

# ARE YOU READY TO RUMBLE?

CEO PAY FOR PERFORMANCE

- 2017 FTSE100 PROXY SEASON -



## OVERVIEW

At the 2016 UK AGM season, investors set an unprecedented trend in corporate governance. FTSE 100 bosses faced revolts over remuneration report votes during a heated series of AGMs that featured defeats and protests over pay at some of Britain's biggest companies. BP's shareholders voted down a remuneration report which recommended a GBP 13,201,207 pay award for Bob Dudley. At the same time, the oil company reported record losses, cut thousands of jobs and froze employees' pay. There were also significant votes against the remuneration report at WPP, where Martin Sorrell received close to GBP 70M. United Kingdom fund managers wrote to FTSE 350 bosses in November 2016 asking them to publish how much their CEOs earn compared with their employees. This was consistent with a UK government green paper, which explored the possibility that companies will be asked to publish ratios of CEO and average worker pay. Furthermore, the green paper recommends the adoption of stronger measures following the defeat of an annual advisory vote e.g. when the vote is lost, a higher proportion of votes in favour would be required for approval not just simple majority. It also touches upon the possibility of making elements of the pay package subject to a binding vote. There has been, however, criticism of this suggestion on the grounds that it will be difficult to implement because it will mean that companies will be unable to make pay awards before shareholder approval is obtained. The green paper also looks at increasing the number of times a binding remuneration policy must be held from the current three yearly intervals.

*"Fund managers wrote to remuneration committee chairmen, stating that pay would receive considerable attention at annual general meetings this year."*

In February 2017, the Investment Association drew up its proposed 'Sin Bin' i.e. companies that overstep the mark on executive pay. The Investment Association is proposing that a company should face a binding vote on its pay policy at a preceding AGM if more than 25% of shareholders vote against the remuneration report. Fidelity International, one of the biggest shareholders in British large cap companies has also proposed that remuneration committee chairs be replaced if more than 25% of shareholders reject the implementation report. In their letter to more than 300 companies in the United Kingdom, Blackrock said they will only approve pay rises for top executives if these companies increase workers' wages by similar margins. The letter from Blackrock also touched upon the need for pay to be linked to long term sustainable performance, hinting that misalignment casts doubt on the quality of the board. These sentiments were not very different from Hermes Investment Management's Remuneration Principles, which were published in November 2016. In the report, the investment management firm described their principles under five headings with particular focus on executive shareholding, alignment, simplicity in pay structure, accountability of remuneration committees and stewardship.

In a Legal & General Investment Management corporate governance report released for 2016, it came to light that the asset manager voted against 118 resolutions in the UK; 14% of these were regarding compensation related resolutions. Standard Life's corporate governance report for 2016 also revealed a similar trend. The company voted against 964 management recommendations of which 42% were related to remuneration and share based schemes. These examples show that many issuers will need to prepare for a showdown during this proxy season as investors will begin to take compensation matters into their own hands unless issuers show restraint over executive pay.

*“Asset managers’ primary concern is with both the quantum of compensation and the prevalence of pay increases which are made without reference to justifiable performance.”*

From April 2017 FTSE 100 proxy season has been in full swing, thus far 50 companies have released their remuneration reports of which 28 have already had their AGM. This is the first of DirectorInsight's FTSE 100 CEO pay for performance tracker, which will be published at regular intervals during the 2017 proxy season. It provides an analysis of FTSE 100 companies' CEO pay<sup>1</sup> and financial performance, using total shareholder return (TSR) as the key financial performance metric, over a one year, three year and five year period. It will track changes in CEO's compensation packages, their relative positioning against other FTSE 100 companies and what the value of a 100 sterling investment is over a period of 3 years. It is important to note that, as we release this pay4performance tracker, rankings of pay and performance will change when we continue to include the remuneration reports for other FTSE 100 companies.

## **2017 SEASON IS SET FOR RECORD HIGH REMUNERATION POLICY RENEWALS**

In line with the UK corporate governance code, shareholders will cast binding votes on pay policies which set out how CEOs will be paid for the coming three years. Sixty six companies submitted their remuneration policies for approval in 2014 but then did not submit their policies to a shareholder vote in 2015 and 2016. Therefore, all things being equal, we expect at least sixty six companies to seek shareholder' approval on their remuneration policy during the 2017 proxy season.

