David Ellis Associates

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Market trends

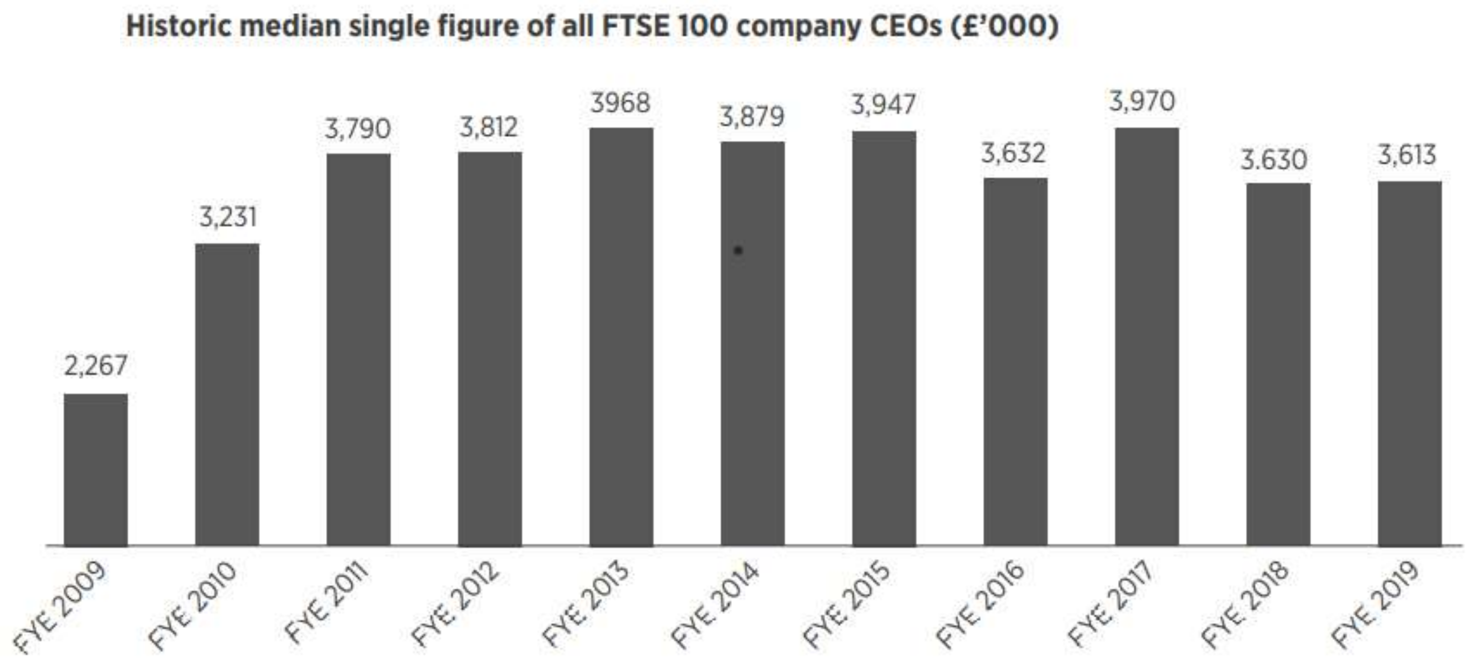
What insights can be gained from the 2020 AGM season on executive pay and equity trends

David Ellis

April 2021

Part One
Setting the scene

Setting the scene (1)



Since FYE 2011, median pay of FTSE 100 companies has continued to oscillate around the £3.80 million mark and is at its lowest level this year since FYE 2011*

* High Pay Centre Research Report, "FTSE 100 CEO pay in 2019 and during the pandemic" (August 2020)

Setting the scene (2)

