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Directors' remuneration in FTSE 100 companies – the story of the 2015 AGM season so far

Initial findings and the reaction of shareholders

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June 2015

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Remuneration strategy conference (12 October 2015)
Join us at our annual conference where we will be looking back at 2015 and discussing how the world of executive remuneration will look in 2016. The conference will take place at our offices at 2 New Street Square. Registration for the conference will open at **www.deloitte.co.uk/events** in the summer.

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Directors' remuneration in FTSE 100 and 250 companies
Each year we produce reports on directors' remuneration in FTSE 100 companies and FTSE 250 companies. These reports allow us to focus specifically on the different remuneration practices and issues faced by these two groups of companies. The reports provide detailed analyses of basic salary, salary increases, annual bonus payments and details of annual and long term incentive design, pensions, notice periods, recruitment and termination arrangements and other aspects of remuneration policy. The reports will be available in the autumn.

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Introduction

The second year of reporting under the new disclosure regulations is now in full swing and over two-thirds of FTSE 100 companies have published their directors' remuneration report so far in the 2015 AGM season. This represents companies with financial years ending on or after 30 September 2014 up to and including those with years ending in January 2015. Over 80% of these companies have already held their 2015 AGM. In this review we focus on how shareholders are responding to the second year of reporting under the new regulations and we also include some preliminary findings from our main report on directors' remuneration in FTSE 100 companies, which will be published in the autumn.

Over 80% of companies made no amendment to the previously approved remuneration policy and shareholders have been asked to vote on the annual remuneration report only.

Now is therefore a good time to review the season so far. There has been no let-up in the media interest in directors' remuneration and, as might be expected, there has again been a focus on a small number of high profile cases where shareholders have voiced concerns. However, the votes from the AGMs taking place so far this year indicate that overall there has been a slightly higher level of support for the remuneration report than last year. Although the median vote in favour is slightly lower at 96% so far this year, compared with 97% last year, more companies have received a vote of more than 90% in favour than last year.

It is also interesting to see that fewer companies are receiving a vote at the lower end of the spectrum, particularly in the larger companies. Only four FTSE 100 companies have received less than 80% of votes in favour of the remuneration report so far this year compared with eight at the same time last year, increasing to ten by the end of the year. In the top 30 companies only one company has so far received less than 80% of votes in favour of the remuneration report compared with five at the same time last year. Only one company has so far received a vote against the remuneration report.

In three of the four companies receiving less than 80% support for the report, the key issue for shareholders was the recruitment arrangements put in place for newly appointed directors. Recruitment arrangements have also caused concerns in other companies albeit to a lesser degree. The focus has been on buy-out arrangements but the size of the overall package has also been an issue. For the company receiving a vote against the report, the arrangements have been modified to address shareholder concerns via a statement issued at the time of the publication of the votes.

This sends a very clear message to companies that although an approved policy is in place, the way in which the policy is implemented may be contrary to shareholder expectations and may result in a significant vote against the report. To avoid this situation, the remuneration committee may want to consider drawing up the parameters of implementation in advance of any potential board appointment to ensure there is clarity right from the beginning of the recruitment process.

In other companies where there have been low levels of support the key issues are most often those we have seen raised many times over recent years: high salary increases and the lack of a clear link between performance and bonus payouts demonstrated by clear disclosure of performance targets.

Only one in five companies reporting so far this year has sought approval of a revised remuneration policy. For the most part this was the result of a planned review of remuneration arrangements and in most of these companies the revised policy includes either a new long term plan, or revisions to the existing plan. Where new plans have been put to shareholders for approval they have typically received a high level of support.

The main impetus behind these changes appears to be the simplification of current arrangements, most often by removing a deferred bonus matching plan. This change may include increasing the maximum award levels to compensate for the removal of awards under other plans, sometimes resulting in an overall lower long term incentive potential. Where new plans have been introduced, or plans have been amended, companies have typically taken the opportunity to introduce other best practice features including further holding periods for vested shares, increasing shareholding requirements and ensuring that clawback and malus provisions are in line with the revised Corporate Governance Code. This response to shareholder pressure is reflected in the overall voting recommendations and outcomes. The median level of votes in favour of the remuneration policy is also 96% so far this year and we have not yet seen a vote against the remuneration policy of a FTSE 100 company in the 2014 or 2015 season.