We see that companies are responding to developments during the past year, and are consequently taking measures to prevent shareholder revolts. The CEO of Reckitt Benckiser had his annual bonus scrapped for 2016, and his performance awards vesting for 2016 were also reduced by 50%.

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<sup>1</sup> • Pay as used in this study refers to the Total figure comprising Base Salary, Benefits, Pensions, Cash Component of Annual Incentives, and Shares that vested in the year as well as Options exercised in the year.

• TSR is defined here as the total return of a stock to an investor. It combines annual changes in share price (adjusted share price), dividends paid and expressed as an annualized percentage.

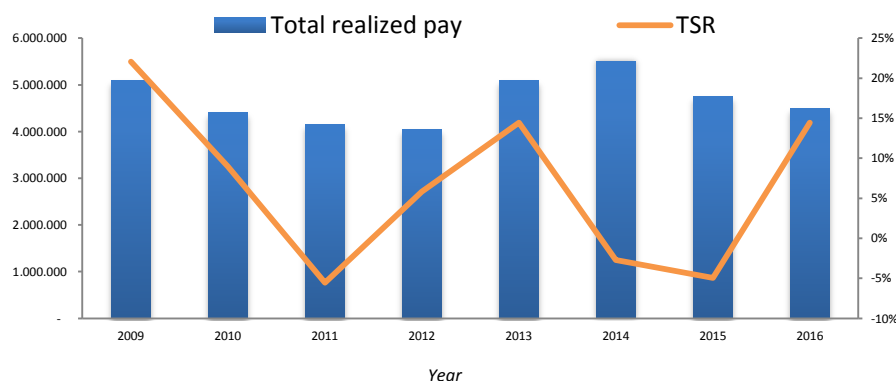
Performance awards granted to him in 2016 were also reduced by 37.5%. Smiths & Nephew's annual report for 2016 also revealed that its CEO's total compensation was reduced by 38% and his shareholding guideline was increased to 300% of his base salary. British Petroleum has revised their remuneration policy according to the annual report released for 2016. Its CEO's pay decreased by 40% and the long term incentive maximum earning opportunity decreased from 700% to 500% of base salary. Imperial Brands withdrew its remuneration policy ahead of its AGM due to an anticipated revolt from shareholders. Ashtead Group Plc. recorded 26% opposition from shareholders for their 2016 remuneration report. In addition, the remuneration policy was rejected by 28% of shareholders.

*“These may be indicative of the many changes in shareholder behaviour that we are likely to see as remuneration policies are renewed this season.”*

An earlier report published by DirectorInsight in July 2016, showed that “Executive pay proposals in the FTSE 100 companies have the highest active votes withheld among other shareholder proposals on the proxy sheet”. For example, Imperial Brands had more than 94% vote in favour of their 2016 remuneration report. Nonetheless, shareholders representing over 7million votes chose to withhold their votes. We also saw that 40% of FTSE 100 companies including the 25 companies with the highest earnings experienced had more than 10% of votes being cast against their remuneration reports in the 2016 AGM season.

From 2008 to 2016, we saw that the price index of the FTSE 100 has increased by approximately 43.60%. The price index of the FTSE 100 rose steadily from 2008 to 2013. From 2013 to 2014, the index price began to decline with a 9.10% decrease for the period 2013 to 2014 and there was a further decline of 4.93% from 2014 to 2015. From 2015 to 2016, the index price climbed 25%.

The graph below shows how total average realised compensation and FTSE 100 total shareholder return evolved during the financial years 2009-2016. We found that the total average realised compensation (TRC) was at GBP 5,088,464 and the TSR was at 22% in the financial year 2009. For the financial year 2010, both TRC and TSR began to decrease. However, TSR fell at a faster rate than Total Realised Compensation. Relative to financial year 2010, Total Realised compensation fell by 5% while TSR also decreased by 15%. Interestingly, financial year 2011 set the stage for the so called 2012 “Shareholder spring” which saw investor protests over both executive compensation and misalignment with performance. After the financial year 2011, both TRC and TSR started rising at a similar pace. There was a sharp increase in -6% recorded as TSR for 2011 to 6% in 2012 representing a 12 percentage point's growth in TSR. After financial year 2013, however, there was a sharp decline in Total Shareholder return from 14% to -3% in 2014. At the same time, Total Realised Compensation increased from GBP 5,093,845 to GBP 5,504,895. Total Shareholder Return further decreased to -5% for financial year 2015.



















