

# Linklaters

Board Pay in FTSE 100 Companies – 2017

All change or no change?

## A snapshot

For many FTSE companies, the first three-year cycle of directors' pay policies ended last year. So this year saw them submitting policies for binding shareholder approval for the second time, as well as seeking the annual advisory vote on pay in 2016<sup>1</sup>.

We have carried out a survey of the 2017 AGM season so far<sup>2</sup>, analysing the key issues for shareholders, how they have changed from last year and what this means for next year. See below for a summary.

The findings need to be seen in the context of the renewed focus on corporate governance and levels of executive pay. The Government announced a major review of these last year and issued a Green Paper on corporate governance last November. This was followed by a BEIS Select Committee Report making a number of recommendations.

## Key findings

- > The media has repeatedly reported on shareholder criticism of companies' pay outcomes and plans, but this hasn't led to large pay vote revolts in 2017.
- > Shareholders did not reject any policy reports. They seem to be reluctant to use their binding vote to do so. However, at least one FTSE 100 company withdrew its policy.
- > One implementation report was voted down.
- > Only 28% of implementation reports had an IVIS<sup>3</sup> amber top<sup>4</sup>, though 39% of policies got an amber IVIS top. The number of red and amber tops for implementation reports fell in 2017
- > There appears to be only a very small correlation between the rating given to the vote by IVIS and the voting outcome. The amber top policies received an average of 94.72% support from shareholders. This could be as a result of greater consultation.
- > Of most concern to shareholders was the increase in basic pay. Limited disclosure was also highlighted, particularly the lack of disclosed targets for bonus pay-outs at the end of the bonus year. However, this did not lead to a call for companies to include a maximum limit on pay as required by the pay rules.

The emerging pattern is one of greater engagement resulting in less formal opposition to pay resolutions. Policies, in particular, are receiving substantial shareholder support. But at the same time, many policies still include elements which may result in large pay-outs, again leaving open the possibility of shareholder dissatisfaction with pay reports in future years. In particular, many companies do not cap levels of pay and allow for generous recruitment packages, alongside buy-out awards.

Companies are also trying to meet investors' expectations for greater disclosure on matters such as bonus performance measures and targets, but overall, there is not much change from previous years.

<sup>1</sup> The rules introduced in 2013 apply to all UK incorporated companies listed on the London Stock Exchange, NASDAQ, an EEA Exchange or the New York Stock Exchange. The rules require enhanced disclosure of board pay, which is subject to an annual non-binding vote, as well as a binding vote on pay policy, which must be put to shareholders at least every three years. Payments can only be made to directors if included in the approved pay policy.

<sup>2</sup> We examined 71 of the FTSE 100, being the number of companies which have had their AGMs as at mid July.

<sup>3</sup> Members of the UK and international investment community subscribe to the IVIS service to help them exercise their voting rights and to enable them to make more informed voting decisions. IVIS is part of the Investment Association.

<sup>4</sup> IVIS rate pay resolutions red, amber or blue. It's up to shareholders' judgement to decide how to vote, but red and amber ratings indicate matters of serious and significant concerns respectively. A blue top indicates no areas of major concern.

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## This research

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### What next for board pay?

The short answer is that there are likely to be changes, but their timing and extent is unclear. We will monitor developments and continue to report on their potential impact:

- > The Queen's speech did not include any mention of corporate governance, so there will be no new legislation in this Parliament. But the FRC have said that it would be undertaking a "fundamental review" of the Corporate Governance Code later this year. Therefore, any changes will be through the Corporate Governance Code, and possibly other industry measures. None will occur speedily.
- > There is likely to be a continued push for greater disclosure of performance measures and targets, particularly for annual bonuses.
- > The EU rules on directors' pay disclosure and shareholders' voting rights have now been finalised and will come into force in EU member states in June 2019. Although the UK may not be part of the EU by then, we do not yet know whether the UK will continue to apply this EU-derived law. Anyway, the EU directors' pay rules are likely to have a limited effect on UK companies since they are generally less onerous than the current UK regime.

