FIT Remuneration Consultants

February 2018 Update

Introduction

As we prepare for the 2018 AGM season we wanted to use this briefing to highlight a few recent developments in relation to executive remuneration, including:

- updated voting guidance from the Pension and Lifetime Savings Association (PLSA)
- our observations on one of the issues arising out of the collapse of Carillion
- a practical consideration for Gender Pay Gap Reporting
- comments on the recently announced voting policy of the Church Investors Group.

PLSA voting guidelines

The PLSA (which has members managing pension schemes with approx. £1 trillion in assets) has released its updated corporate governance policy and voting guidelines for 2018.

The introduction to the new guidelines acknowledges the proposals made by the FRC at the end of 2017 to revise the UK Corporate Governance Code (see our earlier Briefing). However, as those proposals are still subject to consultation, the new PLSA guidelines are based on the existing version of the Code.

There are very few significant changes to the sections dealing with executive remuneration; the new elements in the 2018 PLSA guidelines being:

- an extension of the requirement that, in most circumstances, if shareholders vote against a remuneration report or policy they should also vote against re-election of **all** Remuneration Committee members that have been in post for more than one year (i.e. not just the Chair)
- clarification that the failure by a Remuneration Committee to exercise discretion, in the context of wider circumstances such as serious corporate conduct issues, may be sufficient to trigger a vote against a remuneration report.

The previous detail of the PLSA guidance remains as it was, with the more significant requirements unchanged, such as:

- shareholding guidelines should be a minimum 200% of base salary, to ensure sufficient alignment with shareholders
- there should be a "*strong read across from the company's strategy to the drivers of executives' remuneration*", e.g. by aligning pay metrics to the company's key performance indicators
- there should be retrospective disclosure of annual bonus metrics and targets
- emphasis that clawback and malus provisions "*should not be restricted solely to material misstatements of the financial statements*" (an area that is already receiving further scrutiny in the wake of the collapse of Carillion – see below)
- in the absence of a convincing explanation, pay increases in excess of inflation or those awarded to the rest of the workforce, will be a cause for concern.

Malus and clawback - what are the triggers?

Among many adverse headlines from the collapse of Carillion was the fact that it had recently altered its malus and clawback triggers at its 2017 Remuneration Policy renewal. The previous policy included a trigger as a result of 'corporate failure'. Under the new policy, these became two of the more 'normal' triggers applied by UK plcs, being:

- a misstatement of financial results; or
- a participant is guilty gross misconduct.

However, the previous trigger of 'corporate failure' was removed.

This was already an area of focus by investors, but the Carillion case will further intensify investor scrutiny of the detail of provisions (e.g. nature of triggers, length of clawback period).

Given the notoriety of the Carillion case, we believe that companies should re-examine their malus/clawback triggers and consider whether they remain suitable. For example, our template triggers for the operation of malus/clawback also include cases of reputational damage to the company and if there has been a miscalculation of performance conditions.

Gender Pay Gap reporting

As we have mentioned in recent Briefings, the first reports under the Gender Pay Gap regulations must be published by 5 April 2018. However, at the time of writing, the majority of entities have still not published their data (857 companies have published out of an expected total of c. 9,000).

We understand, unofficially, that many companies are considering publishing their gender pay reports on 8th March (International Women's Day).

One practical point for companies to keep in mind is that, in our experience, the registration process for the government reporting service can take some time to complete. Irrespective of when a company intends to report, we recommend that sufficient time is allowed to engage with the practicalities of the reporting system. This can be particularly cumbersome if the reporting entity is not UK incorporated, as the standard registration process will not apply. Please contact your usual FIT contact if you have any questions regarding the practicalities of the reporting process (or more generally regarding Gender Pay Gap reporting).

Church Investors Group

The Church Investors Group (CIG) has announced its voting policy for the 2018 AGM season. It has signalled a "*harder line*" on a number of issues, including executive pay. In particular it has indicated that it expects companies to:

- include a disclosure of a CEO remuneration ratio (although this only applies to FTSE 350 companies)
- demonstrate "*equitable treatment of staff in terms of pensions*"
- ensure that short term incentive awards do not exceed 100% of salary for on-target performance or a maximum of 200%
- in the case of financial services and pharmaceutical companies, confirm that they pay employees the living wage

The CIG position regarding pensions is not surprising and is consistent with the general direction of travel among investors. It has been reported that CIG will abstain if executive pension contributions are more than 30% of salary.

The focus on pay ratios echoes the approach taken by the Investment Association which recommended voluntary disclosure in 2018 (see our earlier Briefing). It is not clear what methodology the CIG expect to be used to calculate the pay ratio. In newspaper reports it has been suggested that CIG expect the disclosure of a pay ratio "*between the highest and lowest earners*", although this may be a press error as the CIG policy is not that specific. If correct, this goes beyond the recommendation set out in the Government's response to its Green Paper on Corporate Governance Reform which noted an intention for a ratio between CEO pay and the average pay of the UK workforce (see our Briefing). We expect the government to publish draft legislation soon, which will hopefully establish a 'standard' pay ratio methodology. In the interim, we believe many companies will defer publishing until the preferred methodology becomes clearer.

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If you wish to discuss anything arising from this briefing, please ask your usual contact at FIT or call us on 020 7034 1111.