CLIFFORD CHANCE

INVESTMENT BODIES AND PROXY ADVISERS: COVID-19 GUIDANCE ON EXECUTIVE PAY

February 2021

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Proxy advisers and other investment bodies have been particularly focused on the impact of Covid-19 on executive pay during the pandemic. They have given guidance on their expectations on pay decisions and are increasing their focus on effective disclosure and exercise of Remuneration Committee (RemCo) discretion.

Advisers' statements acknowledge the significant challenges that boards are currently facing and the need for RemCos to carefully balance incentivising senior executives at a time where management is being asked to demonstrate increased strength and leadership. RemCos are also being reminded that executives should not be insulated from the impact of Covid-19 and that broader stakeholder interests, including those of shareholders, the workforce and society more broadly, should be taken into account in making decisions on pay.

This Guide sets out the pay-related key expectations of three of the main investor voices, the Investment Association (IA), Institutional Shareholder Services (ISS) and Glass Lewis (GL).

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Distributions of capital/dividends - impact on pay

Proxy advisers have been clear since the beginning of the pandemic that where a company cancels or reduces its dividend this action should be reflected in its approach to executives' pay and companies can expect scrutiny in this area.

Investor Body	Detail
IA	Dividend cancellation or suspension should be reflected in any decisions on executive pay. Shareholders expect RemCos to clearly disclose how the cancellation has been taken into account in their 2019 or 2020 remuneration outcomes.
GL	GL expects that executive pay will be "somewhat affected" where a company has cancelled, reduced or has not resumed the payment of dividends. A company's dividend policy and payout ratio will also be taken into account.
ISS	As part of dividend payouts, companies should disclose any incentive plans where preserved cash from dividend reductions will be used to support and protect their business and workforce.

Adjustments to performance conditions

Caution is advised against adjustments to performance conditions, goals and targets for existing “in-flight” bonus or long-term incentive plan (LTIP) awards, with an added emphasis on the use of RemCo discretion in this area.

Investor Body	Detail
IA	Companies are discouraged from adjusting performance conditions of inflight annual bonuses or LTIP awards (and confirmation is expected in the directors’ remuneration report on this). Outstanding LTIP grants should not be cancelled and replaced (nor should 2021 grants be higher to compensate for lower remuneration in 2020). RemCos should use their discretion to ensure a 'good link' between pay and performance and reasons for use of discretion should be disclosed. See also 'windfall gains'.
GL	Adjustments to inflight awards will generally be viewed negatively. GL will however 'assess one-off deviations' from a remuneration policy on a case-by-case basis and will maintain some flexibility. Should a RemCo resolve to exclude FY2020 from the calculation of the final level of performance target achievement for an outstanding LTIP award, then the value of the affected grant should be reduced proportionally. See also 'windfall gains'.
ISS	Changes to inflight awards will generally be viewed negatively, including repricing of options or amendments to performance metrics. Cancellation of outstanding LTIP awards and replacement with new awards is considered 'potentially problematic’. Any alterations to future cycles of an outstanding LTIP award could however be viewed as reasonable in the event of unclear long-term financial forecasting. Companies should explain the rationale behind any changes and the resulting benefits for its stakeholders including shareholders. A full list of expected disclosures is set out by ISS in its FAQs. See also 'windfall gains'.

New LTIP and RSP awards

Companies considering new incentive awards or new types of arrangements (LTIP and restricted share plan (RSP) awards) should pay particular attention to the statements made by proxy advisers. In particular, enhanced disclosure will generally need to be considered on quantum and the performance targets set.

Investor Body	Detail
IA	Performance targets for new LTIP awards should be sufficiently stretching. Targets should not be adjusted to compensate executives for reduced remuneration outcomes in 2020. RemCos should disclose the process gone through to set the targets. RemCos to be clear about the discretionary powers available to them on vesting and commit to using them, especially where performance outcomes are not consistent with overall company performance or where there are windfall gains (see below). Where companies are considering moving to the use of RSP awards, shareholders will consider the strategic rationale, noting that the inability to set meaningful targets is not a reason in itself for this move. RemCos should consider share price factors in addition to the usual expected discount rate of at least 50% from the LTIP grant level.
GL	Disclosure on the determination of the grant value and the calculation of the number of shares to be granted will be scrutinised, in particular, looking at windfall gains (see below). Adjustment of targets for awards granted in 2021 that are aimed at reflecting an adjustment to the strategic goals communicated to the market is considered to be generally reasonable. Board should 'somewhat limit' future payouts deriving from the adjusted targets (over-performance should be avoided, adjustments should not be aimed at guaranteeing a full payout). Should the RemCo choose not to exercise discretion on these matters (i.e. where this would mean a downward adjustment to the payout), then this should also be disclosed with rationale.
ISS	It may be acceptable for companies to make alterations to future LTIP cycles. For example, a change to relative or qualitative metrics may be viewed as reasonable in the event of unclear long-term financial forecasting. Companies should explain the rationale behind the changes and the resulting benefits for stakeholders.

Windfall Gains

Windfall gains remain a focus for most proxy advisors, with an increased expectation on disclosure, ensuring that RemCos have taken steps to mitigate any impact.

