EMEA Region

GLASS LEWIS

Approach to Executive Compensation in the Context of the COVID-19 Pandemic

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About Glass Lewis

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Our customers include the majority of the world's largest pension plans, mutual funds, and asset managers, collectively managing over $40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

Investors around the world depend on Glass Lewis' **Viewpoint** platform to manage their proxy voting, policy implementation, recordkeeping, and reporting. Our industry leading **Proxy Paper** product provides comprehensive environmental, social, and governance research and voting recommendations weeks ahead of voting deadlines. Public companies can also use our innovative **Report Feedback Statement** to deliver their opinion on our proxy research directly to the voting decision makers at every investor client in time for voting decisions to be made or changed.

The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

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Introduction

The COVID-19 pandemic has not changed Glass Lewis' approach to executive pay. We start from each company's specific circumstances, evaluating remuneration practices through the lens of pay and performance alignment, and the extent to which companies have been able to tie any program changes to this alignment going forward. It's a pragmatic, contextual approach that applies in good times and bad.

However, the landscape for issuers and investors has shifted markedly. The many uncertainties faced by companies and their shareholders highlight the need for effective pay programs. Strong linkages between pay and performance remain crucial despite market-wide disruptions and demonstrating this alignment to shareholders is all the more important. Moreover, the scope of topics to be considered in relation to executive pay is widening, with E&S issues drawing exponentially increased focus, and human capital management becoming particularly relevant during a time of global economic downturn.

Further, issuers would do well to consider that the pandemic has made executive pay a more salient issue for many investors. All companies, especially those who sought special support from governments or executed significant employment cuts, should consider the reputational risk associated with poor pay decisions, particularly quantum payouts. Even those companies who have managed to perform well during this time may face additional challenges in justifying high executive payouts to their shareholders.

Given the increased level of interest in public company pay decisions and related proxy voting recommendations, this document is intended to provide illustrative guidance on the intended application of Glass Lewis' existing policy approach to executive remuneration at companies in the EMEA region under various scenarios expected in the wake of the coronavirus pandemic.

Update: November 2021

We have updated this document to remove specific references to fiscal years in order to clarify that the guidance outlined in this document will continue to apply throughout the course of the COVID-19 pandemic, particularly for companies and industries that continue to be affected by the pandemic.

We would like to highlight that the guidance outlined in this document does not represent any type of temporary policy change on the part of Glass Lewis. Rather, it is intended to offer further insight into how common themes and considerations in relation to the pandemic are accounted for in our holistic assessment of companies' remuneration practices.

Pay-for-Performance Alignment Focus

Glass Lewis's approach to assessing the link between pay and performance for MEA companies has been traditionally based on an evaluation of year-on-year changes in variable pay outcomes, compared to year-on-year developments of a companies' results for the main financial indicators and of shareholders' experience, in terms of share price and dividends. This evaluation has always taken into account a comparative analysis of relevant market and industry peers as well as the perspective of local stakeholders.

While our approach remains holistic, aimed at accounting for the company's overall wellbeing and appropriateness of payouts in relation to peers, we will heighten our focus on the following considerations:

- ***Dividends***. Where a company cancelled, reduced or has not resumed the payment of dividends due to the ongoing crisis, to save liquidity and/or ensure the grant of government aids, we would expect executive pay to be somewhat affected. In this context, a company's dividend policy and payout ratio would be taken into account.
- ***Employees.*** Where a company had to undertake significant layoffs, furloughs or cuts in workforce salaries, we would expect this to be addressed in the remuneration report; in particular, we believe companies should explain how such measures were taken into account by the board when determining variable pay outcomes and salary adjustments for executives. In this context, we believe there should be consistency between changes in the yearly disbursements for employee pay and executive pay.
- ***Stakeholder Perspectives.*** Where relevant stakeholders, such as government agencies or local investor associations, publicly express concerns regarding a company's proposed payouts or pay policies, we believe it is incumbent on the company in question to provide a direct and compelling explanation of how it has accounted for those perspectives. As with all relevant rationales, we will only consider information that is included in public disclosures prepared for shareholder review.
- ***Key Financials.*** In addition to performance of the metrics included in the incentive plans, we may observe results against the company's other KPIs, including absolute and relative TSR, EBITDA, net profit, and historical year-on-year changes thereof. Public disclosure of recent guidance adjustments issued to the markets will be taken into account.
- ***Equity Grants and Share Price.*** When assessing the appropriateness of long-term incentive equity grants, we will scrutinise a company's disclosure around the determination of the grant value and the calculation of the number of shares to be granted. In particular, where share price has been significantly affected and has not at least partially recovered to pre-pandemic levels, we would expect a company to explicitly address the potential inflation of the final value of the award upon vesting, considering a scenario in which share price would have fully recovered – or increased according to pre-pandemic estimates - at the time of vesting. Should the potential for windfall gains on grants appear significant in terms of absolute and relative pay outcomes, we would expect a board to adjust the grant value accordingly, and/or implement adjustments to other elements of executives' pay in order to mitigate this effect.
- ***Diligent Intel.*** For companies in the UK and Europe, we compare realised pay and performance over the past 3+ years according to the main KPIs and relative to Glass Lewis' pre-defined peer groups hosted in the Diligent Intel platform. Where a company has provided exceptional disclosure of its peer group and rationale for their chosen peers, we may also compare peer against these peers using Diligent Intel's bespoke peer comparison tools.