Most companies continue to receive a high level of support from shareholders for the remuneration report.

Shareholder reaction

At the time of writing the two biggest proxy voting services (The Investment Association's Institutional Voting Information Service (IVIS) and the proxy voting service of Institutional Shareholder Services (ISS)) have issued reports on 60 FTSE 100 companies with AGMs in 2015.[1] So far in 2015 the Investment Association has raised concerns in relation to the annual remuneration (implementation) report in more companies than last year. ISS has raised slightly fewer issues this year, made fewer recommendations to vote against and more unqualified recommendations to vote for the remuneration report.

The annual remuneration report

So far in 2015 for FTSE 100 companies:

- The Investment Association has raised serious areas of concern in only one company.
- No particular areas of concern have been raised by the Investment Association in just over half of companies, compared with two thirds in 2014.
- ISS has recommended a vote against the remuneration report of four companies so far, which is lower than last year.
- 35% of companies received an unqualified recommendation to vote for the remuneration report from ISS, which is slightly higher than last year. The top 30 companies received a similar number of unqualified recommendations to vote for.

Almost one in five FTSE 100 companies have sought shareholder approval for a revised remuneration policy report to date in 2015. In most cases this has been in order to implement changes to their executive remuneration structure following a detailed policy review.

The policy report

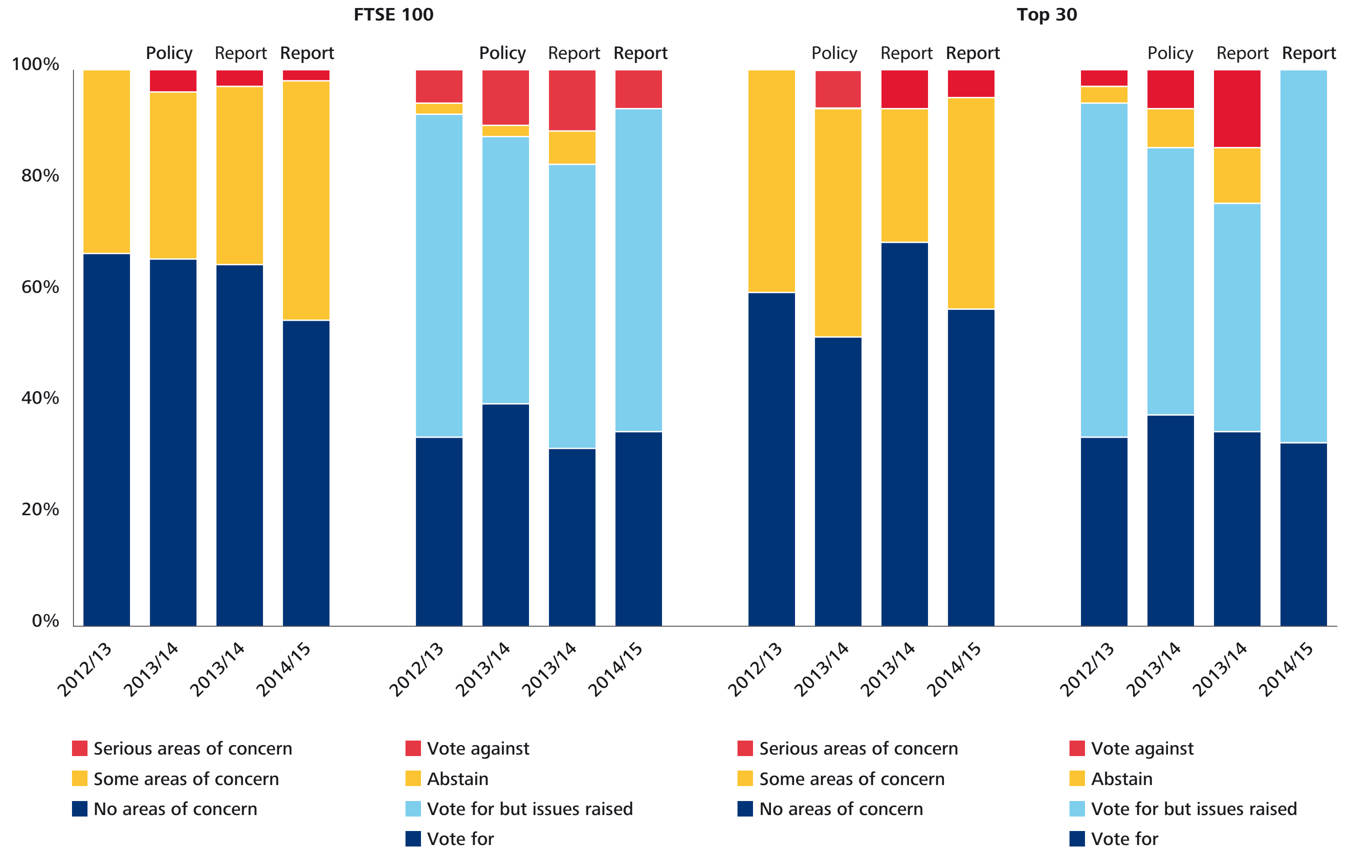
So far in 2015 for the 11 UK-incorporated FTSE 100 companies submitting a revised policy for shareholder approval:

