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Executive remuneration high on UK companies’ agenda as proxy season nears

SYNPOSIS: This article from Activistmonitor, first published in February 2018, quotes Statera Partners co-founder John Dawson. It explores recent trends in remuneration, shareholder activism and the prospects for the 2018 proxy season. Alongside comments from USS’s Daniel Summerfield on the underlying desire for investors to effect change through their vote, John highlights the need for boards to invest in efficient and effective communication in preparation for the next remuneration cycle and to preempt any perceived weakening in governance. Statera Partners LLP was specifically established to provide boards of companies with independent, experienced advice on governance, stewardship, remuneration and activism.

Executive remuneration is set to be a key consideration for boards and investors during the early months of 2018 as UK-based companies gear up for AGM season, according to a corporate advisor and the head of responsible investing at USS Investment Management, one of the UK’s largest pension fund investors.

This year was not predicted to be a major flash-point for remuneration issues given many companies would be approving remuneration reports rather than asking shareholders to sanction new pay policies, said Statera Partners founder and former Rolls-Royce [LON:RR] head of IR, John Dawson.

However, “the Persimmon problem” has seen the issue of executives' remuneration make headlines again, Dawson said, much as BP [LON:BP] CEO Bob Dudley’s payout did in 2016.

It was revealed in late 2017 that Persimmon [LON:PSON] CEO Jeff Fairburn would pocket a bonus of share awards worth around GBP 110m awarded under the company’s 2012 long-term incentive plan, with the bonus scheme’s directly linked to the company’s share price.

Persimmon’s chairman Nicholas Wrigley was forced to resign in December after saying he regretted not capping the company’s bonus scheme. Fairburn said last week he never intended to keep the awards nor did he consider it right to keep them entirely for himself, and would donate a substantial amount to charity.

Further embarrassment could follow at other FTSE companies unless they become more proactive in capping excessive awards and aligning their remuneration schemes with proper performance metrics, Dawson said.

Stark contrasts between executive remuneration and company performance could also result from recent market fluctuations, he speculated.

For instance, the drop in the FTSE’s aggregate market valuation at the end of January - a 5% decrease between 31 December and 19 February - would not be reflected in remuneration awards that measured executive performance up until the end of the calendar year, he said.

A buoyant stock market over the past year means that executive remuneration could be quite high if it is linked purely to total shareholder returns (TSR), Dawson said. Long-term incentive schemes based on TSR are becoming more prevalent and can be adjusted and measured either on an absolute or a relative basis, with weighted metrics referenced to a peer group.

However, such measures can still quite often mean executives get good pay-outs when they actually haven’t driven internal value creation, and should therefore not be applied blindly, Dawson said.

Because shareholders have already had their say on the remuneration policies in earlier years, the dissent may not come directly through AGM votes, but rather via the media and other watchdogs, he said.

USS Investment Management, the UK’s largest private sector pension scheme with GBP 60bn in assets under management, takes a relatively active stance on remuneration issues.

If it feels its views on remuneration are not being taken seriously, it reserves the right to target AGM votes against individual directors who are responsible for setting remuneration strategy, including members of the remuneration committee, according to USS co-head of responsible investment Daniel Summerfield.

USS will not abstain from voting on remuneration issues: “It doesn’t make any sense sitting on the fence on an advisory vote,” he said.

The recent insolvency of Carillion [LON:CLLN] also highlighted the inability of companies in certain cases to claw-back executives’ remuneration even after the company’s spectacular collapse, Summerfield said, noting that USS was not invested.

UK Corporate Governance review and investor voting behavior

Upcoming reviews of the UK's Corporate Governance and Stewardship Codes, as well as BlackRock CEO Larry Fink's "Letter to CEOs" about corporate social responsibility, are driving the thinking now being done in corporate boardrooms, he said.

While Fink concentrated more broadly on societal stewardship in his 2018 letter, it was only a year ago that Activistmonitor obtained a document outlining BlackRock's performance-centric attitude towards remuneration of executives at EMEA companies.

Similarly the UK's Corporate Governance Code places no limits on executive remuneration but states a significant proportion should be performance related, and shareholders should have a role in approving new long-term incentive schemes and changes to existing schemes.

A study by the High Pay Centre and CIPD last year showed FTSE 100 CEO remuneration had fallen by 17% between 2015 and 2016, but still characterised pay packages as "extraordinarily high".

The EU Shareholders' Rights Directive also aims to give investors more of a "say on pay" by way of advisory or binding votes on remuneration at least every four years. The directive is due to take effect in mid-2019.

The paradox is that companies that are making the most progress on pay issues are the ones being singled out in the public spotlight, Dawson noted.

"If the company's doing very well and nobody's being critical then it's quite easy for them to be relatively complacent about all of this and not to take the opportunity to start the ball rolling on scheme redesign and consultation when times are good," Dawson said.

While unhappy investors might traditionally try to hit directors and executives in the pocket - by voting against remuneration reports and policies at the AGM - the more interesting protest votes can occur on agenda items granting the board discretion to issue shares and raise capital, Dawson said.

A vote against the company's ability to raise capital can signal a disconnect between shareholders and the board regarding the company's strategy, and can be a red flag for pure activist investors, he said.

"Those are the ones where I think activists see opportunities to think about whether the company is delivering what shareholders want," he said.

An activist might see that as an opportunity to talk to shareholders about whether or not they would support a move to encourage a break up of the company, or a simplification of the business model, or perhaps show more restraint around M&A and focus on organic growth, he said.

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