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UK Executive Pay & Governance

The 2017 AGM Season So Far...

May 2017

Introduction

In this note we set out our observations on the 2017 AGM season so far, looking at what's been proposed, the investor response and the approach taken by the major proxy advisers. Executive pay continues to generate headlines, but while the media often continues to focus only on changes to the total single figure for the CEO, we have adopted a broader perspective when looking at the key emerging issues.

Despite the recent debates about new pay models, an overwhelming proportion of companies are sticking with current incentive structures.

As the season continues, attention will also focus on the upcoming general election and any manifesto proposals from the major parties. While it may not ultimately be relevant, Labour's leaked manifesto suggests a 20:1 top to bottom cap on pay for companies with government contracts. No formal update on the BEIS green paper proposals (for which the consultation period closed in February) will emerge before the election.

Extent to which new remuneration policies have changed

- **Limited evidence of shift to new pay model**
  - Most companies have been updating their remuneration policies with relatively minor changes; few have opted for a new model.
  - 'Pure' restricted share proposals (in place of LTIPs) have so far generally been withdrawn following insufficient support from investors, either in consultation or post publication. One proposal to introduce them as a new part of the overall package – at Aggreko – was withdrawn ahead of the AGM in the light of investor opposition. Another proposal – at Premier Oil – comes to a vote on 17 May (although in that case the restricted shares sit alongside a PSP and have a performance underpin). Kenmare Resources is pitching restricted shares with no underpin at its AGM on 25 May.
  - Other unorthodox incentive schemes have also attracted opposition. Following the withdrawal of non-standard plans at Chemring (bonus only with deferral) and Safestore (one-off special EPS/ TSR plan) earlier in the year, a value creation plan at Pendragon was passed, but with a 47% vote against.
  - There is some evidence of banks adapting policies to their specific regulatory framework, but this has encountered pushback from ISS. The proxy adviser's opposition to a shift to lower-value but more certain LTIP awards at RBS had little impact on the vote result, however, with one large investor, Norges, publicly supporting the proposal.

- **Quantum reductions at some high-profile companies divert attention away from increases at others**
  - Press attention has focused on large companies such as BP and WPP implementing reductions in future pay through lower incentive opportunities.
  - Others, however, have sought approval for increased limits under the annual bonus scheme, LTIP or both. Although Imperial Brands was forced to withdraw its LTIP increase earlier in the year, companies such as Rolls-Royce and Bunzl have been more successful in gaining investor support for increases.
  - The increased focus of institutions such as BlackRock on executive pensions appears to be having an impact, with few companies proposing increases to contribution levels. This area is expected to get greater attention as time goes on.

- **"Good practice" features being introduced/enhanced**
  - Unsurprisingly, companies are using the policy renewal period to ensure they are up-to-date with investor expectations in terms of features such as post-vesting holding periods, clawback and deferral. As a side note, BT's recent announcement that it has applied malus on deferred share awards was an example of these provisions being applied in practice.
  - Shareholding requirements are also being reviewed and in some cases increased (but not in all cases to the ISS-preferred threshold of 200% of salary).

Our view

Many companies have chosen to play it safe. The lack of traction for the restricted shares model in part reflects the mixed views of institutional investors. Although one large investor – Norges – came out in April in favour of awards of shares held for the long-term, but without performance conditions, most other investors (with the exception of Aberdeen Asset Management and Hermes) are at best lukewarm. Until there is a mood-shift, caution will prevail. The notable number of resolutions withdrawn immediately prior to the AGM in the light of investor opposition may further discourage companies from doing things differently. Remuneration committees which are considering something more radical in 2018 are advised to consult early, with a clear rationale as to why the non-standard structure supports company strategy, to maximise the potential for a successful AGM outcome. This process will need to continue right up to the AGM to ensure there are no nasty surprises.

How have companies applied policies?

- **Investors remain focused on the operation of incentive schemes**
  - Shareholders and proxy advisors continue to police bonus and incentive schemes vigilantly. The first remuneration report voted down this year, at Crest Nicholson (58% vote against), attracted opposition in the light of a reduction in EPS targets used in the long-term plan.
  - The second defeat, at Pearson (66% vote against), stemmed from investor dissatisfaction with bonus payments made to executive directors in the context of company underperformance and a succession of profit warnings.
  - Inmarsat's remuneration report was passed but only by a narrow margin (49% vote against), with investors concerned with the operation of its two bonus schemes.
  - Elsewhere, other large votes against have been registered at companies (e.g. AstraZeneca) where investors have been concerned about the exercise of discretion to increase payments.
  - As promised by the Investment Association, IVIS has been diligent in flagging companies where annual bonus disclosure has lagged best practice. Disclosure of the full target range for financial metrics is now common, although the extent of information provided on non-financial/personal measures continues to vary.

- **Salary freezes at some companies mask big increases elsewhere**
  - Generally, there is still restraint and in many cases salaries have been kept at prior year levels, as companies attempt to stifle criticism of high fixed pay.
  - Investors will register concerns where poorly justified large salary increases are proposed. There have been several companies with 20%+ votes against where the main source of shareholder discontent was salary rises – even if in some cases the increases were single digit. Successful proposals have been targeted at specific individuals where the case has been well articulated and the increase has typically been below 10%.

- **The quantitative Pay for Performance ("P4P") model still does not have a direct impact on ISS vote recommendations**
  - 2017 is the second year in which ISS's P4P analysis has been used. Although a reference to the P4P model was included in ISS' voting guidelines at the start of this year, the model has not influenced the vote recommendations. There are numerous examples of companies with a "high concern" rating under the model getting a "for" recommendation from ISS. Conversely, other "low concern" companies have been the subject of "against" recommendations given other pay issues identified by ISS.
  - ISS now references company-disclosed peers in the model for the first time, but these will not automatically be included by ISS when running the analysis. For example, peer companies outside Europe continue to be excluded.

Our view

The investor focus on incentive schemes reinforces the need for remuneration committees to be diligent in setting targets for both bonuses and long-term plans, and to recognise that their decisions will be scrutinised carefully. Furthermore, any discretion needs to be accompanied by a convincing explanation, and committees must always bear in mind the wider shareholder experience when making pay decisions.

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Voting on directors' re-election

- **Directors are increasingly coming under the spotlight**
  - There is further evidence that investors are following through on commitments to vote against individual directors where pay issues are identified. The chair of Pearson's remuneration committee received a 27% vote against. The former chair of Man Group's remuneration committee was opposed by 26% of those voting, even though his departure from the board later in the year was announced prior to the AGM.
  - BlackRock will vote against all remuneration committee members where it is opposing the remuneration policy.
  - ISS has also taken a tougher line against directors, and has recommended against the re-election of remuneration committee chairs where it has flagged issues over a number of years. However, ISS does not drive all voting outcomes – for example, it supported the re-election of the committee chair at Pearson.
  - ISS has also escalated its "overboarding" policy, recommending votes against directors who have multiple directorships. One non-executive director it opposed at HSBC, Paul Walsh, stepped down from the board before his reappointment was voted on at the AGM.

Our view

Shareholder voting on remuneration issues has now extended beyond the remuneration report and remuneration policy. Boards should be fully aware of the potential implications where investors are raising concerns on pay. ISS' policy on overboarding should also be reviewed closely for those directors who have a significant number of overall commitments.

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