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## How can we help?

Many of the world's largest companies rely on our global incentives practice to advise on their remuneration issues. We deliver quality legal advice with practical commercial solutions across the globe.

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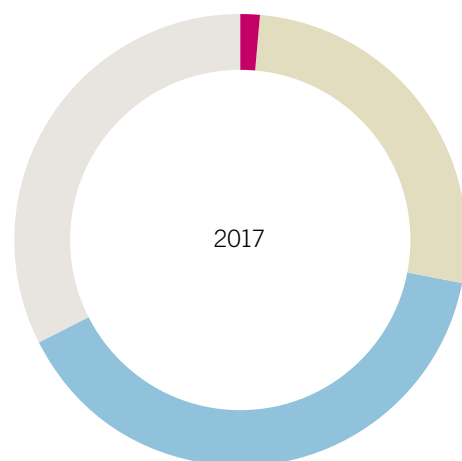
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August 2017

## The Investment Association (IVIS) reports 2017

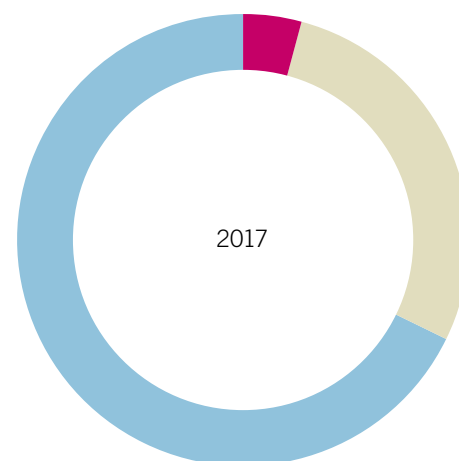
### Policy reports



Red	1
Amber	19
Blue	28
N/A	23

The red top policy received 88.89% shareholder support at the AGM. The amber top policies received an average of 94.72% support, while the blue top policies received an average of 95.56% support. The IVIS colour rating is of course only an indication to shareholders, who exercise their own judgement. But it looks like shareholders are more reluctant to vote against remuneration policies, where their vote is binding, than against implementation reports. No doubt companies are also seeking to resolve issues of concern directly with their shareholders who then support the pay policy.

### Implementation reports



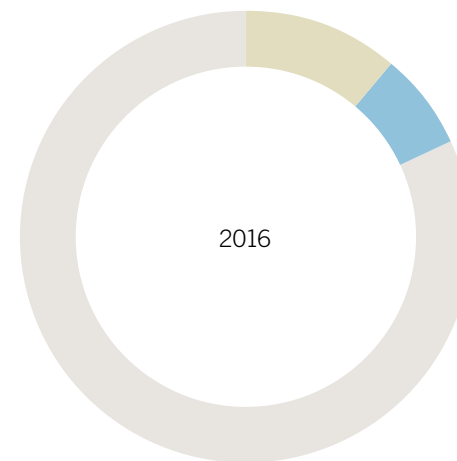
Red	3
Amber	20
Blue	48

Two of the red top reports passed with 61.17% and 88.89% of the votes respectively. (The third 'red top' was for a non-UK incorporated company report, which was not put to a vote.) Those with an amber rating received an average of 88.17% support, though this group included the one implementation report that has been voted down by shareholders so far this year. Blue-topped reports received an average of 95.26% support. Despite the IVIS rating, reports still receive strong shareholder backing, due probably to companies engaging with their shareholders.

Note: In all cases, figures refer to number of companies unless otherwise stated.

