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The story of the 2016 AGM season so far

Directors' remuneration in FTSE 100 companies – Initial findings and the reaction of shareholders

June 2016

The Deloitte Academy: Promoting excellence in the boardroom

We look forward to discussing further with you some of the challenges you will be facing over the next twelve months. Alternatively please contact any of the names listed on the back page if you would like to talk to us about any of these issues.

Remuneration strategy conference (6 October 2016)
Join us at our annual conference where we will be looking back at 2016 and discussing how the world of executive remuneration will look in 2017. 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 July.

Forthcoming reports and surveys

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.

Beyond the Board – Survey of remuneration for positions below the board
We would like to invite you to participate in our free survey of remuneration for the important roles that sit directly below the main board; a group of roles where reliable pay information is often hard to find. Participation in the survey will ensure that you receive up to date and high quality pay, benefit and incentive information for this group of employees at FTSE All Share companies. Data is treated confidentially and there is no subscription fee. We are currently in the process of collecting data for the 2016 survey and results will be published in November. Email executiveremuneration@deloitte.co.uk for further details on how to sign up.

Introduction

We are now well into the 2016 AGM season and the headlines on executive pay have been as relentless as ever. It is now four years since the 2012 'Shareholder Spring' and whereas for the most part the issues of that season related to a small number of high profile companies, this year there is a real sense that a much broader spectrum of FTSE 100 companies are facing a tough time from shareholders. So far 2016 is proving to be the toughest year since the introduction of the vote on directors' remuneration arrangements back in 2002. Over two thirds (70) of FTSE 100 companies have published their annual report so far in the 2016 reporting season and most of these companies have already held their 2016 AGM.[1] It is therefore a good time to take stock of the season so far and assess how shareholders are reacting to the remuneration arrangements being put forward for approval this year. We have also included some preliminary findings from our main report on directors' remuneration in FTSE 100 companies, which will be published in the Autumn.

Just nine companies have amended the approved remuneration policy and therefore shareholders have been asked to vote only on the annual remuneration report in almost 90% of companies. Where new policies have been introduced they have received mixed reactions from shareholders, with two companies receiving less than 80% of votes in favour[2] and the rest receiving votes in favour of 90% and above.

Our analysis of the voting on the annual remuneration report suggests that the 2016 season has been a bruising experience for some companies and challenging for many.

Two companies have so far received a vote against the report and one company just scraped through with a vote of 51% in favour. 10% of FTSE 100 companies have received less than 70% of shareholders votes in favour of the report compared with only 4% last year. 10% of the top 30 companies have also received less than 70% of votes in favour compared with last year where not one of these companies was in this position.

At the other end of the spectrum we are seeing the most significant change. Only 73% of FTSE 100 companies have, so far this year, received more than 90% of votes in favour which is the lowest this has been since the vote came into effect in 2002. Historically this has been more in the region of 80% to 84%. In the top 30 companies this is even more striking with only 57% of companies receiving more than 90% of votes in favour, compared with a more typical 65% to 75% of companies over the past few years.

The median vote in favour of the report across all FTSE 100 companies has remained relatively stable over recent years at 95% but in the top 30 companies it is 91% so far this year which is lower than in prior years (96% last year).

The voting so far demonstrates that shareholders are flexing their muscles over very specific issues and these issues can be broadly summarised as changes in quantum, termination and recruitment arrangements and the active use of remuneration committee discretion. Committees need to be aware that these can be sensitive issues and ensure that decisions are the result of robust and well considered decision making and that they are consulting with shareholders during this process.

1. This 2016 AGM season update is based on the constituents of the FTSE 100 index as at 1 June 2016 with financial years ending between 30 September 2015 and 3 March 2016. The analysis of remuneration trends includes 70 companies. The analysis of voting and proxy agency recommendations is based on companies with financial year ends after 30 September 2015 that were in the FTSE 100 at the time of their AGM and includes 60 companies.
2. The voting statistics quoted only include votes for and against and do not include abstentions.
3. Following the merger of the ABI's Investment Affairs division with the IMA in June 2014, IVIS is now part of The Investment Association.

