Covid-19 and Executive Pay

Cliff Weight, ECB advisory board member, remuneration consultant and director of ShareSoc (the Individual Shareholders Society) offers his personal views on the ethical aspects, reputation management and practicalities of giving and receiving bonuses and LTIPs with the AGM season about to start.

Leaders (directors and senior executives) should, in my opinion, *volunteer* to forgo their pay for the duration of this unparalleled crisis. This should apply to all businesses that are significantly affected by Covid 19.

If your business is in health care, makes incubators, face masks, protective gear or Covid-19 tests, then focus on the priorities of doing that and sort out pay issues later (and anyway you will probably be too busy to read this!). For others:

Global Scope

Covid-19 is a global catastrophe, a personal tragedy for those who die and their loved ones and the knock-on effects of shutting down huge swathes of the economy will wreck the lives of many people, increase unemployment, bankruptcies, poverty, anxiety and stress - and lead to more deaths.

With many companies running out of cash, there will be a huge demand for the services of investment bankers able to help companies restructure their debt and raise new equity. So, I asked myself, what would a giant, vampire squid do? Would it be rubbing its tentacles with glee, getting ready to wrap its itself around its clients and squeeze every last drop out of them. Either they pay big fees to Squidco or they run out of money. The giant squid has the connections to be able to persuade investors to invest in your company. If you do not agree to its terms it will leave you to die. Many businesses that need cash will have no choice but to accept very harsh terms.

Social Contract

However, we are increasingly realising that companies need a social licence to operate. A global government bailout to provide liquidity for banks and companies is necessary for them to operate at all. So why should bankers get paid such astronomical sums?

The Daily Mail ran an excellent story **here** on bankers' pay and dividends. The maximum pay for CEOs in 2020 is HSBC £9.9 million, Barclays £8.1 million, Lloyds £7.5 million and RBS £4.3 million.

None of the UK's major banks has yet (at 3 April) confirmed how they will ensure executive pay appropriately reflects the pressures the industry is under. Many other organisations (e.g. Quantas, Heathrow Airport, Sky, WPP) have acted much faster in cutting pay than the banks, who have been quick to cancel their dividends, but less quick to cut their own pay and only quite recently have paid out bonuses for 2019.

Bank's main cost is payroll, and it would be good to know what they are doing to minimise cash flow in that respect. I cannot see many executives resigning in the present climate, so the rationale for "retain" in the four key remuneration goals (retain, motivate, reward and be able to exit at reasonable cost) is minimal. Those who are suffering from Covid-19 or the knock-on effects of Covid-19, will be less than pleased if bankers continue to get paid at their traditional pay rates.

Many jobs are going to disappear. Many companies will go out of business. I think the recovery of the economy will be slow in many sectors. Unemployment will be huge. Government debt will soar. The savings ratio will soar (as people in jobs will stop discretion spending and try and save a little safety net of cash in case of future disasters), although many will be forced to take on debt in order to buy necessities. This will slow the recovery.

Banks and Bonuses

Banks have been given (almost) unlimited liquidity by the Bank of England. However, some commentators are saying they will still need a bailout if they are to avoid going bust themselves. Banks' need to avoid bad lending will mean that many of their customers will be forced into administration or large restructuring of debt. This could easily be far worse than 2008, when bankers demanded they keep their big bonuses and get bailed out.

Companies and individuals on the receiving end of the bank's services will want to see some recognition of how desperate the situation is. Bankers need to set an example. Leaders should forgo their pay, and others should give up part of their salary while this crisis continues.

These pay cuts should apply to all businesses severely affected by the crisis, such as pubs, hotels, leisure, airports, airlines, non-food retail, etc.

It is not just shareholders who have to suffer (via dividend cuts and if they wish to sell shares, via lower share prices). Suppliers, customers, and employees will be losing contracts, jobs and pay. In today's climate, leaders cannot be seen to be receiving the largesse of egregious executive remuneration. To attempt to do so will lose them the confidence of their stakeholders and that will in the long term be bad for shareholders. Moderation now will be better for all in the long term.

Action

Pay is made up of salary, bonus, LTIPs, options, etc. Bonus pay-out announcements now will be in respect of last year's performance. However, paying out cash now if the company is struggling for cash sends the wrong message.

Waiving the bonus payment now and with a future bonus payment contingent on future performance means it can be excluded from the single figure of total remuneration. In plain speech, this is deferring bonus pay and so long as the company recovers you will get your pay when the company's cash position is better. LTIP payouts are different. They are paid in shares. They should vest as normal. Executives should agree not to sell their shares in these difficult times. Selling shares sends a horrid signal of the executives' confidence in the company.

Should you make new LTIPs awards according to your normal timing or wait six months until things become clearer and it is easier to set targets? Remember that one of the four goals of remuneration is retention. If you make an award of restricted shares now, which vest over the next five years, then this will increase your chances of retaining key executives if the economy does recover. If you award options the retention effect is great if recovery happens (but you end up overpaying unnecessarily), but of negative effect if your share price declines further. Restricted shares are often the best reward mechanism in tough times. Remember also that paying in shares reduces your cash flow compared to salaries and cash bonuses.

Remuneration committees should revisit their claw-back and malus clauses. Can you claw-back or not pay old bonus payments owing to inflated EPS as a result of share buybacks at high share prices? Don't expect a warm reception, from investors, to fund raises from companies, now overleveraged because of previous share buy-backs.

As ECB went to press, it was clear that some companies are heeding this call; we will report more in the next issue.