THE HIGHEST INVESTOR PROTESTS WITNESSED IN THE FTSE 100 WERE IN 2012 AND 2016. TSR FOR FINANCIAL YEARS 2011 AND 2015 WHICH SET THE STAGE FOR THESE INVESTOR PROTESTS WERE -6% AND -5% RESPECTIVELY; THESE WERE THE LOWEST DURING THE PERIODS 2009-2016




















## DIRECTORINSIGHT'S CEO PAY FOR PERFORMANCE TRACKER
















The table below captures the first 50 companies in the FTSE 100 to have released their 2016 annual reports. Total CEO Realised Compensation has been ranked against their peers in the index as well as their respective 2016 TSR. The CEO who so far has the highest realised compensation in the FTSE 100 for 2016, for the 50 companies analysed, is RELX PLC's Erik Engstrom. His Total Realised Compensation for 2016 was GBP 12.7M. Total Shareholder Return (TSR) for the company was 24% in 2016, earning the company a rank of 67 percentile among the 50 companies. From 2014 to 2016, Total Realised Compensation for RELX Plc. CEO grew by 138% while Total Shareholder Return dropped by 2%. Total CEO Realised Compensation for its CEO for the three years (2014-2016) was GBP 33.7M which was ranked 96 percentile among the 50 companies. TSR for the period 2014 – 2016 was 74% which was also ranked 88 percentile among the 50 companies. From the table, GBP 100 invested in RELX Plc. will be worth GBP 174 in 2016.

AstraZeneca has probably recorded the biggest revolt in the FTSE 100 as a record 38.83% of their shareholders did not back their remuneration report. From the pay4performace tracker, AstraZeneca's CEO's Total Realised Compensation was GBP 6.9M which was ranked 80 percentile among the 50 companies analysed for this study. TSR for 2016 was at 0% showing a misalignment between pay and performance. TRC grew by 88% from 2014 to 2016, even though TSR dropped by 32% for the company. TSR for the 2014-2016 was at 41% which means that GBP 100 invested in AstraZeneca will earn investors GBP 141 in 2016.

Some companies with more conservative remuneration policies add an interesting twist to the analysis. Notable among them is Admiral Group. For the financial year 2016, Total Realised Compensation for its CEO was ranked lowest among the 50 companies analysed. TSR was, however, ranked at 60 percentile. Total Realised Compensation grew by 68% from 2014 to 2016 and TSR also increased by 9%. TSR for the period 2014-2016 was at 71%. GBP 100 invested in Admiral in 2014 will be worth GBP 171 in 2016. Admiral's 2016 remuneration report was supported by 94.52%.