Introduction (continued)

In the next few weeks we expect to see the final report from the Executive Remuneration Working Group on the simplification of executive pay. This is proving to be an interesting debate and one of the key messages from the interim report produced earlier this year was that arrangements should be more tailored to the needs of the business rather than the 'one size fits all' model which has been adopted by so many companies.

Next year we expect that at least two thirds of FTSE 100 companies will be seeking shareholder approval for a new policy. Many companies may take the opportunity to implement new arrangements as part of this process. It is worth noting that we have recently seen the first vote against the binding policy in a FTSE 250 company and remuneration committees may want to bear in mind that shareholders have now demonstrated that they are prepared to vote against the policy where there are serious concerns.

Introducing more bespoke arrangements requires better communication and understanding between companies, shareholders and proxy voting services. While companies need to clearly articulate the business case for any proposals, shareholders need to fully engage with the company and provide clear feedback in time for companies to modify the proposals where necessary. Active engagement needs to take place sufficiently in advance of the publication of the report and the shareholder meeting so that issues can be identified and informed decisions can be taken.

Any changes may not be welcomed by all shareholders and companies may need to accept that given the wide range of opinions from shareholders it will be difficult to meet all expectations. Lower votes may indeed become more commonplace as this process gets underway. But active engagement from all parties will certainly be required if the 2017 AGM season is to be less challenging than this one.

Only 73% of FTSE 100 companies, and 57% of the top 30 companies have, so far this year, received more than 90% of votes in favour of the remuneration report. This is significantly lower than the last few years.

So what are the biggest concerns of shareholders?

Increases in quantum

Decisions that lead to significant increases to executive directors' pay packages are a big concern for investors. Concerns include:

- Significant increases in variable incentive opportunity
- Substantial salary increases which have a knock-on effect on the overall size of the package
- Granting of exceptional awards

These issues are often exacerbated by targets which are lower than those set previously or are considered to be insufficiently stretching.

Of those companies receiving 'amber' or 'red' reports from the Investment Association or a recommendation to vote against, or abstain, from ISS, around half have cited issues around quantum.

Link between pay and performance

Investors are making it clear that they expect remuneration committees to set appropriately stretching targets and to exercise appropriate discretion in order to ensure that incentive outcomes and awards reflect the wider performance of the business and align with shareholder interests. Companies have faced a negative reaction for:

- Exercising discretion that results in higher payouts for executives when original targets have been missed
- Adjusting targets which has then resulted in larger payouts
- Failing to adjust large incentive awards and outcomes in the context of poor company performance.

Of those companies receiving 'amber' or 'red' reports from the Investment Association or a recommendation to vote against, or abstain, from ISS, around 40% have cited issues around pay for performance.

Pro-rating of incentives for leavers

Managing the remuneration arrangements of executive directors joining and leaving the company continues to be a highly sensitive area.

For a number of the companies receiving low remuneration votes so far in 2016, the key issue for investors is a lack of pro-rating of incentive awards for outgoing executives.

From a shareholder perspective this does not necessarily demonstrate an appropriate link between pay and performance.

Of those companies receiving 'amber' or 'red' reports from the Investment Association or a recommendation to vote against, or abstain, from ISS, issues around termination arrangements have been raised in four companies.

Retrospective bonus disclosure

Annual bonus disclosure was expected to be a hot topic in the 2016 season, following guidance from the Investment Association, which has proved to be the case.

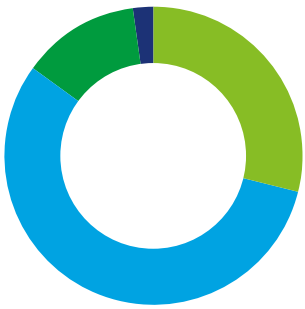
Most companies have responded to the calls for greater disclosure and we are seeing a clear shift in market practice.