- The Investment Association has not raised any serious areas of concern and has given an amber coding to only one company.
- ISS has not recommended a vote against or an abstention for any company.
- ISS has given five companies an unqualified recommendation to vote for the policy report with some issues raised in the other six companies.

The chart opposite illustrates the voting recommendations in the last three years. This demonstrates that there is a difference between the ISS voting recommendations this year compared with last year, with more companies receiving a qualified recommendation to vote for the remuneration report, rather than an against or an abstention. This is particularly noticeable in the top 30 companies. Conversely, IVIS has raised issues in more FTSE 100 and top 30 companies this year (just over 40%) compared with last year (around 30%).

1 Following the merger of the ABI's Investment Affairs division with the IMA in June 2014, IVIS is now part of The Investment Association

Voting recommendations in the last three years



How has this translated into voting outcomes?

So far, in 2015 the level of shareholder support for the remuneration report is similar to, and in fact slightly higher than, previous years. In 2014 79% of FTSE 100 companies received more than 90% of votes in favour of the directors' remuneration report. To date in 2015, 82% of FTSE 100 companies received more than 90% of votes in favour of the remuneration report.

The focus of shareholders continues to be on the largest companies and as in 2014 fewer top 30 companies (72%) received more than 90% of votes in favour of the remuneration report compared with the FTSE 100 generally (82%).

The high level of support for the remuneration reports can be in part attributed to the amount of time and effort companies expended last year in reviewing and developing the remuneration policy to ensure that it was appropriate for the next three years, and consulting with shareholders in drafting both the policy and new style remuneration reports to ensure that they were clear and compliant.

