

LENS ON:

Directors' Remuneration Policy drafting

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In 2023, around 50% of FTSE350 companies will be required to obtain shareholder approval for their Directors' Remuneration Policy ('Policy'). This provides an opportune time to make sure the remuneration framework effectively supports business strategy, rewards for delivery of long-term goals, retains key personnel and reinforces stakeholder alignment.

A substantial amount of time is often spent on strategic changes, such as evaluating the operation of variable incentives and performance metrics, and reviewing alignment to governance and investor expectations. However, it is also key that the Policy wording itself is drafted such that it provides sufficient flexibility in its operation, to enable the handling of unforeseen circumstances over its lifetime.

Areas to review in the Policy drafting include:

Is there sufficient flexibility to make salary increases outside the annual salary review?

The majority of companies set an expectation that salaries are reviewed annually, but the Policy wording needs to be broader. Wording such as 'salaries are *typically* reviewed on [date]' provides sufficient flexibility to adjust salaries at any time.

Can the performance metrics be altered for future award cycles?

There is a requirement to describe the incentive metrics used in the Policy table, however this should be in fairly broad terms. Careful drafting is required to ensure sufficient flexibility is included to change measures and weightings for future award cycles. Wording such as 'up to 20% of the bonus will be subject to non-financial measures' and '*the Committee has discretion to set alternative performance measures and/or weightings*' is helpful.

Is the Remuneration Committee able to adjust the formulaic outcome for both short- and long-term incentives?

Many policies include provisions for the Remuneration Committee to adjust the formulaic outcome if vesting is not appropriate in the prevailing circumstances for short-term incentive awards but not for long-term incentives (and vice versa). Consideration should be given to make sure the provisions cover all incentives, even if the Committee considers it to be less likely to apply its discretion to the long-term incentives. Furthermore, it may also be appropriate to add in the drafting that '*any upward application of discretion would be only after consultation with shareholders*' to give comfort to shareholders that their voice will be considered in such circumstances.

Is the termination treatment sufficiently clear?

The Policy drafting needs to summarise how pay elements are handled in the event of an executive leaving employment. However, Ellason's review suggests many FTSE companies fail to provide sufficiently clear disclosure for all the different stages of an incentive. For example, the disclosure should make it clear how deferred bonuses, and vested LTIP awards held in a post-vest holding period, are treated as the leaver provisions are generally significantly more benign than for unvested awards which have yet to complete their performance period.

Furthermore, IVIS will issue an automatic amber top where companies do not explicitly state in the Policy that bonuses are payable only to good leavers, so this treatment needs to be considered and disclosed.

Does the Policy accurately reflect incentive plan rules, particularly malus and clawback provisions and Remuneration Committee discretions?

A review of Policy against formal plan documentation (and vice versa) ensures that the Remuneration Committee is able to rely on all provisions as necessary; if they are not accurately reflected in the Policy and/or the scheme rules they may not be enforceable. Shareholders now also expect malus and clawback trigger events to include corporate failure.

Does the Policy provide sufficient flexibility to hire?

The Policy will need to include disclosures around the remuneration package for new hires. Companies should ensure that this includes appropriate wording to permit the buyout of forfeited incentives, and the flexibility to use listing rule 9.4.2 to deliver the buyout awards in an appropriate structure.

Is there sufficient clarity around post-termination shareholding requirements?

Most FTSE companies have now extended their shareholding requirements beyond employment, in line with investor guidance. However, a key consideration going forward is the description in the Policy for how these are enforced (which few companies currently provide). A brief overview of the arrangement (e.g. use of a nominee account) will give shareholders comfort that the requirements are effective.

The Ellason team has in-depth experience of working with companies to draft remuneration policies which balance company requirements and shareholder expectations. Please do not hesitate to contact any of the Ellason team should you wish to discuss this issue further.