Great Expectations: Hermes Joins Fray on UK Executive Pay

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Three publications over the last few weeks are particularly relevant for companies preparing their new remuneration policies for 2017 (including most of the FTSE100).

Hermes Investment Management recently published its "Remuneration principles: clarifying expectations". This is its first solo effort – it previously was part of a group of large investors who jointly published their remuneration principles in November 2013. We understand that a draft of the paper was sent to the chairs of remuneration committees in September, presumably to be timely for their deliberations about renewing their remuneration policies. Pretty radical stuff, this – the paper calls for a fundamental rethink of remuneration practices and a challenge to the level of executive pay packages. As we have seen before, "much simpler, more transparent and less-leveraged" awards are encouraged. The suggestion is even made of a move to paying nothing but entirely fixed remuneration, "based primarily on shareholdings, together with a cash salary similar to today's levels". The remuneration committee should be more accountable and its chair should:

- write annually to employees to explain the basis for the CEO's pay in the context of the company's and the individual's performance; and
- seek and take account of employee's views on directors' pay and report on this process in the remuneration report.

The other two releases were updates of existing guidelines.

The Investment Association updated its Principles of Remuneration to reflect issues arising over the 2016 AGM season on which we have previously reported. Amendments include:

- less reliance by remuneration committees on consultants;
- greater emphasis on sustainable business performance and designing structures which support the strategy of the company;
- retention of their personal shareholdings even after directors leave the company;
- a statement by the remuneration committee in the event of a (non-binding) vote of 20% or

more against the remuneration report (we note that in the 2016 AGM season, some FTSE100 companies commented, and even amended their practice on grants, in response to smaller votes against);

- a preference for outstanding awards to be rolled-over on a takeover, rather than become exercisable, and performance to date to be the determinant of the extent of early vesting; and
- guarding against windfall gains as a result of changes in share price (particularly relevant in these times of high share price volatility since the Brexit vote).

Institutional Shareholder Services (ISS) also updated its proxy voting guidelines, effective for meetings from 1 February 2017. In common with other guidelines, the amendments place increased emphasis on simplicity, long-termism, alignment with the company's objectives and ensuring that rewards are not excessive, along with support for "companies to consider pay models which do not fully align with the typical structure found in the UK market" (head above the parapet, anyone?). The head that should roll would be that of the chair of the remuneration committee, who should "be held directly accountable where major remuneration issues have been identified".

Plenty for remuneration committees to think about then, with the gauntlet thrown down for them to step up to the plate (if that isn't mixing metaphors too much). It remains to be seen how many companies will be brave enough to think outside the tried and tested remuneration box ….

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