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Pandemic-led stewardship: the focus on executive pay

At RLAM we recognise the important role of stewardship, whether in preserving or improving returns, or for urging boards to be proactive in managing and leading on ESG opportunities and risks. Amidst the reckoning of a global pandemic, we recognised the need to shift our stewardship efforts and concentrate on areas most pressured by Covid-19. For 2020 this meant a greater emphasis on executive pay, both during company and engagement and when voting on behalf of our clients (see figure 1).

Engaging on pay

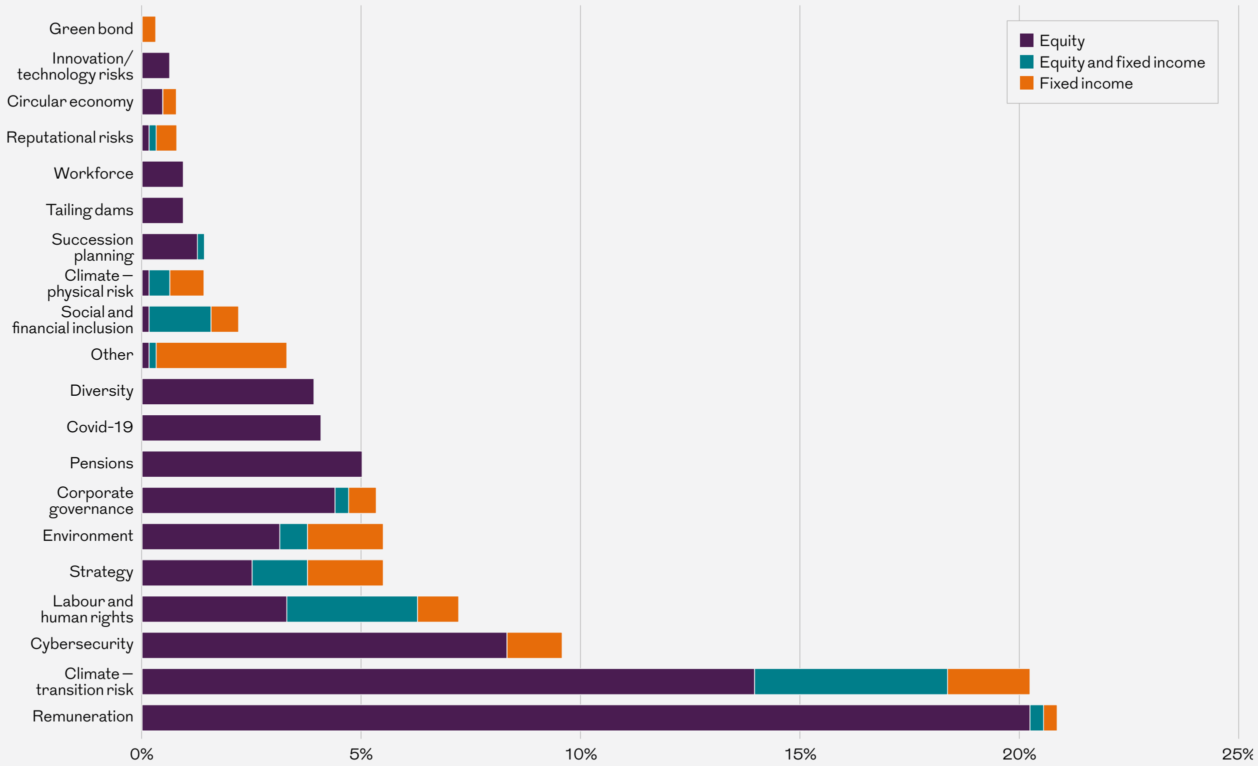
Typically, RLAM targets six key themes when engaging with portfolio companies and issuers, reviewing the themes every two years to amend priority areas. Themes must address the most material risks to our investments, align with our company's culture and values, and be important to our clients. In 2019, after reviewing academic evidence on engagement, assessing external research, and consulting RLAM employees and clients, we selected the six key themes from a long list of potential priorities. These were:

- Climate risk
- Financial and social inclusion
- Innovation technology and society
- Circular economy
- Governance
- Diversity

With the onset of the Covid-19, governance, and more specifically remunerations, became the focal

Figure 1: 2020 engagement activity

Engagement by asset class



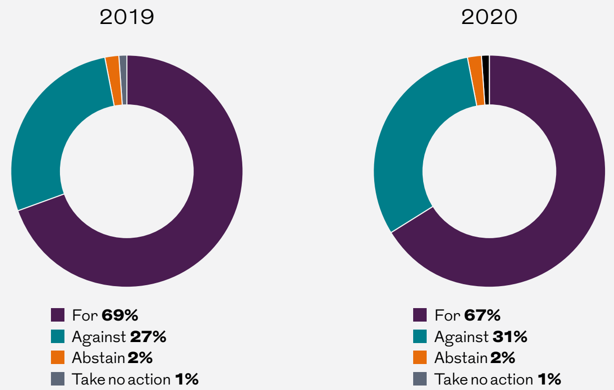
theme for engagement. Calls for the alignment of pay with the workforce and for improvements to other existing pay practices have been circulating for many years but really came to the fore in 2020 due to the pandemic.