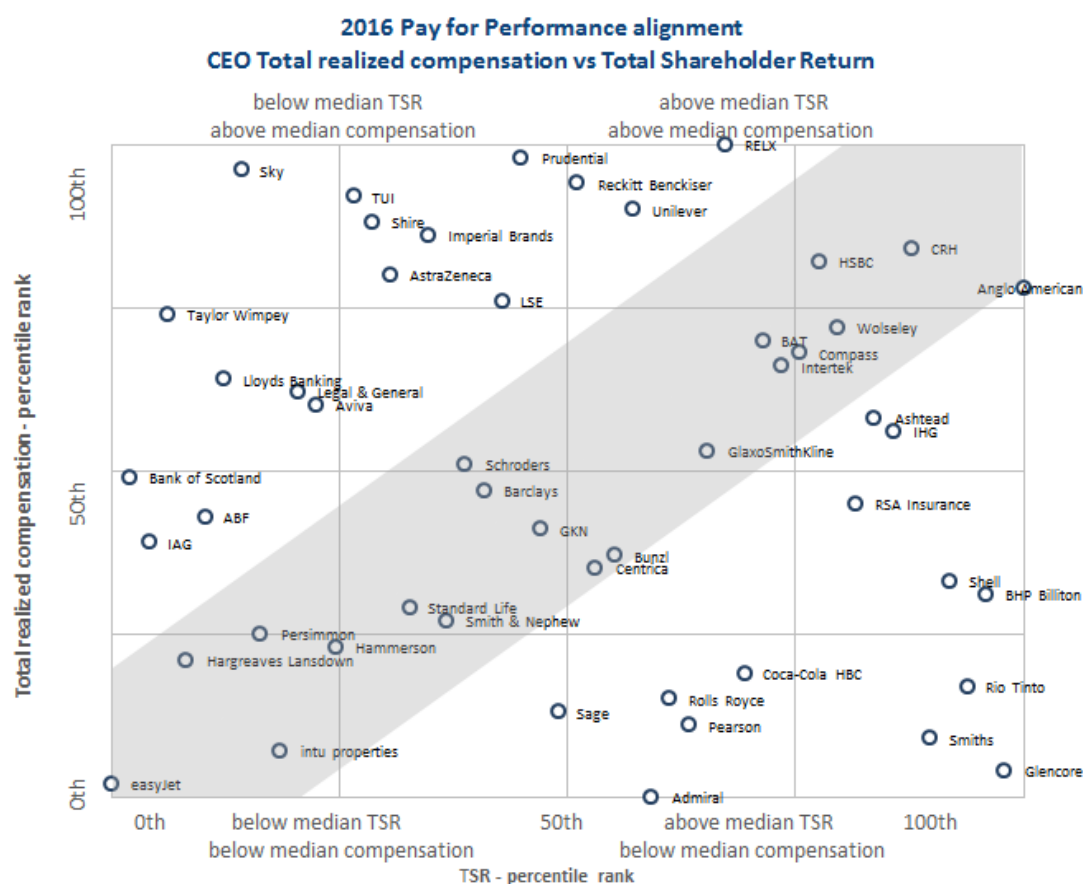
FTSE 100		2016				2014-2016					2014-2016				Remuneration Report AGM Vote outcomes	
		Total Realized Compensation in Million GBP	Compensation Ranking	2016 TSR	Ranking of Performance	Growth 2014-2016 TRC	Δ 2014-2016 TSR	Compensation Ranking	Ranking of Performance	Total Realized Compensation (million GBP)	3Y TSR	Compensation Ranking	Ranking of Performance	Current value of GBP 100 invested in 2014	For %	Against %
	RELX PLC	12.7	100	24%	67	138%	-2%	92	51	3.7	74%	96	88	174	92.88	7.12
	Prudential plc	12.1	98	10%	45	-9%	-4%	50	45	34.0	32%	98	60	132	18-05-2017	
	Sky plc	11.6	96	-8%	15	137%	-18%	90	29	24.7	30%	92	58	130	91.06	8.94
	Reckitt Benckiser Group plc	9.9	94	12%	51	-45%	-2%	25	47	43.8	58%	100	76	158	04-05-2017	
	TUI AG	9.2	92	0%	27	N/A (Due to Merger)	-7%	N/A (Due to Merger)	41	11.4	24%	39	47	124	N/A	
	Unilever PLC	8.2	90	16%	58	26%	6%	67	56	22.6	46%	90	64	146	98.14	1.86
	Shire plc	8.0	88	0%	29	73%	-59%	77	0	20.4	66%	84	80	166	93.22	6.78
	Imperial Brands PLC	7.8	86	3%	35	195%	-25%	94	25	13.9	76%	62	92	176	94.69	5.31
	CRH plc	7.7	84	47%	88	217%	43%	98	82	12.9	101%	49	98	201	82.31	17.69
	HSBC Holdings plc	7.4	82	32%	78	42%	36%	69	80	18.7	19%	82	43	119	96.47	3.53
	AstraZeneca PLC	6.9	80	0%	31	88%	-32%	82	19	18.4	41%	80	62	141	61.17	38.83
	Anglo American plc	6.3	78	287%	100	76%	293%	80	100	13.1	-3%	51	19	97	95.05	4.95
	London Stock Exchange Group plc	6.3	76	8%	43	392%	-34%	100	17	11.8	90%	43	94	190	98.56	1.44
	Taylor Wimpey plc	5.8	74	-20%	7	-4%	-46%	52	7	17.5	57%	76	74	157	98.14	1.86
	Wolseley plc	5.7	72	38%	80	1%	27%	57	72	14.7	56%	66	72	156	98.11	1.89
	British American Tobacco p.l.c.	5.2	70	27%	72	4%	14%	61	64	13.2	61%	53	78	161	92.05	7.95