## The Investment Association (IVIS) reports 2016

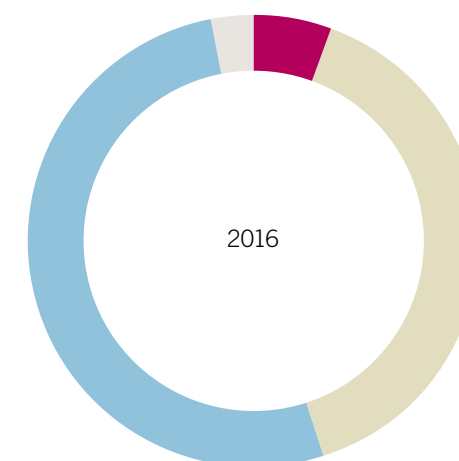
### Policy reports



Red	0
Amber	8
Blue	5
N/A	58

Few companies put their policies to a vote in 2016. However, this shows the same trend of IVIS awarding fewer amber or red tops in 2017 compared to 2016.

### Implementation reports

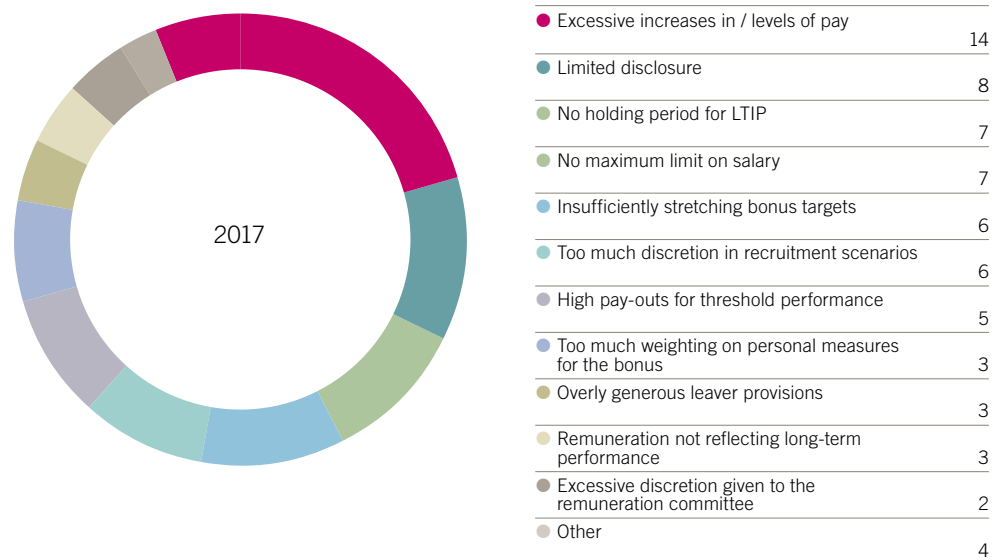


Red	4
Amber	28
Blue	37
N/A	2

The proportion of red and amber tops decreased from 2016 to 2017. This may in part be due to increased consultation with shareholders.

## IVIS reports

### Key IVIS issues in 2017



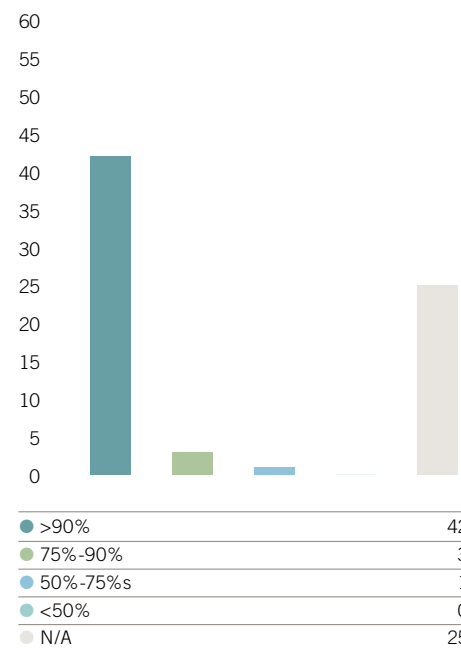
The main issue raised by IVIS was the level of, or increase in, pay. Many companies justified this by saying that they were bringing their pay up to market levels. The ratcheting effect this has on overall levels of pay has been widely criticised.