Adjustments to Plans & Safeguards

Glass Lewis is generally opposed to discretionary adjustments to the terms of incentive plans, especially if such adjustments would affect outstanding awards that have already been granted. Similarly, we generally believe contingent macroeconomic situations, with short-term effects, should not represent a reason to amend the structure of a remuneration package or incentive plan.

While we will not depart from this perspective, we will assess one-off deviations from a remuneration policy on a case-by-case basis and we will maintain some flexibility in accepting certain limited deviations, should appropriate safeguards be in place.

- ***Target Adjustments.*** While continuing to oppose the adjustment of targets for ongoing plans, we believe the adjustment of targets for awards yet to be granted, aimed at reflecting an adjustment to the strategic goal communicated to the market for the relevant metric/s, to be generally reasonable. Nonetheless, considering the downward adjustment of the guidance communicated to investors and the impact of the pandemic on the financial and operational results of the company, we believe the board should somewhat limit future payouts deriving from the adjusted targets. In other words, we believe over-performance should be avoided and the adjustment of targets should not be aimed at guaranteeing a full and unaltered vesting opportunity when compared to prior years.
- ***Non-Financial Metrics & COVID-Specific Metrics.*** Should an annual bonus scheme already be partially based on the achievement of non-financial (individual or collective) goals set annually by the board, we would generally support the selection of a relevant and objective COVID-related target for this fiscal year or the next. However, we believe the use of this metric should not be aimed at ensuring full vesting and the relevant category of non-financial metrics should not be introduced ad-hoc to the bonus scheme.
- ***Long-Term Incentive Performance Period.*** Should a board resolve to exclude any fiscal year from the calculation of the final level of performance target achievement for outstanding long-term awards, we believe the value of the affected grant should be reduced proportionally.
- ***Retention Awards.*** While maintaining a low appetite for one-off retention awards, we will assess the grant of such payments on a case-by-case basis and retain some flexibility in accepting these awards where the company's standard incentive plans have yielded a nil payout. Furthermore, we may take into account the company's risk in terms of management turnover, as well as performance outcomes and pay arrangements for the company's peers. Ceteris paribus, the allocation of a limited one-off award would be preferable to the introduction of an additional incentive plan.

Holistic Look at Pay Outcomes

Ultimately, when assessing a board's decisions on executive remuneration, we will look at year-on-year variations in total pay and expect overall lower outcomes than pre-pandemic levels for all companies that continues to be affected by the crisis. This holistic view implies that our concerns about artificially higher outcomes deriving from one incentive element may be mitigated by lower outcomes on another element, as long as the final year-on-year variation in total remuneration appears adequate.

Although we do not expect any adjustments to base salaries, we believe boards should exercise their discretion to suspend foreseen salary increases, where appropriate. Additionally, while we recognise the forfeiture of a portion of base salary for a period of time represents a positive signal to the market, we find that this token may not be enough to guarantee an appropriate pay-for-performance connection at heavily affected companies.

Exclusion of Executives; Inclusion of Wider Workforce

The issues raised above related strictly to a company's executive directors (or "management board", in a two-tier governance structure). However, our concerns about remuneration adjustments would be largely mitigated should the board decide to exclude top executives from these measures or to expand the advantageous effects to below-board managers and employees. We will not heavily scrutinise one-off remuneration arrangements that positively affect exclusively below-board employees. Nevertheless, we expect any proposals to adjust equity plans for below-board employees to be accompanied by a strong and specific rationale.

Disclosure

As always, we believe any adjustment to remuneration should be supported by thorough disclosure detailing the reasons for and effects of such adjustments. In particular, we expect companies to explain how the performance of incentive metrics was affected by the crisis, what effect the proposed adjustment would have on the plan outcomes and why the adjustment is necessary, e.g. in terms of retention, exceptional efforts by the executive team, or good relative performance.

On the other hand, should the board resolve not to exercise its discretion where any of the above considerations would prompt a downward adjustment, we expect clear disclosure of the board's rationale for this decision.

Expectations for Unaffected Companies

In line with the principle of pay-for-performance, we do not expect companies to amend or deviate in any way from their regular remuneration policy if they have not suffered any negative impact from COVID in terms of financial and operational performance, shareholder returns and employee welfare.

Escalation to Other Proposals

While we will normally express our concerns about a disconnect between pay and performance in a vote on the remuneration report, in some markets such a vote may not be available on the ballot. As such, when necessary, we may escalate our concerns to the ratification of the board's acts or the (re-)election of the remuneration committee.

Similarly, should a vote on the remuneration policy be the only agenda item available in relation to executive pay, assuming our concerns would only relate to the company's remuneration decisions for prior fiscal years, we may support the proposal on the remuneration policy and escalate our concerns to the abovementioned proposals.

Final Thoughts

Glass Lewis' approach to executive pay has not changed. We will generally support proposals that effectively manage to align executive pay and performance, while also considering overall pay quantum, the quality of a company's disclosure, and its responsiveness to material shareholder concerns. The guidance above is not intended to be prescriptive: there are a variety of decisions that boards may take to be successful, with their appropriateness dependent on each company's specific circumstances. Our pragmatic, contextual approach provides us the flexibility to evaluate these compensation decisions even amid a global pandemic.

Regardless of a company's particular circumstances, the effects of the COVID-19 pandemic have been felt to some extent by issuers and investors alike. As such, the burden on issuers will be higher than ever to provide thorough disclosure that allows their stakeholders to understand and evaluate any compensation-related decisions.

We strongly encourage clients, issuers and other stakeholders to contact Glass Lewis to provide feedback or engage with us in response to this post. Join the conversation by emailing info@glasslewis.com.

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