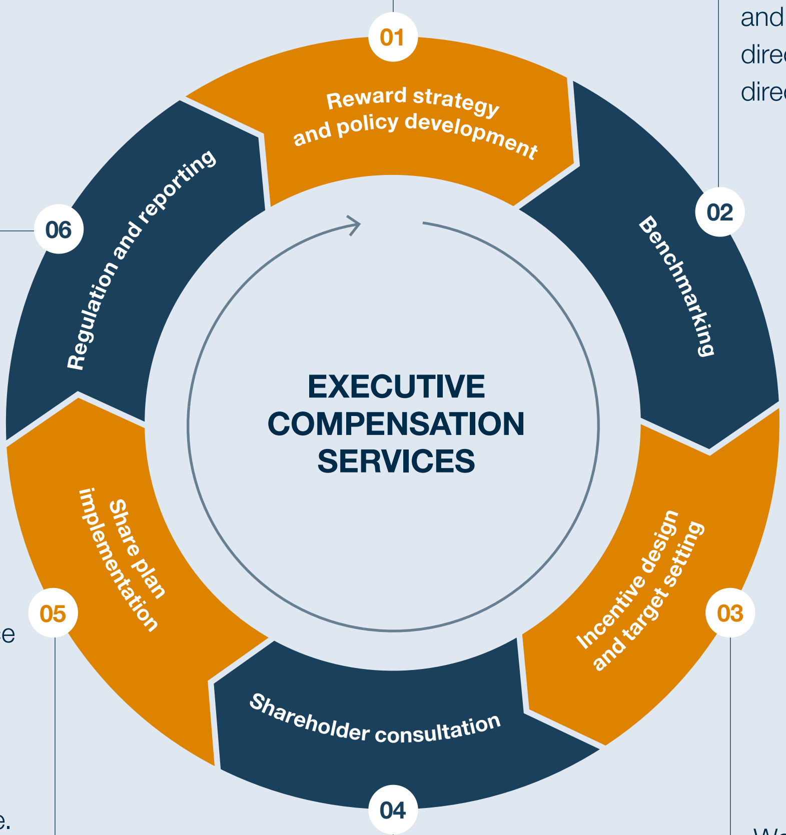
Our growing U.K. Executive Compensation Services advisory practice comprises three Managing Directors with over 80 years' combined experience in advising companies on all aspects of executive remuneration supported by a team of both experienced professionals and graduates.

We can provide a full suite of services, advice and support to remuneration committees and HR or reward teams as shown below.

We can provide full support through all stages of the preparation and review of the DRR, ensuring both technical compliance and effective commercial communication.

Our objective is to support the design of a reward strategy and policy framework that is tailored to the business rather than an 'off-the-shelf' solution.

We can provide market data and insights for non-executive directors and executive directors in the U.K.



Our integrated practice provides access to share plan and tax experts to provide full support through the implementation phase.

We can support businesses in all aspects of incentive plan design and implementation, including determining performance measures, calibrating targets, and assessing outcomes.

We have a wealth of experience in supporting companies in this increasingly challenging area – from developing a tailored strategy and preparing materials to interpreting feedback.

ABOUT A&M

YOUR STRATEGIC PARTNER FOR EXECUTIVE COMPENSATION

One of our market differentiators is that we are a 'senior practitioner-led' practice, meaning that our Managing Directors take a more 'hands-on' and visible role in client relationships than is often the case in other consulting practices. As a strategic partner to the business, our approach is as follows:

BESPOKE ADVICE, TAILORED TO THE BUSINESS

Our objective is to help clients design and implement remuneration that is tailored for their business, rather than market standard that 'ticks the boxes.'

COLLABORATIVE…

As a strategic partner, we aim to work closely in partnership with management teams to understand key objectives, priorities and constraints, which inform our ability to provide tailored and balanced advice.

…BUT INDEPENDENT AND TRANSPARENT

At the same time, we always recognise our ultimate accountability to provide an independent and objective view to the remuneration committee. At all times, we act with integrity and transparency in our interactions with stakeholders.

FACILITATE STRATEGIC DECISION-MAKING

We help the committee assess options strategically in the context of the board's 'risk appetite,' and are recognised for a pragmatic and commercial approach that balances key stakeholder perspectives.

OPTIMISE OUTCOMES

Once decisions are made, we provide effective support to optimise stakeholder outcomes. We add value through all stages of the shareholder engagement process – developing strategy, creating effective materials, and interpreting feedback.

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