While IVIS expressed concerns about some companies having no cap on salary, it still awarded blue tops to many policies which did not include such a cap.

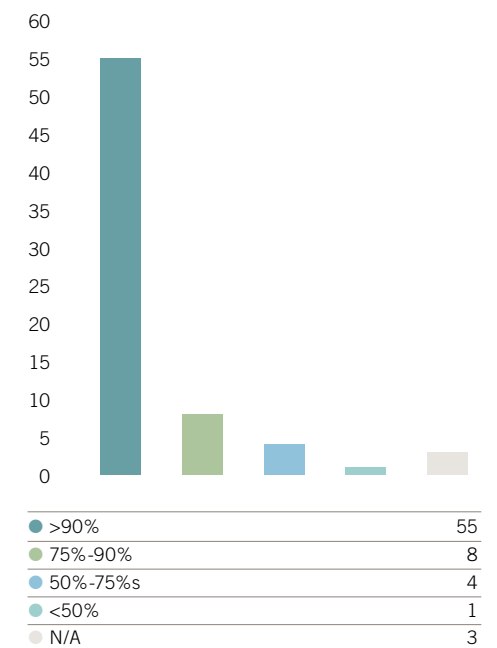
IVIS now automatically award an amber top when LTIP awards do not have a two-year post-vesting holding period.

## AGM voting results

### Votes in favour of policy reports



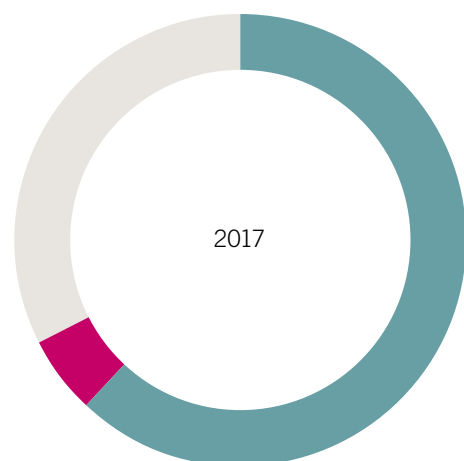
### Votes in favour of implementation reports



Shareholders still support overwhelmingly most implementation reports and pay policies. There have been calls for votes on pay policy to require a 75% 'super majority' to pass (or that less than 75% support for an implementation report would trigger a policy vote the following year), but these figures suggest that such a requirement would have limited impact.

## Policy Issues

Were all policies put to the vote in 2017 due for renewal?

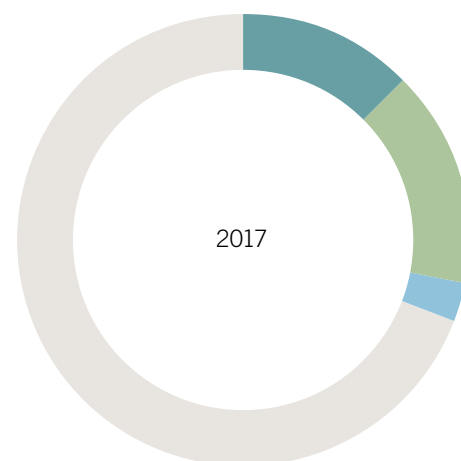


Yes	44
No	4
N/A	23

Many policies were due for renewal this year after the first bidding vote in 2014. (Two of the four policies not due for renewal are post-IPO votes).

Policy renewals have no doubt led to more discussions between companies and shareholders on how the pay policy aligns with strategy. This probably also included discussion of pay levels in 2016. No doubt companies have learnt from previous experience in 2014 and later. This may explain why there have been fewer IVIS amber and red tops, and fewer shareholder revolts this year.

