

## ICGN Viewpoint

### COVID-19 and Executive Remuneration

June 2020

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The global COVID-19 pandemic has underscored the need for a holistic view of governance responsibilities, encompassing not just financial metrics but a wide range of corporate impacts. As expressed in the OECD Guidelines on Responsible Business Conduct<sup>1</sup>, company boards must understand the social and environmental consequences of business operations, set their own priorities to address these and account for associated outcomes. In these unprecedented times, there is an opportunity for boards to demonstrate their understanding of long-term value creation that balances the needs of investors, employees, suppliers and preserves the safety of customers and reputation of the business alike.

As noted in the ICGN Statement of Shared Governance Responsibilities of 23 April 2020, executive remuneration policies and practices are a critical component of these responsibilities.<sup>2</sup> ICGN will soon be publishing a more detailed Viewpoint relating to integrating ESG factors in executive remuneration, but this short Viewpoint focuses on immediate questions relating to executive pay that are of particular relevance in light of the current public health crisis. These are:

- Quantum
- Structures and metrics to guide long-term incentives
- Employees, stakeholders and managing sustainably through the crisis

#### Quantum

General public opinion can be that executives earn exorbitant amounts and are driven by short-term goals<sup>3</sup>. Such perceptions may be exacerbated in the current crisis where vast numbers of people are without work and large segments of the economy are being shut down. When governments rush to the aid of businesses to help cushion the overall economic impact of the pandemic, companies can expect to be scrutinised with regard to how they exercise financial prudence<sup>4</sup>. In some cases, this may call for capping or voluntarily reducing total realised<sup>5</sup> executive compensation throughout the ranks.

Traditionally, many investors have focused less on quantum and more on remuneration policies and structures that link pay and performance. This has reflected a reticence of investors to assume the role of arbiters as to what is or is not a socially acceptable quantum of pay. However, in current times investors cannot be blind to quantum as the economic fallout of the global pandemic continues to take its toll, particularly in exacerbating economic inequality and

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<sup>1</sup> See OECD Guidelines on Responsible Business Conduct: <http://www.oecd.org/industry/inv/responsible-business-conduct-and-human-rights.htm>

<sup>2</sup> ICGN Letter, Governance Priorities During the Covid-19 Pandemic, May 2020.

[https://www.icgn.org/sites/default/files/5.%20ICGN%20Letter%20to%20Corporate%20Leaders\\_23%20April%202020\\_1.pdf](https://www.icgn.org/sites/default/files/5.%20ICGN%20Letter%20to%20Corporate%20Leaders_23%20April%202020_1.pdf)

<sup>3</sup> Kaplan, Steven Neil, Executive Compensation and Corporate Governance in the U.S.: Perceptions, Facts and Challenges (August 22, 2012). Chicago Booth Research Paper No. 12-42; Fama-Miller Working Paper. Available at

SSRN: <https://ssrn.com/abstract=2134208> or <http://dx.doi.org/10.2139/ssrn.2134208>

<sup>4</sup> This can affect a range of capital allocation issues, including remuneration, dividends and the issue of other capital instruments.

See ICGN's Viewpoint on Covid-19 and Capital Allocation, April 2020: <https://www.icgn.org/covid-19-and-capital-allocation>

<sup>5</sup> The variable part of executive pay is typically the larger proportion than the fixed one and is more practical and often contractually easier to adjust than the fixed one. This could be done through an 'emergency button' type measure where an existing remuneration policy change could be adjusted in consultation with main shareholders and be put to vote retroactively at the following AGM.

diminishing opportunities. As noted in a recent ICGN Viewpoint on Covid-19 and Systemic Risk<sup>6</sup>, the question of fairness is also important for companies that are forced to lay off staff or ask staff to operate with pay cuts. Company management and boards are dealing with a fine balancing act between their employees' health, honoring supplier agreements and supporting customers by restarting operations ahead of time, which can put both employees and customers at risk.

Maintaining or increasing executive pay in such cases could threaten stakeholders' trust and motivation as well as the company's social license to operate. As such, COVID-19 has the potential to invigorate a debate about high levels of executive compensation and its impact on income inequality and society's capacity to respond to global emergencies.

### **Structures and metrics to guide long-term incentives**

In addition to quantum, the current crisis also sharpens the debate on structural aspects of remuneration, particularly the question of excessive reliance on short-term financial metrics – some of which may be obsolete- in remuneration plans. This can relate to incentive structures, but it also can raise questions as to the most appropriate metrics to guide long-term incentives. There is growing recognition of the difficulty of setting well-fitting multiyear performance targets in long-term incentives plans, in a changing - and sometimes unpredictable - world.