- This year all companies have disclosed the retrospective bonus measures, compared with 95% disclosing last year, although where measures are non-financial in nature specific details are not always given.
- Just over 90% of companies disclose the weightings that apply to these measures, up from 70% in 2014.
- Around 70% of companies provide details of their financial targets. This has increased from last year when less than 50% of companies provided details. A further 17% of companies provide partial disclosure of financial targets.
- Where financial targets are not disclosed, or are only partially disclosed, over 50% of companies use commercial sensitivity to justify the poor disclosure. Almost 60% of companies providing poor or partial disclosure commit to fully disclosing targets next year or in the next two to three years.
- Around 70% of companies also give some indication of the targets for non-financial measures but 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.

Disclosure of retrospective financial targets

- No disclosure
- Representation of performance without disclosing actual targets
- Actual performance disclosed and partial disclosure of targets
- Full disclosure

Disclosure of retrospective non-financial targets



- No disclosure
- Representation of performance without disclosing actual targets
- Actual performance disclosed and partial disclosure of targets
- Full disclosure

However, lack of disclosure was still raised as an issue in almost one in five FTSE 100 companies, and while in itself would be unlikely to warrant a red report or a vote against recommendation, it has been a contributing factor to these reports and in a few companies has been the sole reason for an amber report from the Investment Association.

Disclosure of prospective targets

Companies continue not to disclose prospective bonus performance targets on the grounds that they are commercially sensitive. However most companies fully disclose the financial performance measures and almost 60% of companies fully disclose the non-financial performance measures. Over 80% of companies also disclose the relative weighting of each measure.

Recommendations from the proxy voting agencies

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 2016. 21 of these companies are ranked in the top 30. The reports and voting recommendations reflect the growing lack of support.

In total 50% of the companies reported on so far have received either an 'amber' or 'red' report from the Investment Association or a recommendation to vote against or abstain from ISS.

So far in 2015 the Investment Association has raised concerns in relation to the annual remuneration (implementation) report in slightly more companies than last year and has raised a greater number of serious concerns. ISS has generally raised slightly fewer issues this year, but so far has made slightly more recommendations to vote against or abstain.

The policy report

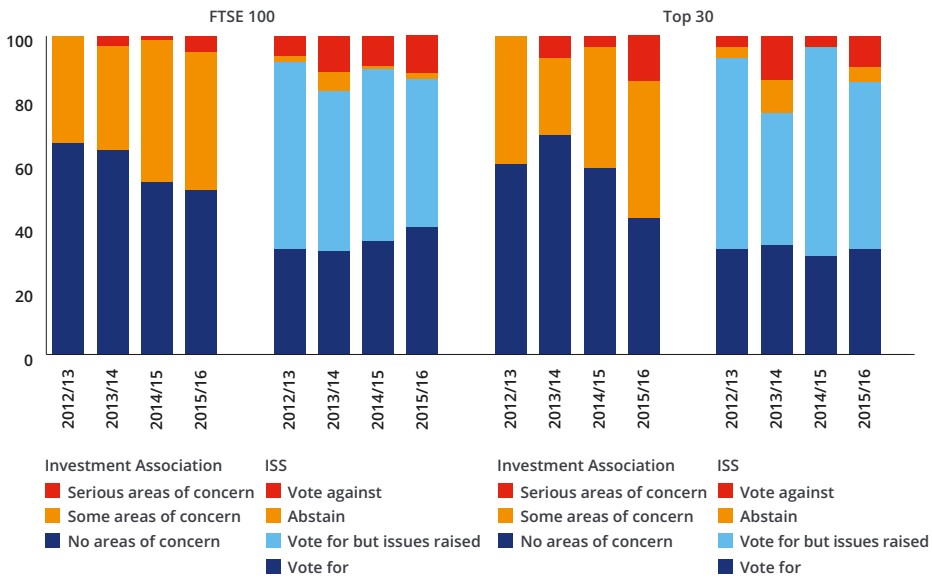
- Only around 15% of FTSE 100 companies have sought shareholder approval for a revised remuneration policy report to date in 2016.
- In four of these companies no issues were raised.
- Where issues were raised in relation to the new policy these were mainly related to the quantum of the package, the recruitment arrangements and where there was no post vesting holding period.