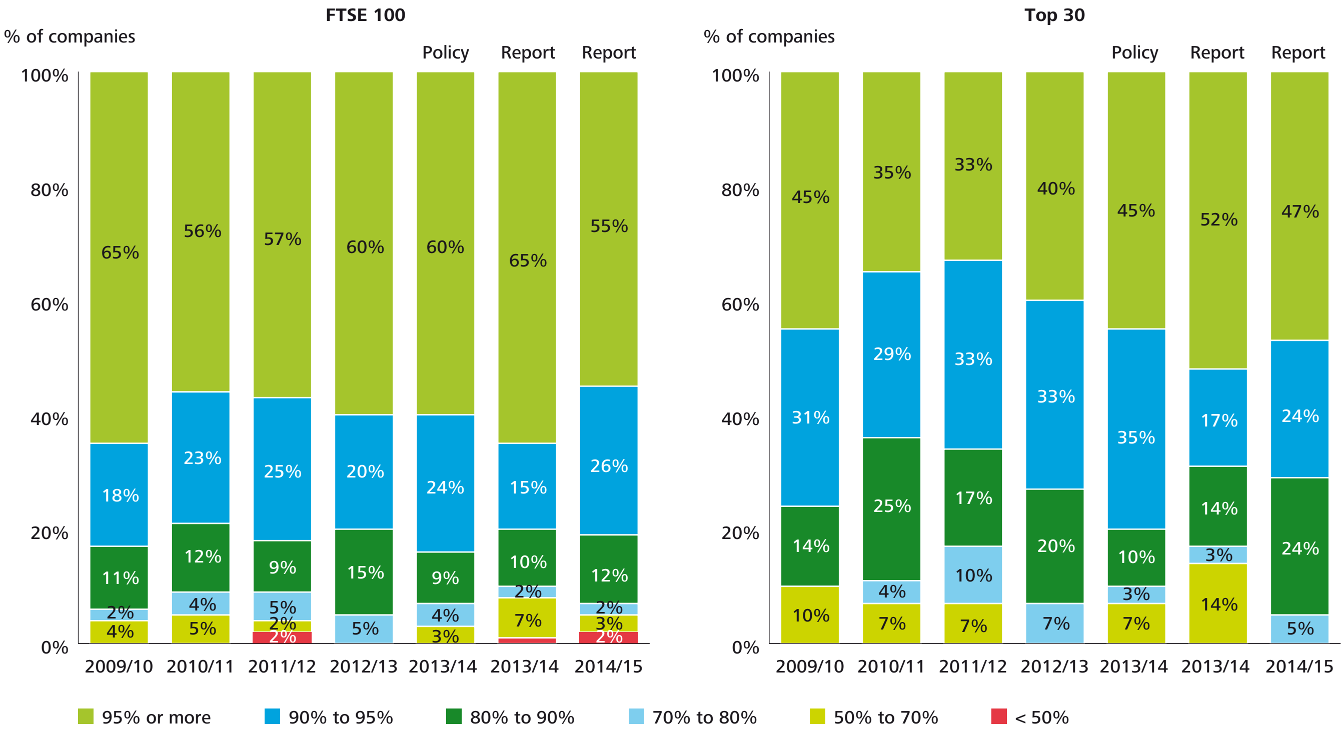
82% of FTSE 100 companies have so far received more than 90% of votes in favour of the remuneration report.

Support for the remuneration report has been generally lower in the largest companies.

We are still seeing shareholders take a strong position where practices are not considered to be in line with best practice and this is evident at the lower end of the voting spectrum. Whereas no FTSE 100 company received less than 70% of votes in favour of the directors' remuneration report in 2013, five companies received less than 70% of votes in favour in 2014 and so far, in 2015, three FTSE 100 companies received less than 70% of votes in favour, with one of these companies receiving a vote against the report as noted above. In these three companies recruitment arrangements were raised as key areas of concern by shareholders. None of these three companies are in the top 30.

The following chart highlights these trends and also shows patterns in shareholder voting over the past five years. The charts illustrate that the level of support for the remuneration report is generally higher this year, following a general decrease, albeit not that significant, over the preceding four years.

Proportion of votes in favour over the past five years

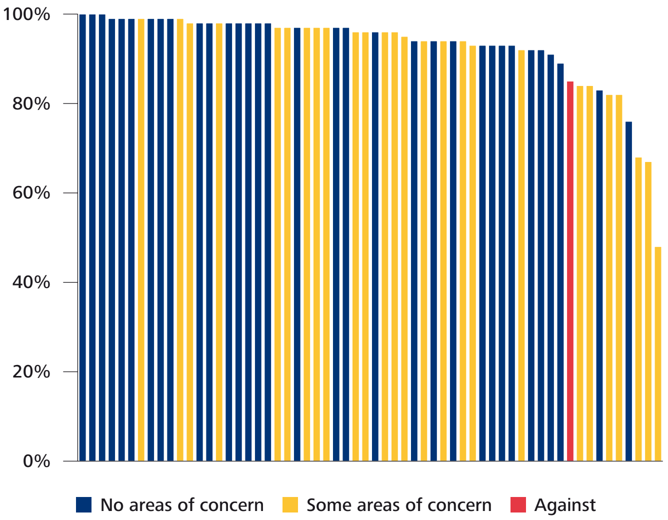


Note: Due to the sample size the 2% of companies with a vote against the report in 2015 represents only one company.

