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Insights

EXECUTIVE PAY – WHAT TO CONSIDER FOR FY 2020/21

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SUMMARY

Executive pay has been a hot topic for a number of years but the uncertainty created by the pandemic has resulted in an increased level of scrutiny of public company pay decisions and revised related proxy voting recommendations. This note highlights some of the key issues/guidance companies will need to consider when reporting on executive pay for financial years 2020/21 together with a reminder of the financial reporting deadlines.

Highlights - recommendations/guidance

Investment Association ('IA') 2021 Principles of Remuneration and Shareholder expectations during COVID

Application: companies with a Main Market listing, premium or standard, but also relevant to companies listed on other public markets, such as AIM.

Bonuses – if a company has taken Government/shareholder support eg. furloughed employees or raised capital through fundraisings, bonuses should not be paid unless there is a clear rational. IA members expect a higher level of disclosure on how Remuneration Committees have determined financial targets, especially when they are lower than the previous year.

Government support – companies that have accepted business rate relief or similar support should disclose how these have impacted remuneration outcomes.

Dividends - if a dividend has been suspended/cancelled, companies should clearly disclose how this has been reflected in 2019 or 2020 remuneration outcomes either through the use of discretion or malus provisions to correspondingly reduce any deferred shares related to the 2019 annual bonus.

Post-employment shareholding policies - shareholders are keen to understand the enforcement mechanisms in place to ensure these policies are enforced once a director leaves.

Pensions - as previously announced, IA members consider pension contributions for the executive directors should be aligned with those available to the majority of the company's workforce.

See our earlier blog for further details of the IA's expectations.

QCA Remuneration Committee Guide

Application: this 2020 guide applies to small and mid-sized quoted companies eg. AIM.

The Companies Act 2006 ('Companies Act') remuneration reporting regulations do not apply to companies admitted to AIM, Aquis Stock Exchange (AQSE) or companies not incorporated in the UK. However, the QCA guide notes that there is a general expectation from shareholders and wider stakeholders that AIM (and AQSE) companies disclose details of directors' remuneration arrangements and in particular that larger AIM companies voluntarily provide the same level of disclosures as their equivalent Main Market listed peers.

The QCA guide contains guidance on the essential areas for companies to consider:

- Remuneration disclosures to be considered by all AIM companies under AIM Rule 19 (details of directors' remuneration including emoluments, compensation, share options etc) and section 412 Companies Act (information about directors' benefits).
- Additional remuneration disclosures to be considered by AIM companies (referred to as 'QCA Recommended') and 'Optional enhanced' disclosures for larger companies and/or those with institutional shareholders as well as companies seeking to adopt high-quality reporting practices. QCA Recommended disclosures include an annual statement by the remuneration committee chair with various disclosures and a future policy table in the remuneration policy, both of which are requirements for Main Market UK incorporated companies.

Glass Lewis UK Proxy paper guidelines 2021 and Glass Lewis 2021 guidance in light of the pandemic

Application: listed companies ie. Main Market issuers. When assessing AIM company remuneration reports Glass Lewis take a broadly similar approach as for Main Market issuers particularly with regard to the alignment between executive and shareholder interests and protections against unmerited pay. They recognise that remuneration structures and levels of disclosure may be less developed in AIM companies.

The Glass Lewis 2021 guidance on 'approach to executive compensation in the context of the COVID-19 pandemic' provides illustrative guidance on the intended application of Glass Lewis' existing policy approach to executive remuneration in the wake of the pandemic. For companies that have been affected by the crisis, Glass Lewis will look at year-on-year variations in total pay and expect overall lower outcomes than in the previous year. Companies are expected to explain how the performance of incentive metrics was affected by the crisis, what effect the proposed adjustment would have on plan outcomes and why any proposed adjustments are necessary, e.g. in terms of retention, exceptional efforts by the executive team, or good relative performance.

In particular, the guidance focusses on a number of issues including:

- Dividends - where a company has cancelled/reduced dividends, executive pay should be "somewhat affected" (and in this context, a company's dividend policy and payout ratio would be taken into account).

- Employees - where a company has undertaken significant furloughing of staff or cut workforce or workforce salaries, this should be addressed in the remuneration report with an explanation of how such measures were taken into account by the board when determining variable pay outcomes and salary adjustments for executives. In this context, Glass Lewis believes there should be consistency between changes in the yearly disbursements for employee pay and executive pay.

- LTIPs - if the share price has been significantly affected and has not at least partially recovered to pre-pandemic levels, Glass Lewis expect the potential inflation of the award's final value upon vesting to be explicitly addressed, considering a scenario in which the share price would have fully recovered or increased according to pre-pandemic estimates at the time of vesting. If the potential for windfall gains appears significant in absolute and relative terms, the grant value should be adjusted accordingly, and/or other elements of executives' pay adjusted to mitigate this effect.

ISS UK & Ireland Proxy Voting Guidelines 2020 and Updates for 2021

Application: effective for meetings on or after 1 February 2021 and applies to companies listed in the UK and Ireland. It will also apply to companies incorporated in the Isle of Man, Jersey and Guernsey, and which are either listed in the UK and Ireland or on The International Stock Exchange.

The 2021 update includes a new recommendation for investors to focus on the extent to which pensions contributions are aligned with those available to the wider workforce together with the requirement for companies to have appropriate post-employment shareholding policies.

Financial reporting deadlines

In 2020, the Government introduced legislative measures granting UK companies an automatic extension of three months for filing their accounts. This applies to companies that have a filing deadline that falls between 27 June 2020 to 5 April 2021. After 5 April 2021 it will be replaced with an application process to Companies House, with companies granted a discretionary three-month extension where they cite coronavirus as a factor impacting the timely completion and/or audit of accounts.

AIM: AIM companies can apply for an extension of up to three months to publish annual accounts (within 9 rather than 6 months of the financial year end date). The request must come from the nominated adviser prior to the current AIM Rules reporting deadline. If an AIM company wishes to utilise the additional one month period for its half yearly report, it must notify its intention to do so, via a RIS, prior to its reporting deadline. The company's nominated adviser must inform AIM Regulation of this separately.

Main Market: The FCA has provided temporary relief for listed companies granting them an additional 2 months to publish annual accounts (within 6 rather than 4 months of the financial year end date) and an additional month to publish half-yearly financial reports (within 4 rather than 3 months of the financial half year end date).

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