Investor Body	Detail
IA	Companies should disclose the approach they have taken and any factors they will or have considered when judging if there has been a windfall gain from LTIP grants made in 2020. For companies that reduced the size of any grant, this should also be stated.
GL	A company's disclosure on the determination of the grant value and the calculation of the number of shares to be granted under a new award will be scrutinised, in particular looking at windfall gains. Should the potential for windfall gains on grants appear significant in terms of absolute and relative pay outcomes, GL would expect adjustment to grant value and/or implement adjustments to other elements of executives' pay in order to mitigate this effect.
ISS	Companies should carefully consider and address the risk of windfall gains, deriving from circumstances out of executives' control.

Annual bonuses

Varying degrees of caution are expected from companies in respect of annual bonus awards, again the emphasis is on increased disclosure where any discretion is exercised and care should be taken when applying any non-financial conditions.

Investor Body	Detail
IA	Where RemCo discretionary powers are used, this should be matched with increased disclosure on rationale and outcomes (including disclosure if lower than last year) and why they may have allowed for payouts under non-financial elements only. Enhanced disclosure is expected where companies have made adjustments to variable pay performance measures as a result of exceptional circumstances, such as rent concessions and waivers (disclosure on what has been included/excluded and the rationale). Companies should also consider whether a higher portion of bonus should be deferred into shares.
GL	Where a RemCo has already adopted an annual bonus scheme which is partially based on non-financial metrics, a selection of Covid-19 related targets can be used for FY 2021 and FY 2022. However, GL cautions against the use of non-financial metrics in general for ensuring the full vesting of awards or to be introduced ad-hoc into any bonus plans.
ISS	Above-inflation pay rises or increases in variable pay opportunity are likely to be considered inappropriate and should be supported by a particularly compelling rationale. See also 'position on government aid'.

Salary

Companies are generally expected to show constraint in terms of salary increases and quantum of pay awards generally, being mindful of RemCo discretions and wider workforce issues (although salary reductions are not expected).

Investor Body	Detail
IA	Companies should show 'continued restraint' on salary increases and on overall quantum of pay. Any increases, if made, should be in line with the wider workforce and should be justified in disclosures.
GL	No expectation on companies to adjust base salaries downwards, however RemCos should use their discretion to suspend salary increases where appropriate. The forfeiture of a portion of base salary for a period is a 'positive sign' for the market, but may not be enough to guarantee a pay-for-performance connection if a company has been heavily affected by the pandemic.
ISS	Above-inflation pay rises or increases in variable pay opportunity are likely to be considered inappropriate and should be supported by a particularly compelling rationale. Temporary reductions to salaries or the partial waiver of some pay components might however mitigate other negative pay practices.

Government Aid for Covid-19

In general, investor bodies expect extreme caution from companies who have received government aid or other assistance when setting senior executive pay.

Investor Body	Detail
IA	Where a company has required government support or taken government loans this should be reflected in executive remuneration outcomes and generally should only make annual bonuses for either FY2020 or FY2020/2021 in 'truly exceptional circumstances'. RemCos should disclose how they have considered the impact of any indirect support (e.g. business rate relief) on remuneration outcomes.
GL	All companies, especially those seeking special support from governments or executing significant employment cuts, should consider the reputational risk associated with poor pay decisions, particularly quantum of payouts.
ISS	Companies that experienced poor performance, imposed sacrifices on their workforce or required government and/or shareholder support or other funding are generally expected to pay little or no variable pay to their executives.

The wider workforce and other stakeholder considerations

In general terms, companies should align executive pay decisions with any changes made to the wider workforce and be mindful of the interest of broader stakeholders.

Investor Body	Detail
IA	RemCos should ensure executive remuneration is aligned with the approach taken for the general workforce.
GL	Where a company had to undertake significant layoffs, furloughs or cuts in workforce salaries, this should be addressed in the directors' remuneration report. In particular, companies should explain how such measures were taken into account when determining variable pay outcomes and salary adjustments for executives. Consistency expected with any changes to employee pay. Companies will not be heavily scrutinised for one-off remuneration arrangements that positively affect exclusively below-board employees but any such proposals to adjust equity plans for these employees should come with a "strong and specific rationale". Views of other stakeholders, like government agencies to be taken into account, including a direct and compelling explanation of how this has been done.
ISS	As above. Companies that experienced poor performance, imposed sacrifices on their workforce or required government and/or shareholder support or other funding are generally expected to pay little or no variable remuneration to their executives.

Retention bonus/'one off' awards

Companies should generally avoid retention awards but proxy advisers have indicated that these may in some cases be considered appropriate.

Investor Body	Detail
IA	The IA have not said anything specific about retention awards within the context of the pandemic, however they are generally not supportive and believe that they rarely work for board members.
GL	GL has a 'low appetite' for one-off retention awards. Awards will be considered on a case-by-case basis where a company's standard incentive plans have not paid out.
ISS	Discretionary one-off payments should normally be avoided. Where these are made, the company should explain why that approach was taken and how such actions further shareholder interests. Should be 'limited in magnitude and a truly isolated practice'.