As unemployment started to increase in early 2020 and the number of lower-level employees placed on furlough schemes grew, early engagement with firms to ensure that workers were being treated appropriately was essential. RLAM saw positive engagement results from firms including Rentokil and Dunelm, where board directors and executives took significant salary cuts, and bonuses and long-term incentives were suspended. Follow up engagements about plans to reinstate pay saw a renewed positive response from Dunelm, which provided a small cash bonus to all shop floor staff in recognition of their efforts in re-opening their shops. Head office employees did not receive their normal bonus, although a small share award was made in recognition of their hard work. Another company in the hospitality sector consulted us on similar plans in late 2020/early 2021.

We also had to engage with some more controversial remuneration proposals in 2020, such as with companies seeking to override their formula for bonuses or share awards and trying to ensure sizable executive pay-outs despite the negative impacts of Covid-19. In cases where shareholder dividends were cut, where redundancies were made, or where the government furlough scheme was in place, we pushed back.

One of the more interesting pay trends that emerged in 2020 surfaced due to the difficulty in setting performance targets under wildly different business conditions. Because of this, many firms proposed a change from performance based remuneration to Restricted Share Plans (RSP), which pay the contract holder according to the company's share price. While most of these engagements remain confidential at the time of writing, our responses have varied. Where we do not feel that there is a high degree of difficulty in setting targets, we have pushed companies to strengthen their proposals.

Figure 2: Executive remuneration votes



Figures are subject to rounding and therefore totals may not always equal 100%.

Case study

Wizz Air

The company was one of the first we saw following the initial lockdown in the UK to propose a remuneration vote for a financial period that had been impacted by the pandemic. As such this was a test case for how companies should and could respond, and our purpose when voting was to signal just what would be deemed acceptable to both shareholders and the general public.

The airline industry has been one of the most severely affected by Covid-19 and ongoing global travel restrictions. In line with decisions made by most other companies during lockdown, the CEO of Wizz Air voluntarily reduced his salary by 25% for the second half of March, and agreed to receive no salary for April 2020. For the period between May 2020 and the end of March 2021, he also agreed to a 15% salary reduction.

While we acknowledge the voluntary nature of these salary cuts, at the AGM we had serious concerns around the company's decision to adjust (and increase) the outcome of bonus awards. The decision was made to apply upwards discretion to the annual bonus, essentially removing the financial impact of the pandemic from the assessment of performance under these grants. We understood Wizz Air's rationale that the impact of the pandemic struck in the last month of the 12-month performance period of the annual bonus and wiped out the previous 11 months of good performance. However, the upwards discretion, which essentially ignored the negative effects of the global pandemic was not in our opinion appropriate, especially given the wider employee and shareholder experience during the months leading up to the AGM.

As a result, we decided to vote against the company's remuneration report at the AGM in July. 51.6% of shareholders also decided to oppose this resolution and voice their concerns with the arrangements.

Voting on pay

As the main proxy voting season in 2020 coincided with the first UK lockdown, we saw companies take sensible steps in foregoing salaries and suspending bonuses. Although voting season was slightly more complex and unpredictable than usual, it was in some ways quiet as firms postponed decisions on long-term strategic planning.

A large percentage of our active equity assets remain in UK listed companies, where we as a UK business have greater ability to engage and influence company behaviour. As such we focus our efforts around reviewing the executive remuneration of these companies, whether they are large or small, main market or AIM listed. Globally we voted against or abstained at 1155 out of a possible 3556 times, or 31% of the time on remuneration, around 4% more than the previous year (see figure 2). We wrote to these companies at the time of the AGM to express our concerns with the remuneration report and/or policy and invited them to engage with us further.

Walking the walk

As a member-owned business, RLAM has a natural alignment with our clients. We are not seeking to maximise quarterly returns to shareholders but are focused on building our business in the best long-term interests of our members. Remuneration for our people, including fund managers and analysts, is intimately tied to our successful delivery of better outcomes for our customers through a scorecard approach to bonus delivery, which considers a wide range of metrics. As the continued development of RLAM's responsible investment strategy is a key pillar of our strategic vision for 2025, our progress on responsible investment is also tracked through the RLAM Business Scorecard. This has a direct link to the calculation of discretionary bonuses for all staff, dependant on year-end outcome.

We evaluate our people's performance on both 'what' they deliver and 'how' they deliver it – paying particular focus to how they deliver good customer outcomes and demonstrate the Royal London values. Starting in 2021, our investment professionals will also have a specific performance goal relating to responsible investment and integrating ESG considerations into the investment process. The impact of ESG on investment risk should be considered for all investment decisions and documented. In addition, ESG and sustainability impacts of investment decisions should be understood with a view to minimising and/or mitigating those impacts in accordance with the objectives of the fund. This performance goal supplements existing remuneration incentives for investment specialists and the wider senior population, which are tied to the long-term financial performance of our funds.

RLAM's remuneration is structured in a way that incentivises our people to deliver the best outcomes for our customers over the short and long term while considering ESG risks and opportunities, and without taking excessive risk.

The views expressed are the author's own and do not constitute investment advice.

To find out more about our approach to stewardship and responsible investment and read our 2021 report visit rlam.co.uk/SRI

Contact us

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