	Compass Group PLC	4.8	68	31%	76	-23%	15%	42	66	16.5	67%	72	82	167	94.33	5.67
	Intertek Group plc	4.8	66	27%	74	101%	52%	84	86	9.5	17%	27	41	117	26-05-2017	
	Lloyds Banking Group plc	4.6	64	-10%	13	-75%	-7%	7	43	32.3	-16%	94	11	84	11-05-2017	
	Legal & General Group Plc	4.4	62	-2%	21	6%	-18%	63	27	12.7	29%	45	56	129	25-05-2017	
	Aviva plc	3.8	60	-1%	23	113%	-12%	88	33	9.9	21%	31	45	121	10-05-2017	
	Ashtead Group plc	3.8	58	44%	84	-44%	-10%	27	37	14.8	118%	68	100	218	71.84	28.16
	Intercontinental Hotels Group plc	3.8	56	45%	86	-45%	13%	23	62	13.3	100%	56	96	200	05-05-2017	
	GlaxoSmithKline plc	3.7	53	22%	66	-31%	32%	40	76	15.8	15%	70	37	115	04-05-2017	
	Schroders plc	3.7	51	4%	39	-9%	-2%	48	49	14.4	26%	64	51	126	94.74	5.26
	The Royal Bank of Scotland Group plc	3.6	49	-26%	2	44%	-42%	71	11	8.5	-34%	21	2	66	11-05-2017	
	Barclays PLC	3.5	47	5%	41	-66%	13%	13	60	17.6	-11%	78	15	89	10-05-2017	
	RSA Insurance Group plc	3.5	45	41%	82	111%	34%	86	78	7.6	50%	19	68	150	05-05-2017	
	Associated British Foods plc	3.1	43	-17%	11	-56%	-47%	15	4	16.7	16%	74	39	116	98.35	1.65
	GKN plc	3.0	41	11%	47	208%	17%	96	68	9.0	-4%	25	17	96	04-05-2017	
	International Consolidated Airlines Group, S.A.	3.0	39	-25%	4	-50%	-46%	19	9	13.5	15%	58	35	115	14-06-2017	
	Bunzl plc	3.0	37	14%	56	-43%	-10%	32	35	13.7	54%	60	70	154	97.77	2.23
	Centrica plc	2.8	35	14%	53	4%	29%	59	74	8.5	-21%	23	9	79	08-05-2017	
	Royal Dutch Shell A plc	2.7	33	59%	92	-84%	54%	2	90	22.3	26%	88	49	126	23-05-2017	
	BHP Billiton plc	2.7	31	76%	96	-39%	99%	36	96	10.1	-15%	33	13	85	98.90	1.10

	Standard Life plc	2.6	29	1%	33	-4%	-15%	55	31	9.7	15%	29	33	115	16-05-2017	
	Smith & Nephew plc	2.6	27	3%	37	-44%	-38%	30	15	12.8	50%	47	66	150	98.85	1.15
	Persimmon plc	2.1	25	-8%	17	-32%	-42%	38	13	7.2	68%	15	84	168	90.19	9.81
	Hammerson plc	2.1	23	-1%	25	-49%	-25%	21	23	7.4	27%	17	53	127	99.41	0.59
	Hargreaves Lansdown plc	2.0	21	-17%	9	-74%	6%	9	53	11.1	-3%	35	23	97	89.98	10.02
	Coca-Cola HBC AG	1.9	19	25%	70	57%	54%	73	88	5.6	7%	9	29	107	20-06-2017	
	Rio Tinto plc	1.8	17	68%	94	-67%	77%	11	92	11.4	7%	41	27	107	12-04-2017 and 04-05-2017	
	Rolls Royce Holdings plc	1.7	15	18%	62	-42%	48%	34	84	5.9	-44%	11	0	56	04-05-2017	
	Sage Group plc	1.7	13	11%	49	-56%	-8%	17	39	7.1	75%	13	90	175	90.90	9.10
	Pearson plc	1.5	11	18%	64	-17%	25%	44	70	4.5	-29%	7	4	71	05-05-2017	
	Smiths Group plc	1.4	9	56%	90	-77%	79%	5	94	11.2	6%	37	25	106	97.82	2.18
	intu properties plc	1.3	7	-7%	19	-12%	-32%	46	21	3.9	14%	4	31	114	99.63	0.37
	Glencore Plc	1.2	4	207%	98	26%	208%	65	98	3.2	-3%	2	21	97	24-05-2017	
	easyJet plc	0.9	2	-40%	0	-85%	-54%	0	2	22.3	-27%	86	7	73	92.06	7.94
	Admiral Group plc	0.7	0	17%	60	68%	9%	75	58	1.4	71%	0	86	171	94.92	5.08