The annual remuneration report

- The Investment Association has raised serious areas of concern in three companies. These are all top 30 companies.
- The number of companies where no particular areas of concern have been raised by the Investment Association remains the same at around half of companies. However in the top 30 companies the number of companies where no concerns have been raised has decreased from around 60% to around 40%.
- ISS has recommended a vote against or abstain on the remuneration report of eight companies, representing 13% of the companies reported on so far, which is slightly higher than 10% last year. Three of these are in the top 30.
- 40% of companies have so far received an unqualified recommendation to vote for the remuneration report from ISS, which is slightly higher than last year. A third of the top 30 companies received an unqualified recommendation to vote for which is the same as last year.

The chart below illustrates the voting recommendations on the annual remuneration report in the last four years.

Voting recommendations for the annual remuneration report in the last four years (2016 includes proxy voting reports published for meetings held up to the end of May 2016)



How has this translated into voting outcomes?

As noted above, so far in 2016 the level of shareholder support for the remuneration report is generally lower than in recent years, particularly in the top 30 companies. The median vote for the report is 95% in FTSE 100 companies, marginally lower than the 96% – 97% we have seen in the last five years. In the top 30 companies the median vote so far this year is 91%, which is lower than at any time in the past ten years. In 2015 82% of FTSE 100 companies and 76% of the top 30 companies received more than 90% of votes in favour of the directors' remuneration report. To date in 2016, 73% of FTSE 100 companies and only 57% of the top 30 companies received more than 90% of votes in favour of the remuneration report.

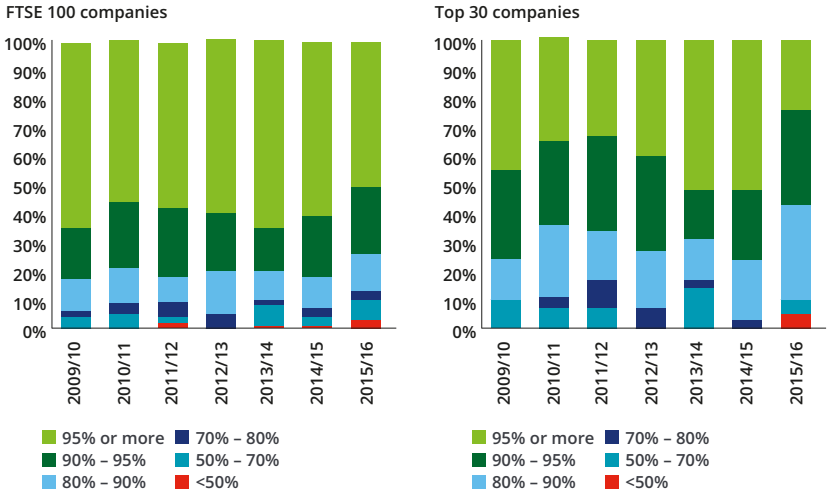
It is worth noting that almost 90% of FTSE 100 companies still have more than 80% of votes in favour of the report. Remuneration committees should not become complacent and where the number of votes in favour has decreased significantly it is important to engage with shareholders to identify, and where possible address, any areas of concern. However, given the spread of shareholder views and the increasing reliance on proxy voting agencies it may be that anything above an 80% vote in favour may be considered a good outcome.

It is also important to recognise that shareholders are taking 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. Over recent years votes of less than 70% in favour have been relatively rare, typically around the 4% or 5% level.

So far in 2016, seven FTSE 100 companies received less than 70% of votes in favour compared with only four over the whole of 2015. This includes the two companies receiving a vote against the report as noted above.

The overall level of support for the remuneration report is lower than at any time since 2010 in FTSE 100 companies and more noticeably in the top 30 companies.

