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Rethinking Executive Pay

As the economic environment tightens, the pressure on remuneration committees looks set to intensify. **Katherine Savage**, People Advisory Services Partner at EY, tells **David Hobbs** how they can create pay policies that are fair, balanced and reflective of a company's performance

What should RemCos be focusing on in the coming months?

COVID has exponentially elevated the need for companies to demonstrate agility in making real-time, business-critical decisions to safeguard their workforces while managing costs. RemCos need to assess the impacts of the crisis on business performance. They must then carefully consider the need for prudence with regards to executive pay and scrutiny of their public disclosures for alignment with the new realities of their business.

Could you describe some of the main issues from a shareholder point of view?

We are seeing an increasing influence of proxy voting on remuneration resolutions and an increased stakeholder focus on the importance of independence. To operate effectively, RemCos must be able to provide appropriate challenge and oversight to business leaders, and the role of independent external advice should not be underestimated.

Reporting requirements also continue to evolve at pace. These require firms to consider not only their impact on internal processes, but also the wider narrative required to supplement such disclosures and potential implications on their employer brands with key stakeholders.

Applying a COVID lens, RemCos need to be particularly careful of making decisions on executive bonus or long-term incentive outturns which are misaligned with decisions made for the wider workforce. There could also be challenges for organisations thinking of reinstating salaries that were reduced during the pandemic.

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Should there be some restraint from businesses regarding senior executive pay?

We expect to see greater levels of transparency and focus on the development of fair pay principles to support broader employee total reward packages – COVID only heightens this focus. We anticipate the ongoing debate concerning executive pay restraint and recognise that those sectors hardest hit by the pandemic will likely see reduced remuneration levels for some time.

What restrictions are being imposed on companies, particularly those that received Government financial support?

For firms that received Government financial support, there are three main areas of focus. Firstly, those that took advantage of the Coronavirus Corporate Financing Facility (CCFF) may have to produce a letter that details how they are showing restraint around executive pay. The Treasury has published a pro forma of what they would like to see in the letter. Its version of restraint says, “We expect that companies will commit to no pay rises or cash bonuses to senior management, including the Board and company management.”

Restrictions for companies taking advantage of the Coronavirus Business Interruption Loan Scheme (CBILS) include their agreement to not award pay raises or cash bonuses to senior management, except where they were declared before the loan was taken out and are in keeping with similar payments in the preceding 12 months. Compensation amounts paid must also not have a negative material impact on the borrowers’ ability to repay the loan.

The Coronavirus Large Business Interruption Loan Scheme (CLBILS) has been extended from £50m to £200m, but borrowers will face restrictions on the way they remunerate executives if they receive loans above £50m under the scheme. Other than in certain specified circumstances, the government is excluding funding under CLBILS in excess of £50m to any company which pays cash bonuses, or awards any pay rises, to its senior management, including the Board. This could, however, leave the door open to bonuses being delivered entirely in shares, and for other share awards to continue to be made. >

Are there any sectors that have come under closer scrutiny in the past months?

Yes, financial services in particular. In July the Prudential Regulation Authority welcomed the decisions by large UK banks to suspend dividends and buybacks on ordinary shares until the end of 2020. It also expects banks not to pay cash bonuses to senior staff, regardless of whether they had received government support.

The PRA will also undertake its assessment of firms' distribution plans beyond the end of 2020 in Q4 2020. That assessment will be based on both the current and projected capital positions of each bank, considering the level of uncertainty on the future path of the economy, market conditions and capital trajectories prevailing at the time.

The European Central Bank has extended its recommendation not to pay dividends until January 2021 and has clarified the expected pace for banks to restore capital and liquidity positions. It also expects firms to exercise extreme moderation on variable remuneration to conserve capital during the COVID crisis.

What is the situation for companies that took advantage of the Coronavirus Job Retention Scheme (CJRS)?

Continuing high executive pay packages are not considered acceptable for companies in receipt of taxpayer-funded support schemes. Although no specific restrictions exist, it is noteworthy that the US CARES Act (Coronavirus Aid, Relief and Economic Security Act) requires companies seeking benefits to agree to limits on total compensation packages for higher paid employees and directors, with restrictions remaining in place for specified time periods after the loan to the company has been repaid.

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The potential for reputational and employer brand damage is significant given the scrutiny on executive pay.

How will COVID-19 impact momentum around Environment, Social & Governance (ESG) matters?

Reimagining how we work presents opportunities to accelerate ESG activities, whilst recognising that stabilising business performance is the current top priority. We are seeing organisations take time to reflect on how not to simply return to the 'old ways of working'. They're considering utilising the pandemic as a potential opportunity to accelerate key business transformational priorities that support longer term value objectives. This could have a profound impact on ESG initiatives, such as paperless processes, hybrid workplace models that include evolving location strategies, opening up broader and more diverse talent pools and reduced travel as teaming via technology becomes the norm. ■

Katherine Savage
Partner, Financial Services
People Advisory Services
EY

Katherine is People Advisory Services Partner at EY, specialising in total reward strategy and design. She joined the company in 2015 and has extensive experience built over more than 20 years in creating effective reward and HR strategies across leading global organisations. She has spent much of her career within emerging markets and organisations in periods of unprecedented change and crisis management.

Contact Katherine through:
www.criticaleye.com