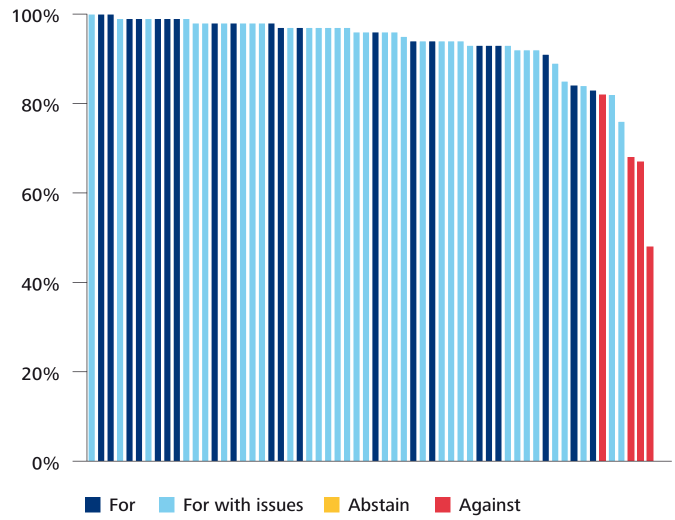
The following charts illustrate the proportion of shareholders voting in favour for each company and how this relates to the colour coded IVIS reports from the Investment Association and to the proxy voting recommendations of ISS. As we have noted in previous years we see a high correlation between the voting recommendations from ISS and the voting outcome. Many US shareholders will automatically follow ISS recommendations and companies with a significant US shareholding may want to take note of this.

FTSE 100 proportion of votes in favour of the annual remuneration report for each company in 2015
(Includes meetings held up to the end of May 2015)

% votes in favour **Investment Association IVIS colour code**

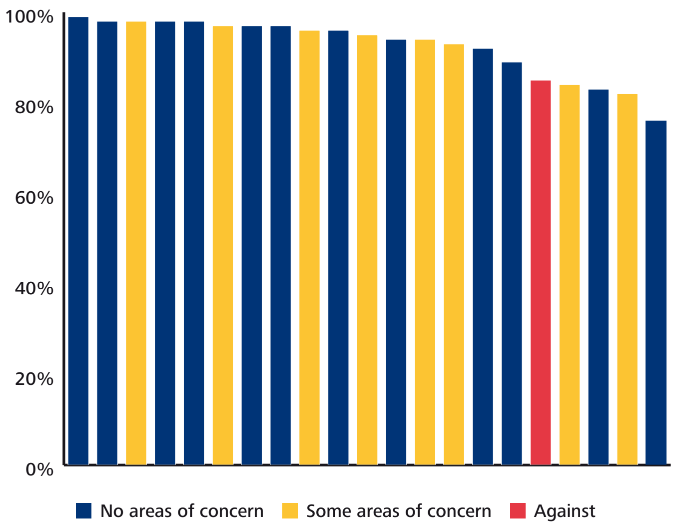


% votes in favour **ISS Voting recommendations**

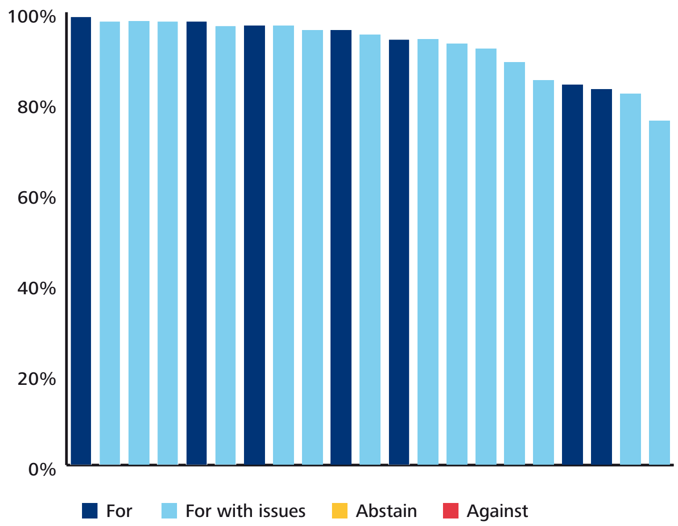


Top 30 companies proportion of votes in favour of the annual remuneration report for each company in 2015
(Includes meetings held up to the end of May 2015)