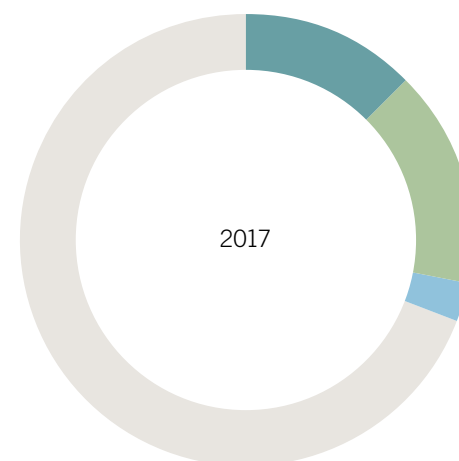
Extent of change in policy since last policy



Substantial change	20
Some change	24
No change	2
N/A	25

Most remuneration committees are making gradual changes in pay policy. Even where there have been substantial changes, overall structures are pretty similar. The move away from LTIPs to other pay structures has not materialised yet.

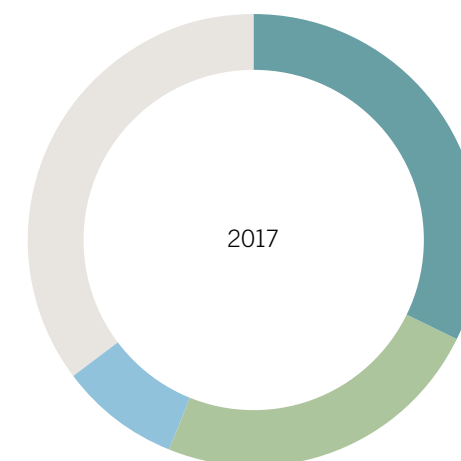
Where no policy vote in 2017, what has been included re policy in the implementation report?



Full policy	9
Summary of policy	11
Website reference only	2
N/A	49

The rules only require a website reference to where the policy may be found, but companies are clearly doing more. There has been little change in companies' practice re policy compared to 2016. It is interesting that the Investment Association have dropped their request that companies include their policy table, though this may be because it is less relevant this year since most companies presented revised policies for shareholders' vote.

Complexity of the 'grandfathering' clause<sup>6</sup>



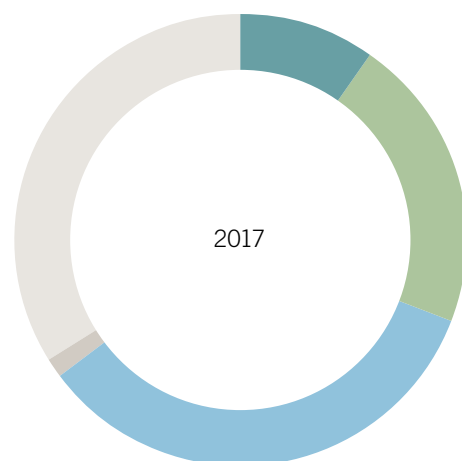
Sophisticated	23
Simple	17
None	6
N/A	25

Time will tell if simple grandfathering clauses will create problems by not being extensive enough to cover all payments that companies wish to make in the next three-year cycle. It's interesting that several companies did not include a grandfathering clause at all.

<sup>6</sup> A payment must be within a policy at the time it is made. Many awards are likely to be granted under one policy but vest under another, different, policy. For the first time in 2017 companies have had to consider carefully how to ensure awards granted and other commitments made under their 2014-16 policies can be lawfully paid under the 2017 policy.

