KPMG

COVID-19
Leadership in executive pay

KPMG Board Leadership Centre

The impact of COVID-19 is putting nearly every facet of business to the test. While COVID-19 is first and foremost a public health emergency, boards have a role in showing leadership and empathy as they steer their organisations through the current phase of the crisis and the longer term. In particular, boards face another important test in terms of how they will deal with executive pay. Strong and decisive leadership here could engender support among shareholders and other stakeholders (employees, activists, proxy advisers and wider society), while failure to lead on these issues could have a much more serious long term impact on corporate reputation and trust.

We have highlighted below some of the key headline issues that we think Boards (and remuneration committees) should be thinking about over the coming weeks and months in relation to reward and incentive plans.

All of these issues are likely to be scrutinised by investors next year, so it is important for remuneration committees to consider them now. Engaging with directors, senior executives and shareholders early to decide on the appropriate ways forward and detailing the rationale as to how the committee arrived at its decisions will be crucial.

Points for remuneration committees to consider:

- Should 2020 vestings, payments and grants be reduced or deferred?
- Is salary reduction of relevance in the context of wider workforce sacrifices?
- Revisit your existing guidelines for the application of discretion and clawback to ensure they are robust
- Consider your messaging/communication and work closely with the management team to get this right
- Have one eye on the future and how today's decisions will be communicated to shareholders next year
- Consider whether costs can be reduced and savings made by reducing award sizes, transferring NICs and/or making more use of a tax-advantaged share scheme

Specific areas for review and consideration include:

Deferral of the payment of bonuses

If bonuses for the last financial year have not already been paid, the remuneration committee may wish to consider whether it is possible to defer the payment of any bonus until later in the year, or perhaps reduce the amount of any payment to the extent permitted. This may help with cash-flow and shareholders may view this as an appropriate response, particularly where head count has been reduced and employees placed on furlough.

Defer future grants

Remuneration committees may wish to consider adopting a '*wait-and-see*' approach and defer any grants (in whole or part) and the setting of performance conditions of any new awards until later in the year, or next year, when the outlook is clearer - provided that this is permitted under the rules of the relevant scheme.

Performance Conditions

In the light of the recent downturn in both share prices and economic activity, remuneration committees should carefully review and consider the terms of any performance condition applying to incentive plans and decide whether or not the performance conditions should be amended. Remuneration committees should be very cautious of the likely investor reaction to any adjustments or the exercise of discretion - and should also consider the wider context of the workforce in arriving at any decision.

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Determining the number of shares over which future awards are granted

If new share awards are granted in 2020 and award size is determined based on a percentage of salary, remuneration committees are advised to consider what share price should be used to determine the number of shares over which LTIPs and other share awards (including deferred share bonuses) are granted. In particular, should grant values be based on the current low share price or a pre-COVID-19 price? Investor bodies have made their views clear that where there are material share price reductions, award levels should be scaled back proportionately.

Caps on LTIP pay-outs are likely to be another feature which will give investors comfort that management will not benefit from any 'windfall' gains in the future.

Salary reductions

With discussions regarding workers being furloughed, we are already seeing some boards leading the way by agreeing to reductions in salary for a period of time. 'Sharing the pain' is an important principle in maintaining fairness across the workforce.

Share plan dilution issues

Under investor guidelines, usually, the number of shares issued or issuable in respect of awards granted under any employee share plan are limited, in a rolling ten-year period, to 10 percent of the issued ordinary share capital at any point in time.

In falling markets, this headroom is used up more quickly. Establishing an employee share ownership trust to satisfy awards with market purchased shares is a potential solution, although the cash requirements of purchasing shares in the market should be carefully considered.

Use of tax advantaged schemes

For many businesses, cash-flow will be tight and costs will need to be controlled.

Remuneration committees may wish to consider whether to incentivise employees by granting awards under one or more of the tax advantaged share plans available in the UK (CSOP, EMI, SAYE or SIP). This could reduce employer's NIC liabilities and help manage cash for the employer. Additionally, the potential income tax savings could mean that delivering the same net benefit to employees would require fewer shares, reducing the cash cost of purchasing shares, or the dilution to shareholders of using new issue or treasury shares.

Transfer of employer NICs to employees

Where costs are under strict control, transferring employer NICs may help alleviate some of those pressures in the short term while also reducing longer term cash requirements. Transfer of NIC for 'in flight' awards will require careful consideration of the plan rules for enforceability, as well as the wider people implications of making such a decision. Employees can claim tax relief at their marginal rate on the amount of employer NICs they pay.

Funding for share plans

If an employee share trust has surplus unallocated assets and loans have been made to the trustees to acquire shares, the remuneration committee may consider whether it's appropriate to ask the trustees to repay some or all of the sponsoring company loans. This may help where cash is required in the business.

SAYE and SIPs – employees on furlough

Many companies will be considering whether to furlough employees under the job retention scheme. For companies operating a SAYE or SIP into which employees contribute regular monthly contributions, it is important to note that contribution reductions / withdrawal can apply whilst on furlough. Companies contemplating furloughs which operate these plans should consider this as part of their communications to affected employees.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

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