% votes in favour **Investment Association IVIS colour code**



% votes in favour **ISS Voting recommendations**



What are the key issues shareholders are likely to be concerned about?

As discussed in the introduction, shareholders are clearly ready to register their concerns over the way in which remuneration policies are being implemented, particularly in relation to the recruitment arrangements for new board appointments. In all three of the companies receiving less than 70% of votes in favour of the remuneration report the reason for the vote against was primarily the recruitment package for a new appointment, focusing particularly on the buy-out arrangements.

Typically there will be a number of factors contributing to a vote against recommendation from ISS or a red/amber coding from IVIS. In respect of the advisory vote on the remuneration report by far the most common issues raised again this year are the level of salary increases and the lack of retrospective disclosure of bonus targets, particularly where the bonus pay outs have been high. The complexity of arrangements has been raised as an issue contributing to an amber coding this year.

We have summarised some of the main issues raised in Investment Association reports coded red or amber, and ISS reports with a vote against recommendation below:

The annual remuneration report

- Recruitment arrangements.
- Salary increases.
- Lack of disclosure of performance measures and particularly retrospective bonus targets.
- Overall quantum.
- Link between pay and performance.
- The complexity of the remuneration arrangements.

Service contracts

In February 2015 Old Mutual Global Investors announced that it expected UK companies to reduce directors' service contracts to a notice period "substantially below 12 months" by March 2016. It is too early to say whether this position will receive broader support from other investors. So far in 2015 we have not seen any evidence of companies moving towards shorter notice periods. This may in part be because this would constitute a policy change and most companies have not revised their policy this year.

Recruitment arrangements are still a key issue for shareholders despite companies having an approved policy in place.

Disclosure and remuneration trends in FTSE 100 companies

As noted above, in our preliminary analyses of the remuneration disclosures, policies and practices in FTSE 100 companies we are seeing a continuation of the key trends that we saw emerging last year.

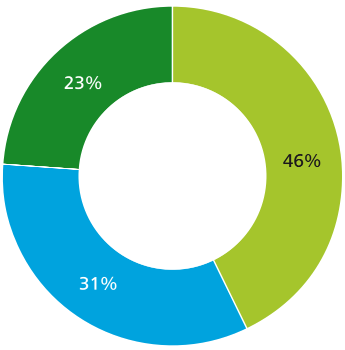
Remuneration policy – second year

- Around 80% of FTSE 100 companies have not sought shareholder approval of a new policy in 2015.
- Of those companies:
  - 42% included the full policy report again this year
  - 53% included a summary only
  - Three companies did not include any details of the approved policy
  - 41% updated the scenario charts
  - 53% did not include the scenario charts at all.
- Of the nine FTSE 100 companies that issued clarification statements last year, after publication of the directors' remuneration report, half have incorporated that statement into their policy this year.

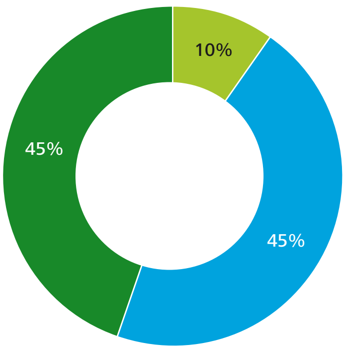
Annual bonus disclosure

- The lack of disclosure in relation to bonus pay outs has again been one of the key issues raised by shareholders during the 2015 AGM season, although the level of disclosure has improved since last year.
- 95% of companies retrospectively disclose the bonus measures although where these are non-financial in nature specific details are not always given.
- Around 90% of companies disclose the weightings that apply to these measures, up from 70% in 2014.
- Almost half provide full details of financial targets with around a third providing partial disclosure. Where the plan includes non-financial measures just over half give some indication of the targets, although few give specific details.
- Even where the actual targets are not disclosed, the majority of companies are providing details of the degree to which the targets were achieved though the majority still only provide partial details.
- The following charts illustrate the extent of these disclosures:

