SLAUGHTER AND MAY/

NEWSLETTER

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INCENTIVES BULLETIN

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Both the Investment Association (the **"IA"**) and Glass Lewis have this week published their guidance in relation to UK listed companies' executive remuneration for 2022. In this bulletin, we explore what are likely to be the key issues in the next AGM voting season.

COVID-19 GUIDANCE

Last year, at the start of the pandemic, the IA issued guidance stating that, where a company has raised additional capital from shareholders or taken Government support (such as furlough for its employees) during the pandemic, payment of annual bonuses is generally not expected. The IA has confirmed that it will be taking a similar approach in 2022 and we expect that this will be part of the 'new normal' for companies going through straitened times.

ESG TARGETS

Given the recent COP26 summit, there is unsurprisingly an increased focus on ESG-related issues. Both Glass Lewis and the IA support the remuneration of directors being aligned to the agreed ESG strategy of the company, but are keen to see that these metrics are robust and capable of independent scrutiny (so that they cannot be used to artificially inflate executive pay).

ALIGNMENT OF EXECUTIVE DIRECTOR PENSION CONTRIBUTIONS TO THE WIDER WORKFORCE

As previously trailed in last year's guidance, the IA proposes to 'red top' (i.e. recommend a vote against) companies that have not aligned the rate of employer pension contributions payable for their executive directors with those for the wider workforce by 31 December 2022. As a matter of practice, most companies have now aligned their contributions but, for those who have not done so, this is likely to be a voting issue in 2022.

BASE PAY

The IA and Glass Lewis continue to be concerned about companies increasing levels of base pay to achieve a perceived median benchmark against peers or to be in line with 'market levels'. Justifications for base pay increases should be fully reasoned and disclosed to shareholders. The IA is also mindful of the 'knock on' effects of increasing base salary when variable pay opportunities are expressed as a percentage of base salary. Increasing base salary in these circumstances effectively also increases the executive's bonus opportunity and size of their LTIP awards.

USE OF COMMITTEE DISCRETION

The exercise of discretion in connection with directors' variable pay (such as to disapply the time pro-rating of awards or to override the formulaic outcome of performance targets) remains a key area of concern for shareholders. In its new guidance, the IA states that, where discretion has been used, the remuneration committee should explain how it has considered the “experience of material stakeholders” when applying that discretion. Companies should therefore consider carefully how to communicate any exercise of discretion with shareholders as part of their Directors’ Remuneration Report.

VALUE CREATION PLANS

The IA have seen companies increasingly move towards the adoption of Value Creation Plans. Broadly speaking, these plans seek to deliver to management a proportion of any share price growth, normally above a pre-determined hurdle. Shareholders’ concerns focus on the fact that these arrangements may be uncapped and may reward management simply for a rising stock market. We are aware of a number of companies that have either adopted or are considering adopting Value Creation Plans and shareholder reaction should be borne in mind when designing the arrangements to be proposed to shareholders. Particular consideration should be given to the suitability of a Value Creation Plan for the specific circumstances of the company in question, any appropriate overall cap on the value of awards, the heightened risk of dilution posed by this type of plan and the need for particularly robust and stretching performance conditions.

REMUNERATION COMMITTEE ACCOUNTABILITY

Glass Lewis has updated its guidance to reflect a move towards holding remuneration committees personally to account for concerns regarding remuneration policies presented for shareholder approval and/or a company’s pay practices. Where they have material concerns, Glass Lewis may recommend that shareholders vote against re-election of the remuneration committee chair or, if the chair is not up for re-election, a long-serving committee member. In particularly egregious circumstances, Glass Lewis may recommend that shareholders vote against the whole remuneration committee.

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