Environmental, social and governance (ESG) factors are not the only long-term metrics, but they have a key role to play. ICGN's Guidance on Executive Remuneration<sup>7</sup> emphasises the use of ESG metrics to guide both board and investor assessment of long-term performance and sustainable value creation. Similarly, Principle 6 of ICGN's Global Stewardship Principles<sup>8</sup> call for investors to promote long-term value creation and integration of ESG factors.

It is important to incorporate sustainability-related performance factors that the executive team can be held accountable for and directly influence-- and to look beyond the current crisis and also anticipate its aftermath when non-COVID related ESG factors, climate risk in particular, will also require urgent attention. These factors have the potential to impact the bottom line of the business in the mid and long term. This can be through reputational damage, other risk-laden decision-making, or the actual interruption of business continuity.

### **Employees, stakeholders and managing sustainably through the crisis**

The pandemic also increases the attention paid to how executive remuneration relates to the health and safety of employees, suppliers, customers and the rights of investors, including end beneficiaries. Particularly in the current period immediate ESG-related responsibilities for companies call for:

- Staying focused on the long-term vision and mission, keeping long-term performance measures related to these.
- An increased focus on relevant sustainability issues. For example, having a strong corporate culture and good relations with local communities (including where employees come from) will help a company face the challenges.

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<sup>6</sup> See ICGN Viewpoint on Covid-19 as a new systemic risk, March 2020: <https://www.icgn.org/coronavirus-new-systemic-risk-implications-corporate-governance-and-investor-stewardship>

<sup>7</sup> ICGN Guidance on Executive Remuneration, 2016: [http://icgn.flpbks.com/icgn\\_executive-remuneration\\_2015/#p=4](http://icgn.flpbks.com/icgn_executive-remuneration_2015/#p=4)

<sup>8</sup> ICGN Global Stewardship Principles, 2016: <http://icgn.flpbks.com/icgn-global-stewardship-principles/#p=1>

- Executives taking the responsibility for fair treatment of employees, suppliers and customers and ensuring their health and safety.
- Managing the crisis: Keeping staff up to date on how the crisis is affecting the business and how the business will respond to further aggravation of circumstances.
- Commitment to continue providing fair contracts and working conditions.
- Understanding that there may be reputational risk to a company that maintains high levels of executive pay or grants large variable pay awards while seeking special support from governments or executing significant employment cuts.

Remuneration committees and the board more generally must be alert to these issues and related risks in their executive remuneration policies and how these policies are applied in the current crisis environment. Investor scrutiny is essential when assessing, engaging and voting on executive remuneration plans.

### **Engagement questions for investors to pose to companies relating to COVID-19 and remuneration**

- What unique risks does the company and industry face in the context of the current public health crisis?
- Can you define opportunities for balancing long-term value creation, short-term strategic agility, and the building of stakeholder ecosystems all at the same time?
- Do you have a long-term incentive plan in place? What are the relevant ESG-related performance metrics and gateways for these? What is the evaluation and vesting period for it?
- How you approach setting well-fitting multiyear performance targets in long-term incentives plans, in a changing -- and sometimes unpredictable -- world?
- What help would you welcome from the investment community on this?
- Do you benchmark your current remuneration practices against peers in the context of the pandemic? How do you know which peers to look at for best practice?

### **About ICGN Viewpoints**

ICGN Viewpoints are produced by Secretariat and by our member-led Policy Committees. While not defining a formal ICGN position on the subject, they provide opinion on emerging corporate governance issues and are intended to inform and generate debate. With the support of ICGN's Board Governance Committee, this ICGN Viewpoint was drafted by Richard A. Bennett, a former member of ICGN's Board of Governors, and Eszter Vitorino-Füleky, a member of ICGN's Board Governance Committee. We welcome dialogue with the ICGN Secretariat and/or Committee chairs, as follows:

Gigi Dawe, Co-chair, ICGN Board Governance Committee: [gdawe@cpacanada.ca](mailto:gdawe@cpacanada.ca)

Carola van Lamoen, Co-chair ICGN Board Governance Committee: [c.van.lamoen@robeco.nl](mailto:c.van.lamoen@robeco.nl)

George Dallas, ICGN Policy Director: [george.dallas@icgn.org](mailto:george.dallas@icgn.org)