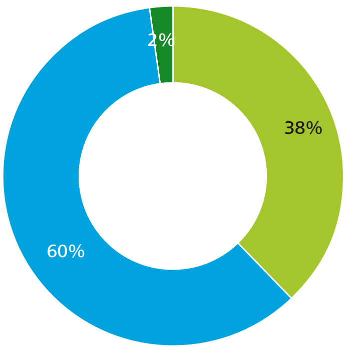
Actual financial targets disclosed retrospectively



Actual non-financial targets disclosed retrospectively



Extent to which targets achieved disclosed retrospectively



In full | Partially | Not disclosed

- Companies continue not to prospectively disclose bonus performance targets on the grounds that they are commercially sensitive. However most companies fully disclose the financial performance measures and, where the plan includes non-financial measures, the measures used are disclosed in just over half of the companies. Around two thirds of companies also disclose the relative weighting of each measure.

Clawback and malus

- Following the change to the UK Corporate Governance Code (which takes effect for financial years ending in 2015) many companies have reviewed their clawback and malus provisions. Of those companies publishing their reports so far in 2015, around 85% of FTSE 100 companies are already fully compliant with the Code and have provisions in place to recover sums paid and withhold unvested awards under all their incentive plans.

- Apart from a couple of exceptions the remaining companies are partially compliant and most of these specifically note that they intend to strengthen their provisions in future.

Longer time horizons

- Shareholders have continued to apply pressure to incorporate longer time horizons in long terms plans and the number of companies where the performance share plan incorporates a further holding period following the end of the performance period has continued to increase. At least nine companies reporting so far this year have introduced this feature.

- Over half of all performance share plans now include a further holding period for at least part of the award. Last year around one in three plans had this feature.

- Almost 60% of plans now incorporate time horizons longer than three years for at least part of the award, either in the form of longer performance periods or further holding periods.

- There are now 40% of performance share plans where participants will not receive any of the shares vesting before the fifth anniversary of the grant of the award. This has increased from around a quarter of plans last year.

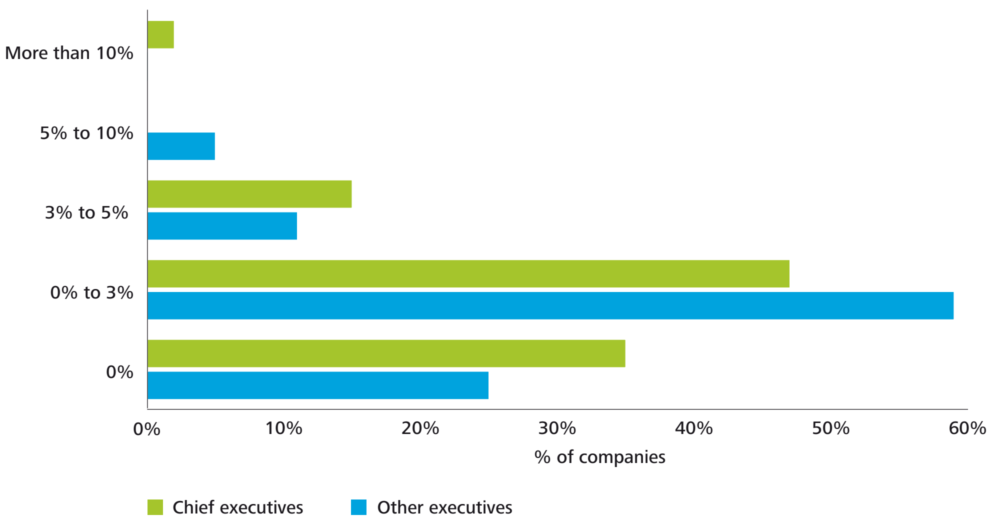
Salary increases

- 90% of FTSE 100 companies have disclosed salary information for 2015. The median salary increase is around 2.2%, which is similar to last year (2.5%).

