PAY IN UK LISTED COMPANIES: INVESTMENT ASSOCIATION EXPECTATIONS ON EXECUTIVE PAY DURING THE COVID-19 CRISIS

In response to requests from listed companies, the IA published a statement on 27 April on how RemCos should reflect the impact of COVID-19 on executive pay. The statement can be accessed here.

The IA recognises the challenge that RemCos face at this time; juggling the need to incentivise management teams showing real leadership whilst ensuring their pay is aligned with the expectation of employees, investors and other stakeholders. The statement is a welcome steer and we have summarised the key points and our views on practical considerations for RemCos below.

CC Comment: Emphasis is placed on the use of RemCo discretion and transparency through shareholder engagement and disclosure. The IA also advocates in many cases taking a medium to long-term approach in terms of executive pay decisions. Given that the impact of COVID-19 is unclear, taking any drastic action now should be discouraged and most RemCos we are speaking to are taking a 'wait and see' approach. Ensuring you have enough flexibility in bonus and LTIPs is therefore key, as companies will need to be clear on what discretions and other powers they have in place for future decision making.

KEY POINTS FOR COMPANIES

Suspension of dividend and adjustments to bonus outcomes

The IA has already said that where dividend payments are suspended or cancelled, a RemCo should consider how this is reflected in its approach to executive pay. The statement firms up their position, setting out that where bonus for 2019 has already been paid out, companies are expected to consider the use of malus or other discretions to reduce share awards related to the 2019 annual bonus, or otherwise to reflect this in 2020 bonus outcomes.

CC Comment: Companies will want to consider carefully how this is addressed, paying close attention to the malus powers in their plans and policies and the employee relations issues that almost inevitably arise if an individual is told that 'malus' has been used. Adjusting 2020 bonus outcomes may make more practical sense, as COVID-19 is a 2020 FY issue and a forward-looking change will typically be easier to operationalise. Where companies need to unwind dividend share awards, consideration should be given to adjusting outstanding awards or making adjustments to future grants.

Adjustment of performance conditions

The IA does not expect RemCos to adjust performance conditions for annual bonuses or outstanding LTIP awards to account for the impact of COVID-19. However, where a RemCo considers that the performance of the company and shareholder experience are not commensurate with pay outcomes, then it should use its discretion to ensure a strong link between pay and performance. RemCos should engage with their shareholders and disclose the reasons for the use of discretion.

CC Comment: The statement is advocating a 'wait and see' approach, again placing an increased emphasis on RemCo discretions to be able to adjust awards further down the road. RemCos will want to ensure they are comfortable with the scope of their powers now, so that they are not caught out at the time of vesting. The statement stops short of addressing other key areas of concern for businesses, however. For example, many companies are grappling with the question of whether to amend or revisit existing LTIP performance conditions where it has become clear that they are no longer effective in incentivising participants or otherwise considering making 2020 variable pay contingent on COVID-19 specific targets. No guidance on these issues is provided in the statement.

Windfall gains - LTIP awards already granted in 2020

Many December year-end companies will already have made LTIP grants in 2020 and the IA accepts that no adjustment needs be made to grant size to reflect any drop-in share price solely related to COVID-19. However, the IA expects RemCos to look at the general market and share price response over the performance period to ensure that there will be no windfall gains on the vesting of these awards.

RemCos should set out in their next Directors' Remuneration Report the approach they will take and factors they will consider when judging if there has been a windfall gain from any LTIP grant made in 2020.

LTIP grants in the coming months - grant sizes and performance conditions

Concerns have been raised by businesses over the appropriate size of LTIP grants and the ability to set meaningful performance targets at this time. RemCos are working through various options, including: granting on the normal timeline, setting both performance conditions and grant size now; granting now but committing to setting performance conditions at a later time; or delaying the grant to allow the RemCo to more fully assess the impact of the crisis at a later time.

Whichever approach a RemCo takes, this should be explained to its shareholders. Again, the IA emphasises that a RemCo should be clear about the discretionary powers available to it on vesting and commit to using those powers to ensure that outcomes reflect company and executive performance as well as the experience of other stakeholders. Shareholders will again expect the RemCo to use its discretion to reduce vesting outcomes where windfall gains have been received.

On grant size, granting awards at maximum opportunity in cases where share prices have fallen substantially is discouraged.

On performance conditions, where a RemCo grants an LTIP award at the usual time while delaying setting performance conditions, the IA recommends that the conditions are set within a reasonable period of up to six months from grant. Where a RemCo delays the LTIP grant entirely, a performance period of 3 years following grant is still expected. However, where this is not possible, a RemCo may shorten the performance period by up to 6 months, as long as an explanation is provided and adequate post-vesting holding of shares is in place. Where the performance period is shortened, grant sizes should be similarly reduced.

CC Comment: Given the current status of the COVID-19 pandemic and associated timing issues, the more sensible approach may be for companies to grant now, making it clear in all related grant and employee communications, as well as during relevant shareholder discussions, that the RemCo has broad discretion on performance outcomes that will be considered pre vesting.

Raising capital and Government help

Where a company is seeking additional capital from shareholders or takes aid from the government (for example furloughing employees) this should be reflected in the executives' remuneration outcomes.

RemCos and management teams are expected to be even more mindful of the wider employee and workforce pay issues through the COVID-19 period. Companies should be consistent and fair in their treatment across the board - where decisions negatively impact the wider workforce, for example where employees are being asked to take reductions in salary, a similar approach should also be followed by executives.

Impact on Directors' Remuneration Policy and shareholder vote

For companies taking their Directors' Remuneration Policy to shareholders at an upcoming AGM, the IA confirms that there is no expectation that these policies should be rewritten to address the COVID-19 crisis. However, if companies are seeking to propose variable pay increases in 2020, then the RemCo should carefully consider if such an increase remains appropriate.

CC Comment: Although helpful insight from the IA, this is likely to have come too late in the day for many companies. Many companies have already taken a view on freezing executive pay increases ahead of the AGM season.

For companies that have not yet started consulting on their Remuneration Policy, bringing forward a number of substantial changes in circumstances where the company is significantly impacted by COVID-19 may not be appropriate, and companies may want to adopt a 'wait and see' approach.

CLIFFORD CHANCE

INCENTIVES CONTACTS

Sonia Gilbert
Partner

T +44 20 7006 2041
E sonia.gilbert
@cliffordchance.com

Andrew Patterson
Partner

T +44 20 7006 6160
E andrew.patterson
@cliffordchance.com

Catrin Wright
Head of Practice Development: Incentives

T +44 20 7006 2920
E catrin,wright
@cliffordchance.com