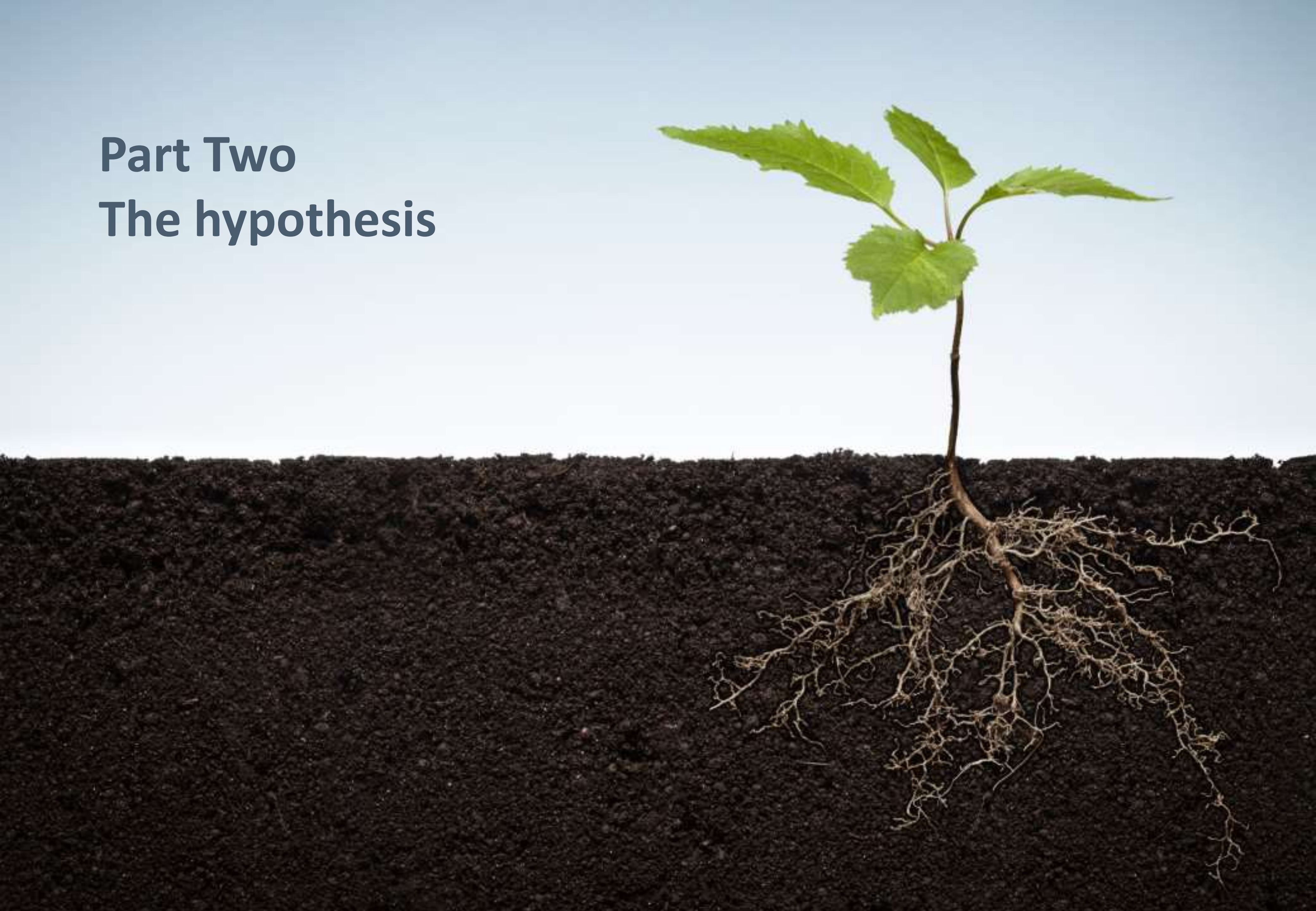
The Public Register was set up by the Investment Association for the year commencing 2017. The Register details companies in the UK FTSE All Share that have received significant opposition by shareholders to a resolution.

Year	2017	2018	2019	2020
Number of Companies*	53	62	64	60
% of FTSE All Share**	9	10	10	10

* Means the number of companies in the FTSE All Share entered into the public register for significant opposition to the Remuneration Policy and/or the Remuneration Report.

** Means the % of the FTSE All Share so entered (assuming an average number of companies in the FTSE All Share over the period of 610).

Part Two
The hypothesis



The hypothesis

The shareholder dynamic

Five mistakes will continue to dominate the shareholder agenda – companies will choose to make them with purpose

Your remuneration report is not the answer - one (increasingly dense) narrative will never suit a multi-stakeholder debate

Executive Pay for 2020-2030

There is no ‘next big thing’ – absent UK plc moving to create one. Single issue interventions to move the market will continue

The story has moved on – those companies that fail to appreciate this will get the roughest ride

The new narrative

Part Three
The shareholder dynamic

The shareholder dynamic

Base pay

- positive adjustments to base pay in excess of those applied to the majority of the workforce

Annual bonus

- Delivery of an element of the bonus related to strategic or personal performance when the performance of the organisation has resulted in zero pay-out under the financial measures

Long term incentive

- The adjustment to a performance metric during the performance period which enhances the quantum vesting

Pension

- Providing a pension equivalent at a contribution level higher than that which applies to the bulk of the business

One-offs

- payments on hiring that are not performance related
- payments to reward the closure of a deal or transaction
- significant exit payments for executives whose employment is terminated
- a special LTI focussed on one period of turn-around

Part Four
The new narrative

The story has moved on…

Organisations have spent many years seeking to show that executive pay is not as high as it looks – using a variety of techniques of comparison.

We now know that executive pay has not really gone up over the last ten years. Which is the answer to the high pay question.