## What did reports say?

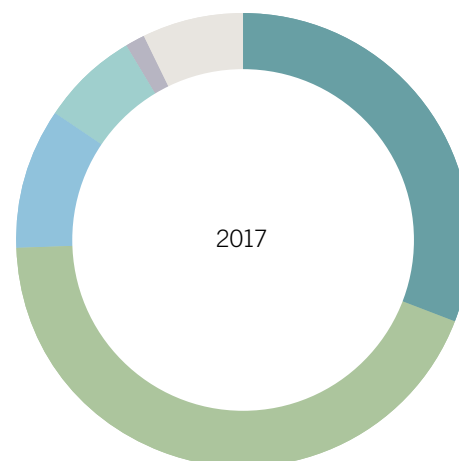
Policy statement on how wider pay and employment conditions were taken into account



Good detail	7
Some detail	15
Just "considers"	24
No information	1
N/A	24

Most companies have given very little detail as to how the pay and employment conditions of employees of the company were taken into account in setting the policy for directors' pay. Greater transparency is a key theme of the Taylor Review and, with the public mood focusing more on high pay and the Government considering action in this area, companies may come under greater pressure to be more transparent.

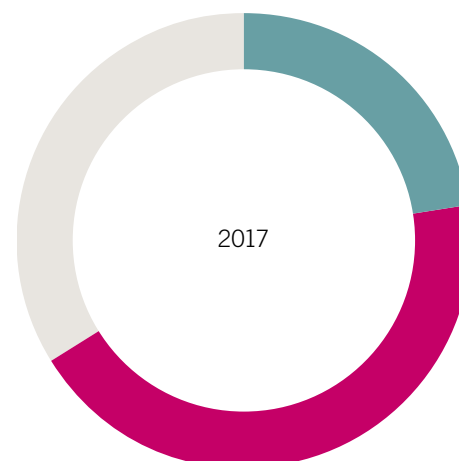
CEO pay relative to other employees' pay



All employees	22
UK employees	31
Employees of other regions	7
Management	5
Other	1
N/A	5

Companies must show a comparison between the change in pay for the CEO and for other employees, but they have some flexibility to choose a subset of their employees as the comparator if more appropriate. Most companies chose all employees in a particular region. However, a small number used the pay of management as the comparator. Unless this approach is properly justified, it defeats the purpose of the rule: to consider the difference between the CEO's pay and that of the wider workforce.

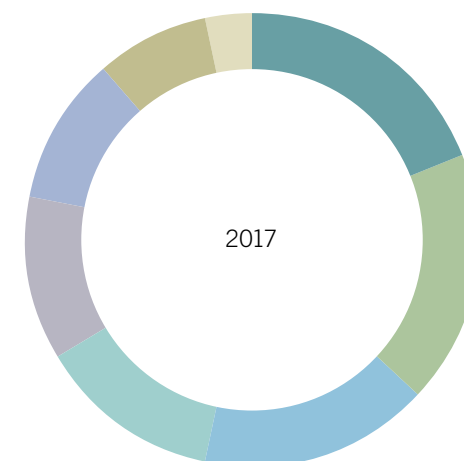
Cap on salary in the policy?



Yes	16
No	31
N/A	24

As in previous years, many companies did not include a maximum cap on salary levels in their policy, despite the rules requiring them to do so. However, many such policies still received an IVIS blue top.

Basis on which pay increases may be made



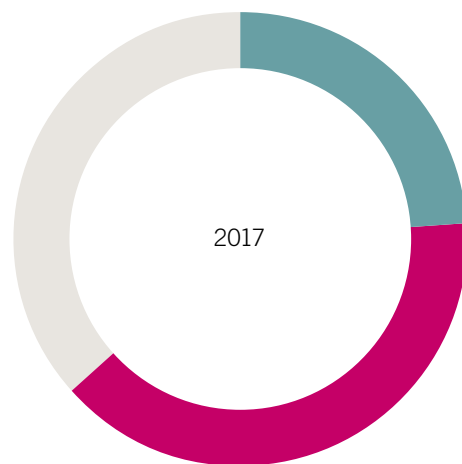
Market levels	42
Individual performance	40
Other employees	36
Role	29
Individual's experience	26
Company performance	23
Economic conditions	18
Other	7

Many companies acknowledged the ratcheting effect of considering market levels when setting executive pay, but it is still the most common consideration.