- Around a third of companies are not increasing the salaries of executive directors in 2015 which is slightly less than last year.

- The following chart illustrates the range of salary increases given to the chief executive and other executive directors so far in 2015. These increases are based on the same individual performing the same role and therefore exclude any higher than usual increases given as a result of a change in role or where the increase reflects the development of an individual recently appointed to a role. A very small number of companies have given increases in excess of 5%; for the most part these are the result of a market re-alignment and are fully explained.

2015 salary increases to executive directors



- Of the companies where data on salary increases was disclosed and relevant (i.e. not as a result of a change in incumbent or a change to the role) over the three year period 2013 – 2015, most companies have awarded an increase in at least two of the three years:

  – Almost half of these companies gave a salary increase to executive directors in each of the three years

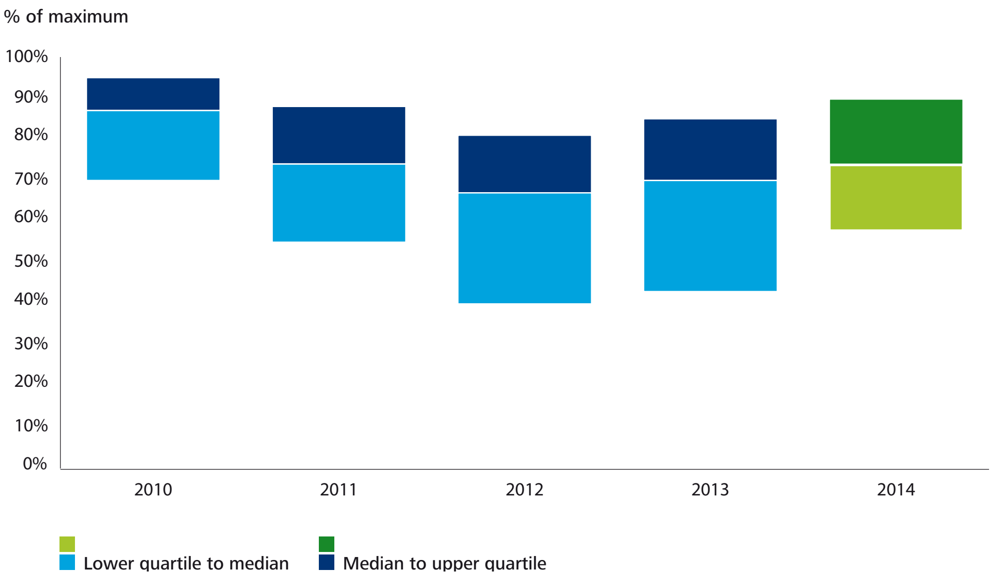
  – Over a quarter gave an increase in two out of the three years

  – Only 12% have given no increase for three consecutive years and 12% gave an increase in only one of the three years.

Annual bonus pay outs

- Bonuses paid so far in respect of performance in 2014 appear to be just slightly higher than those paid last year. The median bonus pay out is 73% of maximum, or around 120% of salary, compared with 70% of maximum last year.
- 3% of companies (8% last year) have made no bonus payment to executive directors in respect of 2014 while 10% of companies (7% last year) have paid the maximum bonus.
- The following chart illustrates the range of bonuses paid to executive directors over the last five years.

Bonus pay outs in the last five years – % of maximum



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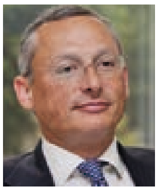

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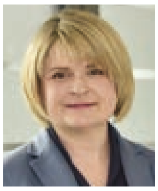

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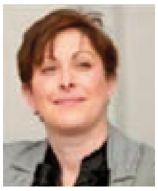

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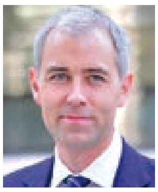

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