It is not, however, the answer to the low pay question. And this is where the debate now lies. Your CEO pay ratio should now form the **focus** of your pay outcomes debate.

Focus on the lower quartile pay outcomes and explain what has shifted (and what you plan to shift) and why. Seek to contextualise your ratio appropriately so people may understand what you really mean and what you are doing.

For example

- If your pay ratio excludes outsourced workers, consider making it clear that this is the case (and why)

- Consider including pay for other high earners other than the CEO – there is real interest from a governance perspective in understanding whether levels of pay seen by the CEO are experienced elsewhere in the business – or whether there is just one "rockstar"

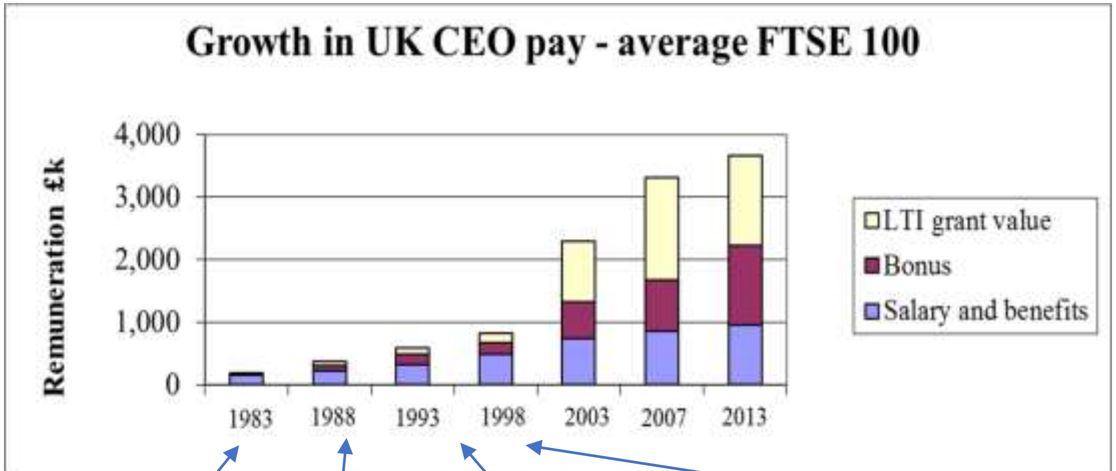
- Set out a road-map to simplify broad based employee pay to make sure the headline rates are clear and comprehensive

- Tell the story of how your encouragement of long term saving by your people has reaped positive rewards – for example, via your all-employee share plan successes

The evolution of the reward narrative over the next decade will move us away from technical shareholder driven justifications for pay outcomes and toward specific standalone disclosure on pay transparency. The advent of the *"fair pay report"*

Part Five
The next ten years?

What can we glean from our past?



Introduction of approved executive share options (1984)

Introduction of earnings cap for final salary pensions (1989)

Increased disclosure of remuneration quantum (1995)

The rise of the PSP (and the demise of approved options)

The market was also the friend of executive pay. In April 1984, the FTSE100 index was 1,096.30. On 31 December 1999, it stood at 6,930.20 and had been on a steadily increasing curve in the intervening period. In that period, performance shares, the vesting of which was linked (at shareholders' insistence) on relative TSR, took over from market-priced share options. The rest, as they say is history….

The Chairman's Group

MAIN CONCLUSIONS

It was agreed:-

(i) "Chairmen's Group" should be established on an on-going basis.

(ii) Mechanisms should be established within the Group to exchange information on a regular basis covering a wide range of remuneration parameters and that relevant international comparisons should also be made.

(iii) A small "in-house" secretariat should be set up.

(iv) Remuneration of executive directors and senior management in the UK is too low on any international comparison and this is not rational nor acceptable.

(v) High pay for senior people is more acceptable if a significant element is visibly linked to performance and achievement.

(vi) Greater use of well based performance-related schemes will need to be made in the UK.

(vii) The Group would meet again after the first collection of data had been compiled, probably within six months.

31st August 1982.

The missing piece of the jigsaw

When looking for a cause that leads to an effect, the trick is to try not to be too clever. Why did executive pay shoot up in the 30 year period we are looking here? Because executives in organisations were working hard throughout that period to make sure that it did.

Likely outcomes?

Quantum will remain static

We currently have a system of checks, balances (and pressure) that is producing a net zero growth outcome. Executive pay quantum will remain static for a while longer as the trends emerging from year on year pay ratio disclosures begin to hit the public domain.

Most likely outcome - with a well developed system to keep quantum in check

Quantum will decrease

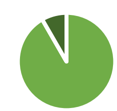
Single issue or company interventions by institutional investors seeking to "move the market" will be the biggest drivers of change. Pension, holding periods, post cessation guidelines etc. prove the effectiveness of the technique.