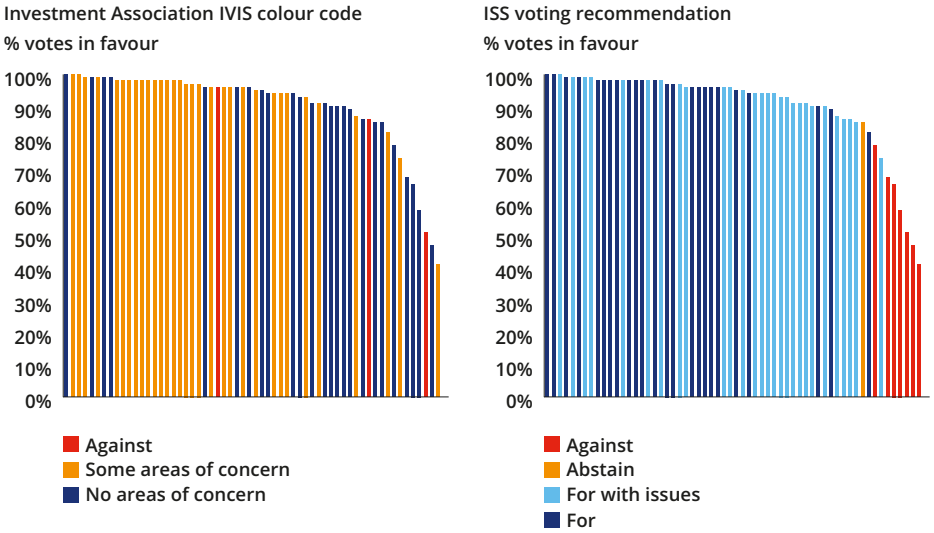
Proportion of votes in favour of the annual remuneration report over the past seven years (2016 includes meetings held up to the end of May 2016)



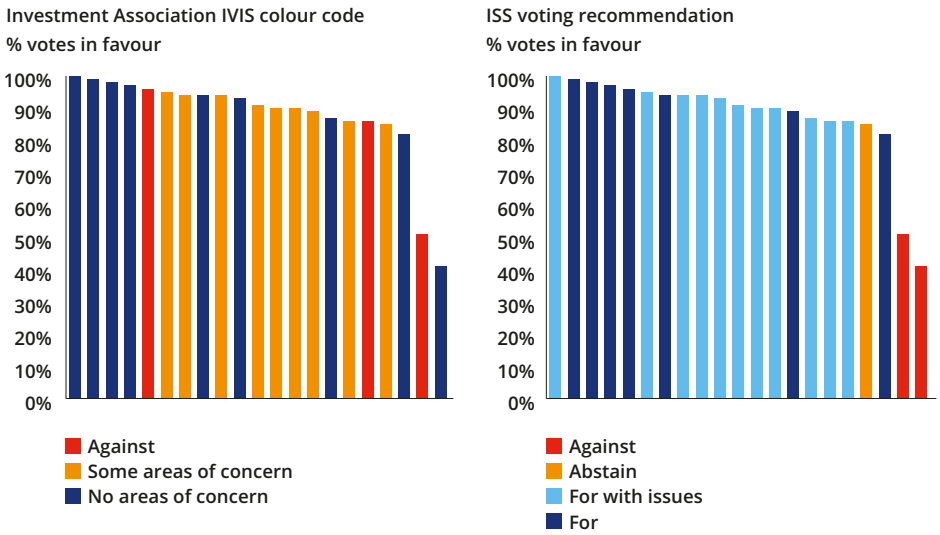
The following charts illustrate the proportion of shareholders voting in favour for each company and how this relates to the colour coded IVIS reports from the Investment Association and to the proxy voting recommendations of ISS.

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 2016
(2016 includes meetings held up to the end of May 2016)



Top 30 companies proportion of votes in favour of the annual remuneration report for each company in 2016
(2016 includes meetings held up to the end of May 2016)