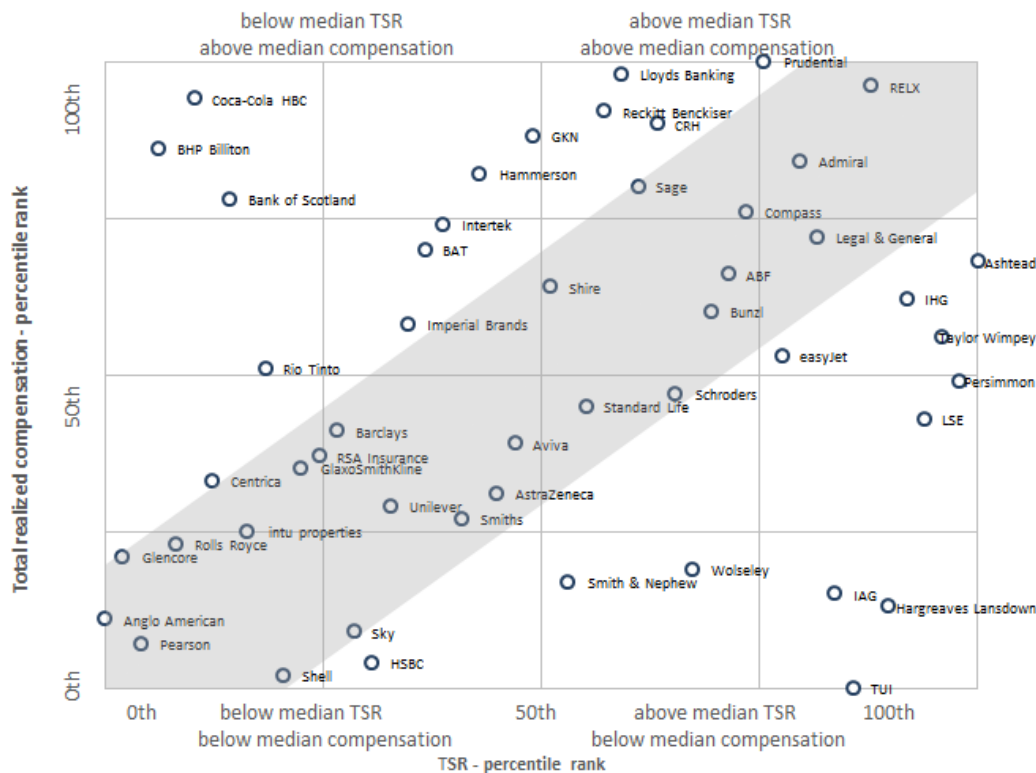


The following charts show a company's relative degree of alignment for CEO pay and TSR performance over a 1, 3 and 5 year period against other FTSE 100 companies which are included in this pay for performance analysis. The companies that are situated within the grey area are considered companies that have a strong connection between pay and performance. The companies above the grey area, show a pay for performance misalignment at this stage. It is important to note that this analysis was based upon 50 companies and ranking may change when the final list is updated in the graph when we start adding other FTSE 100 companies in our next publication.