However, this area now needs to be seen alongside the existence of malus and clawback provisions in most remuneration policies. There is therefore a residual power to adjust or reclaim pay in the light of circumstances when payments are made, or after payment. Companies may come under increasing pressure to use these powers.

## What did reports say?

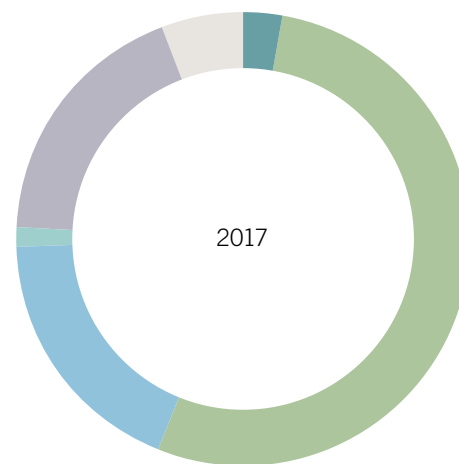
Have companies disclosed bonus measures in the policy table?



Yes	17
No	28
N/A	26

Most companies did not disclose their bonus measures in their policy table, despite being required to do so by the rules. However, many did give a general outline of the kind of measures they will use and said that specific measures would be decided each year.

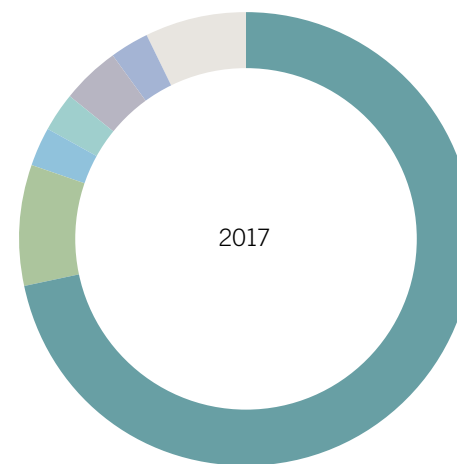
Have companies disclosed bonus targets



Disclosed	2
Will disclose next year	38
Will disclose next year, unless commercially sensitive	13
Will disclose when no longer commercially sensitive	1
No information	13
N/A	4

The Investment Association's guidance states that targets should generally be disclosed within one year of the award and no later than two years. Most companies committed to disclose their targets within this period, though a substantial number gave no commitment to disclose the targets at all.

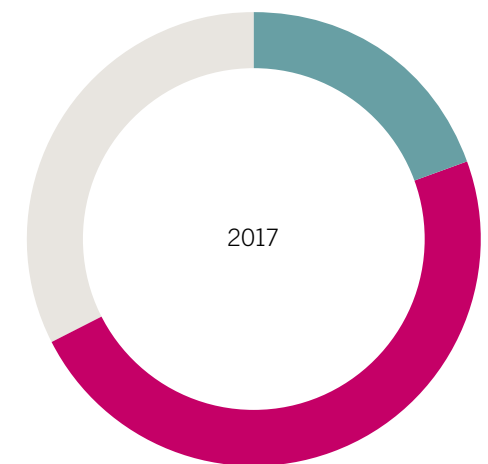
Have companies disclosed LTIP targets?



Disclosed	51
Some disclosed, others will do after vesting	6
Some disclosed, others are sensitive	2
Will disclose next year	2
Will disclose after performance period 3	3
No information	2
N/A	5

As in previous years, companies were far more likely to disclose their LTIP targets in advance, on the basis that they are generally less commercially sensitive than bonus targets.

Do recruitment policies allow higher variable pay?



Yes	14
No	34
N/A	23

IVIS have expressed concerns at companies having recruitment policies which allow them to exceed their policies' pay limits, but there has been no reduction in the number of companies that do so. This right to award higher variable pay is in addition to companies' ability to grant buy-out awards to new recruits.



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