Key remuneration trends in FTSE 100 companies

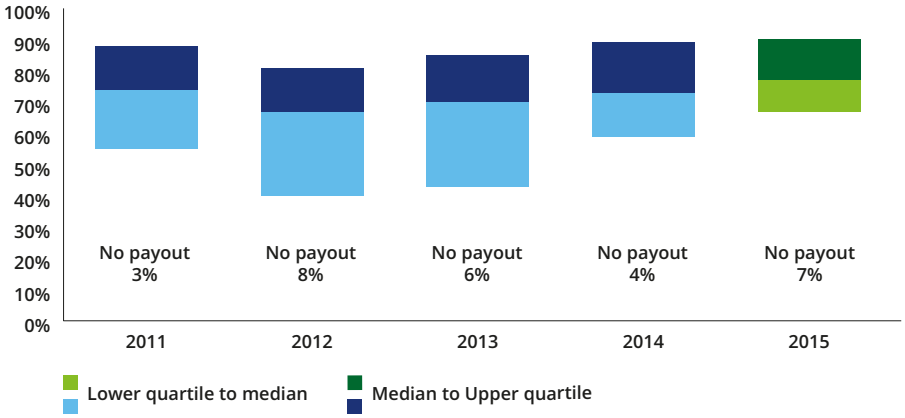
Salary increases

- Almost 90% of FTSE 100 companies reporting so far this year have disclosed the salaries taking effect in 2016.
- The median increase across all of these companies is 2% for all positions. In the top 30 companies the median increase is less than 1%.
- Almost a third of executive directors in FTSE 100 companies will receive no increase in 2016. This rises to 40% for the chief executive. In the top 30 companies half of all executive directors will receive no increase.
- Where increases have been given they are typically of less than 3%. Less than 15% of companies have given increases in excess of 3%.

Incentive plans

- Bonus payouts so far this year are higher than last year (see chart below). The median bonus payout is currently 77% of the maximum that may be paid (80% for the chief executive) compared with 73% last year.
- Only four companies have paid no bonus in respect of 2015.
- 14 companies (around 20% of those reporting so far this year) applied discretion to the bonus payout. In all but two companies this resulted in the payouts being decreased.
- Seven FTSE 100 companies have introduced new performance share plans so far this season. One of these measures performance over five years. Of the remaining six plans, five have an additional holding period.
- Of those companies reporting the vesting of 2013 awards so far this year, the median level of vesting is around 40% of the maximum award. Three companies applied discretion, decreasing the level of vesting in one company and increasing in the other.

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



Longer time horizons

- Shareholders continue to press for incentive plans to be operated over longer periods. The typical way companies have achieved this is to add a further holding period at the end of the performance period. Some companies have introduced longer performance periods and in some cases have incorporated both longer performance periods and further holding periods. At least six companies have so far introduced longer time horizons since last year.
- Around two thirds of performance share plans incorporate time horizons of more than three years for at least part of the award, either in the form of longer performance periods or further holding periods.
- 11 companies (representing 12% of performance share plans in operation) measure performance for at least part of the award over a period longer than three years. This has increased from nine companies last year.
- 55% of companies now include a further holding period, compared with 51% last year. In many cases the vested shares are released after two years but in some cases the shares may be released in instalments over a period following vesting.
- In 42% of plans participants will not receive any shares before the fifth anniversary of the award. This has not changed since last year.

Contacts

Stephen Cahill
020 7303 8801
scahill@deloitte.co.uk

Helen Beck
020 7007 8055
hebeck@deloitte.co.uk

William Cohen
020 7007 2952
wacohen@deliotte.co.uk

Sally Cooper
020 7007 2809
sgcooper@deloitte.co.uk

Nicki Demby
020 7303 0083
ndemby@deloitte.co.uk

Anita Grant
0118 322 2861
anigrant@deloitte.co.uk

Juliet Halfhead
0121 695 5684
jhalfhead@deloitte.co.uk

Nick Hipwell
020 7007 8647
nhipwell@deloitte.co.uk

Mitul Shah
020 7007 2368
mitulshah@deloitte.co.uk

John Cotton
020 7007 2345
jdcotton@deloitte.co.uk

David Cullington
020 7007 0899
dcullington@deloitte.co.uk

Clare Edwards
020 7007 1997
clareedwards@deloitte.co.uk

James Harris
020 7007 8818
jamesharris@deloitte.co.uk

Katie Kenny
020 7007 2162
katkenny@deloitte.co.uk

Dennis Patrickson
020 7007 1996
dpatrickson@deloitte.co.uk

Ali Sidat
020 7007 2818
asidat@deloitte.co.uk

Julie Swann
0121 695 5081
jswann@deloitte.co.uk

Shona Thomson
020 7303 4965
shthomson@deloitte.co.uk

Deloitte.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

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