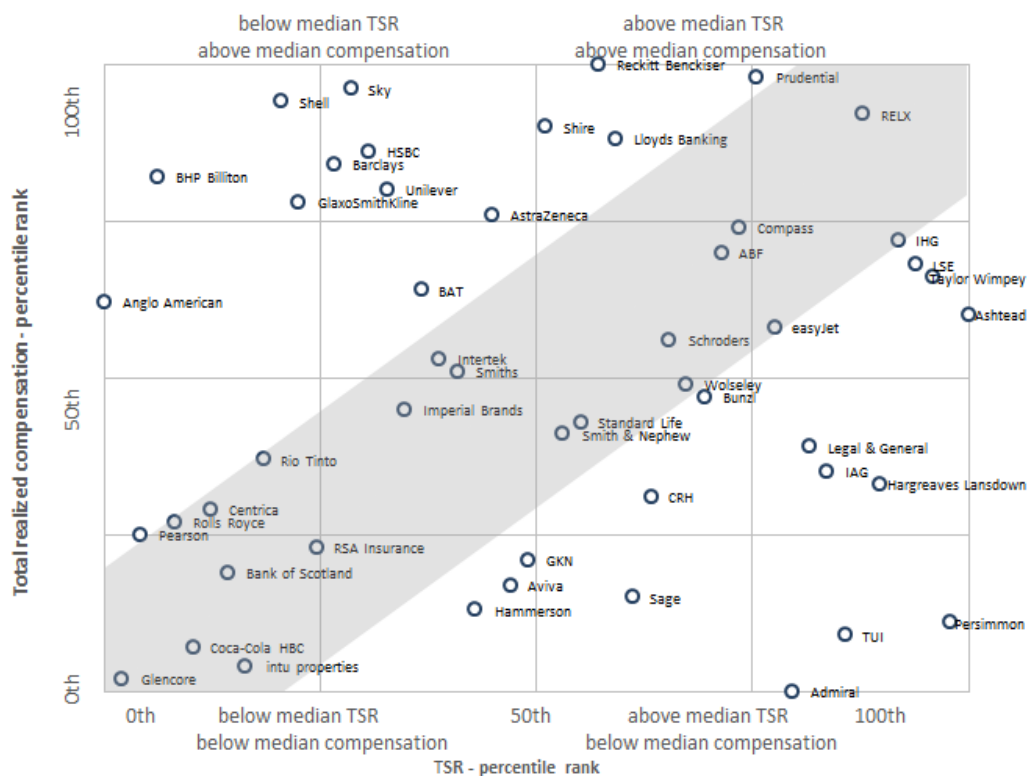
THE GRAPH SHOWS THAT COMPANIES SUCH AS SKY PLC, TAYLOR WIMPEY, AND LONDON STOCK EXCHANGE DEMONSTRATE A NEGATIVE MISALIGNMENT BETWEEN PAY AND TSR. THE PAY RANK IS HIGHER THAN THAT OF TSR. ALSO ON THE LIST OF COMPANIES WITH NEGATIVE MISALIGNMENT IS RELX PLC, RECKITT BENCKISER AND PRUDENTIAL PLC. SCHRODERS, BARCLAYS, STANDARD LIFE AND GLAXOSMITHKLINE SHOW AN ALIGNMENT BETWEEN PAY AND PERFORMANCE. INTERESTINGLY, MINING COMPANIES RIO TINTO, BHP BILLITON AND GLENCORE ARE SOME OF THE COMPANIES SHOWING POSITIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE.

## 2014-2016 Pay for Performance alignment CEO Total realized compensation vs Total Shareholder Return



ANALYSING PAY FOR PERFORMANCE ON A THREE-YEAR BASIS, WE NOTE SOME INTERESTING CHANGES. RECKITT BENCKISER, IMPERIAL BRAND, RELX PLC. WHICH WERE SHOWING NEGATIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE ON A ONE YEAR BASIS ARE NOW SHOWING AN ALIGNMENT BETWEEN PAY AND PERFORMANCE. TUI, PRUDENTIAL, SKY PLC. MAINTAINED THEIR NEGATIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE. SMITH & NEPHEW, ROLLS ROYCE, GLENCORE HAVE IMPROVED THEIR POSITIONS FROM POSITIVE MISALIGNMENT INITIALLY AND NOW SHOWS ALIGNMENT BETWEEN PAY AND PERFORMANCE. SMITH & NEPHEW WHICH SHOWED AN ALIGNMENT BETWEEN PAY AND PERFORMANCE ON A ONE YEAR BASIS IS NOW SHOWING A POSITIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE. ADMIRAL GROUP STILL MAINTAINED POSITIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE ON A THREE-YEAR BASIS. ANGLO AMERICAN ALSO MOVED FROM POSITIVE MISALIGNMENT UNDER ONE YEAR TO NEGATIVE MISALIGNMENT UNDER THE THREE-YEAR STUDY