The Restricted Share debate is a red herring and adoption of such arrangements will remain on a "by exception" basis UNLESS the accepted red lines on design are relaxed.

Meaningful reduction would require a policy shift – less likely

Quantum will increase

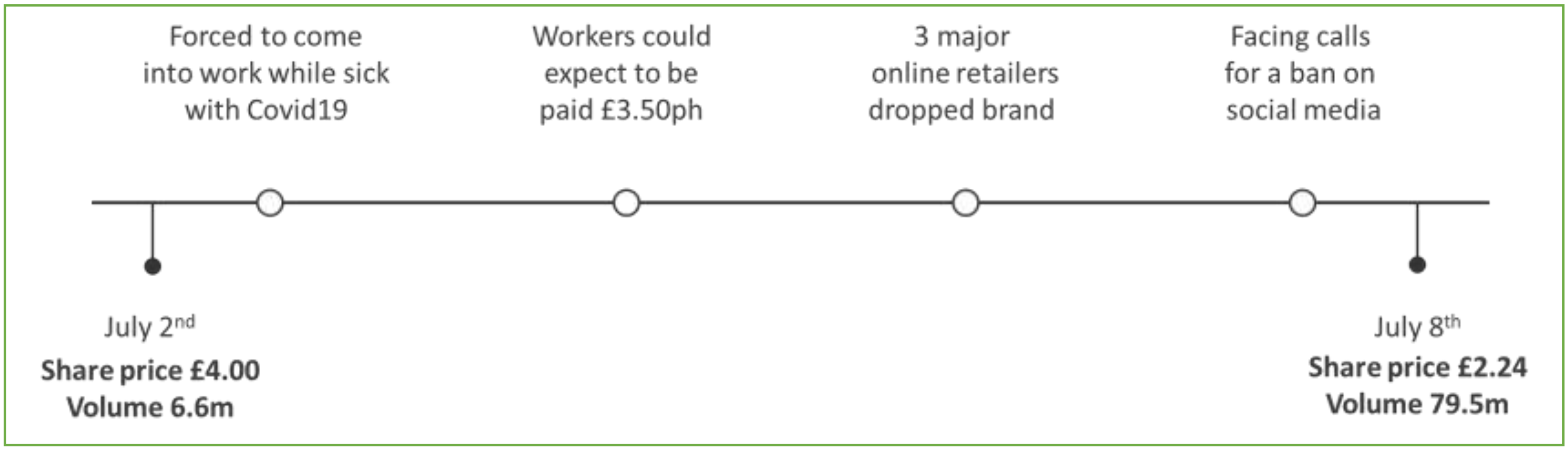
UK PLC, with the support of government, will make a case for a levelled playing field with the PE community and/or the listed US market – seeking to create an environment where the UK can point to its newfound post-Brexit competitiveness.



Least likely outcome –would require expressed political will

And the final thought?

The pay fairness movement will dominate the narrative. The brand damage that a low pay story may inflict will increase to out-weigh the investor/proxy agenda.



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Appendix

About David Ellis Associates

About David Ellis

David helps organisations with their strategic people issues, particularly during periods of disruption or transformation. He has built and led consulting businesses, latterly as a Big Four partner, for over 25 years. His deep expertise lies in the creation of reward and broader people strategy to support business success.

To bring that to life a little, David spends much of time engaged in:

- Executive compensation consulting for listed, private, publicly owned or mutual type entities and anything in between.
- Strategic reward reviews for larger private or listed organisations – looking at pay and grading, job evaluation and the cascade of reward strategies throughout a business.
- Helping founders/ majority shareholders/ family business owners pay senior professional management teams. Essentially, brokering a deal between the two parties to reach a happy medium of upside versus protecting the business for the long term.
- Management Incentive Plan and second tier management equity and incentive arrangements for PE backed portfolio companies. And designing similar arrangements for corporates who desire a PE styled returns model for a new acquisition.

About David Ellis

- Transactions – including retention arrangements, the treatment of variable pay and equity arrangements on a deal and any related investment and exit terms, harmonisation of conditions and post deal incentivisation.
- Performance management systems and processes including linkages to reward, learning and talent strategies.
- The role of wellbeing strategies in a modern employee value proposition and the move from generic benefits policies to a focus on delivering wellbeing to support an organisation's purpose, culture and values.

Does David have a USP? With experience comes breadth. Which means he is generally called in to address board level questions or concerns that require a clear early steer on likely direction of travel incorporating the effect of tax, accounting, “the market”, the global horizon, an understanding of the bear traps, what would be reasonable or not on the facts and how to deliver a project to take that big picture view through to conclusion.

Specialties: reward, share plans, employee experience, performance management, transactions, communication, executive compensation, governance, future of work

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