## 2011-2016 Pay for Performance alignment CEO Total realized compensation vs Total Shareholder Return



ANALYSIS OF PAY FOR PERFORMANCE ON A FIVE-YEAR BASIS HIGHLIGHTS SOME CHANGES. RECKITT BENCKISER AND IMPERIAL BRAND WHICH IMPROVED THEIR RANKING ON THE THREE-YEAR BASIS ARE BACK TO SHOWING NEGATIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE. ANGLO AMERICAN, HOWEVER, MAINTAINED A NEGATIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE ON THE FIVE-YEAR STUDY. SKY PLC., PRUDENTIAL, ROYAL BANK OF SCOTLAND CONSISTENTLY SHOWED NEGATIVE MISALIGNMENT BETWEEN PAY AND PERFORMANCE OVER A ONE YEAR, THREE YEARS AND FIVE YEARS' ANALYSIS.

Stay tuned for our next report!

## APPENDIX

### **Our methodology on total realised compensation explained**

The realised compensation includes all realised components of compensation in the year of interest. It is defined as the sum of total indirect compensation realised and total direct compensation realised for one year. It consists of base salary + benefits + other compensation + bonus + deferred cash bonus + deferred share bonus + value of performance/restricted shares vested + value of performance/restricted options exercised. Total realised pay is calculated based on performance indicators that have been met during the performance period. Most companies clearly disclose the performance period and vesting period, and the percentage that will be paid in the next year. For example, for shares that will vest on March 31, 2016 but where the performance period ends at December 31, 2015, shares are included in realised compensation for the financial year 2015. When the company doesn't disclose the average share price over the last quarter, we use the company year-end share price to calculate the value of the vested multiyear share packages. In line with UK practices, adjustments are usually made in the following year when the company disclose the exact share price on which the shares vested. For options, we calculate realised pay when the options have actually been exercised

In the event there were two CEOs in a year for a company, for example due to a change in CEO, we explored the companies on individual basis and annualized compensations depending on the issue at hand to make the total realized compensation as realistic as possible.

### **Total Shareholder Return (TSR)**

Total shareholder return is defined as the total return of a stock to an investor. It combines annual changes in stock price and dividends paid and are expressed as an annualised percentage. This will be calculated over one year (1Y), three year (3Y) and five year (5Y) period. The growth in 3 yr and 5 yr TSR is calculated by the percentage points of difference between latest year and 3/5 year prior.

Please note that all figures have been rounded up in the table outlining the CEO pay for performance analysis.

### **Investment return of 100 sterling**

This figure looks to calculate how much an 100 sterling company investment would be worth over a period of time by indexing the TSR over multiple years.

## Pay for performance Analysis

We conducted a study on CEO realised compensation to determine degree of alignment relative to peers in the FTSE 100 on a 1, 3, 5 years basis. The degree of alignment is determined by subtracting the compensation rank from the performance rank within a scope of +20 or -20. Results obtained on either side determines a more generous or a conservative remuneration policy. Therefore for the three and five years' study, the percentile rank is calculated by the Total Realised Compensation over the period subtracted from the sum of the period TSR performance.

## Definition of financial years

FTSE 100 companies have different year end dates. The most common year end dates are displayed below; 31/12, 31/3, 31/7 and 30/9. The main rule applied is that in a specific year, financial year end dates until 31/3 is reported as financial year of the previous year. All financial year end dates after 31/3 are reported as the year in which the financial year ends.

**This article is produced by:**

Edna Frimpong, Governance Research Analyst

Aniel Mahabier, CEO DirectorInsight

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## About us



DirectorInsight is a specialist provider of data analytics and intelligence on the “G” of ESG. We help corporations, institutional investors, financial institutions and professional services firms to efficiently and effectively manage the increasing challenges they face in reviewing and addressing corporate governance risks and associated decision-making. DirectorInsight provides an integrated web-based, data technology solution, to independently analyze data on the value creation and governance practices of leading listed companies across the globe, in a single convenient solution. **Please contact us on +31 (0) 20 416 0662 or visit our [website](#) when you would like to obtain further information or a demo.**