The Future of Work—No More “One Size Fits All”

Executive long-term incentive plans below Board level in FTSE 100 companies

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Introduction

- EY conducted detailed qualitative research across the FTSE 100 in 2019, with the intention to prove the validity of two hypotheses:

1 | Alignment

We believe that companies no longer operate an aligned LTI policy across their executive populations at Board, Executive Committee (ExCo) and below ExCo level

2 | Response to the Future of Work

Companies are adapting their LTI plans to better respond to globalisation, changing workforce demographics and employee expectations

- We interviewed 20 FTSE 100 organisations from a wide range of sectors. The combined size of participants corresponded to:

c. 30%

Of FTSE 100 in terms of **market capitalisation**

c. 25%

Of FTSE 100 in terms of **global revenues**

c. 45%

Of FTSE 100 in terms of **employee base**

Alignment of interest between the executive cadre is fast becoming a thing of the past

Plan types

FTSE 100 companies no longer cascade down grant policy from Board to the broader Senior Management team to ensure the alignment of interest of the executive cadre:

89% have different LTI arrangements by level

11% operate one consistent LTI plan across all levels

63% of participants use a different plan type below Executive Directors (either Restricted shares or options)

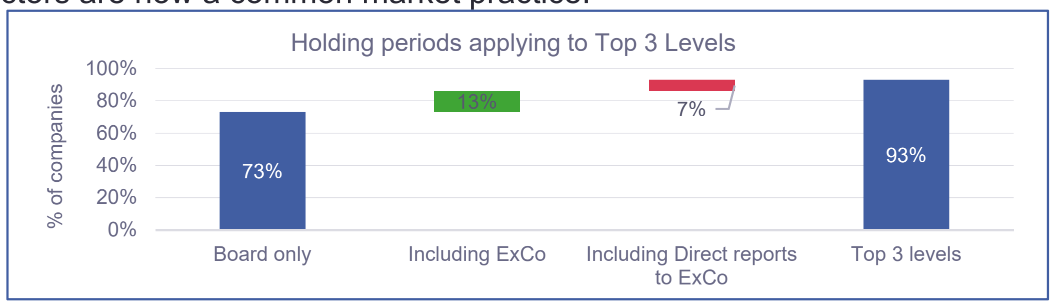
16% of participants use plans subject to fewer performance conditions at lower levels in the organisations

Vesting / holding periods

Different vesting and/or holding periods below Executive Directors are now a common market practice:

37% of participants had shorter vesting periods for employees below the Board

93% of participants apply holding periods only to their Top 3 levels

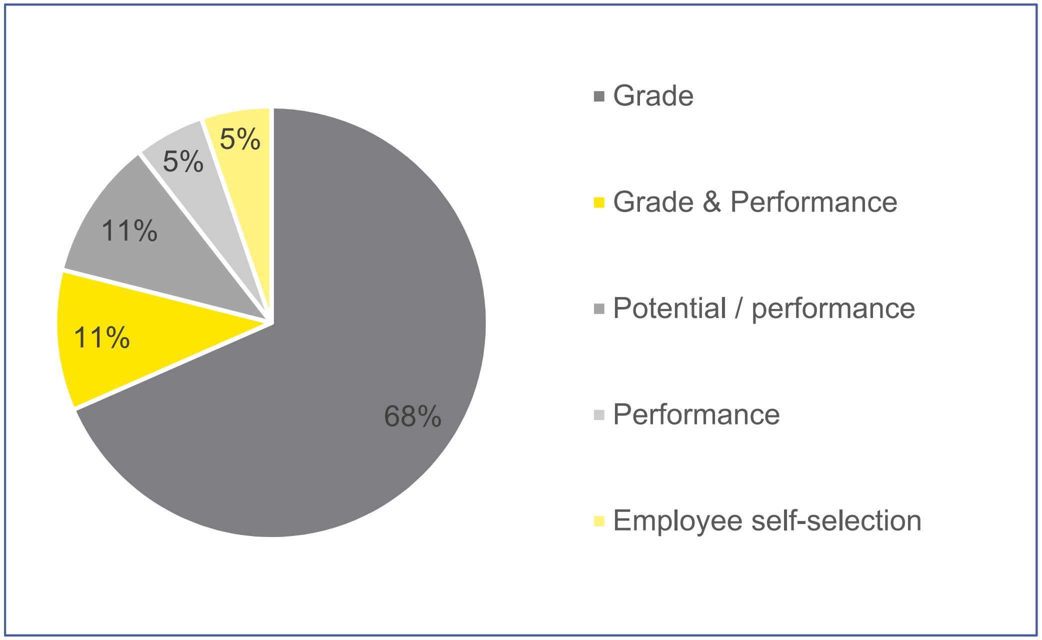


Share ownership guidelines

15% of participants extend shareholding requirements to all LTIP participants. The majority apply shareholding requirements to Executive Directors, ExCo and their direct reports, with some extending it to the Top 100-150

Emerging and high performing talent is now a greater focus

- Fixing eligibility and grant quantum by **work level** remains market practice
- However, LTIs are nowadays increasingly used to **communicate to high performing potential** and talent that such individuals are a key part of the future
- Practice operates outside the traditional grading structures - over half of the companies who determine LTI eligibility based on grade allow for such flexibility – built on **leadership recommendation** rather than formulaic process
- Approximately **16%** now allocate LTI awards solely based on **performance / future potential**, without differentiating award levels by grade



The global role is only a partial reality

- Approaches to grant policies vary across organisations:

68% of participants operate a globally consistent LTI policy

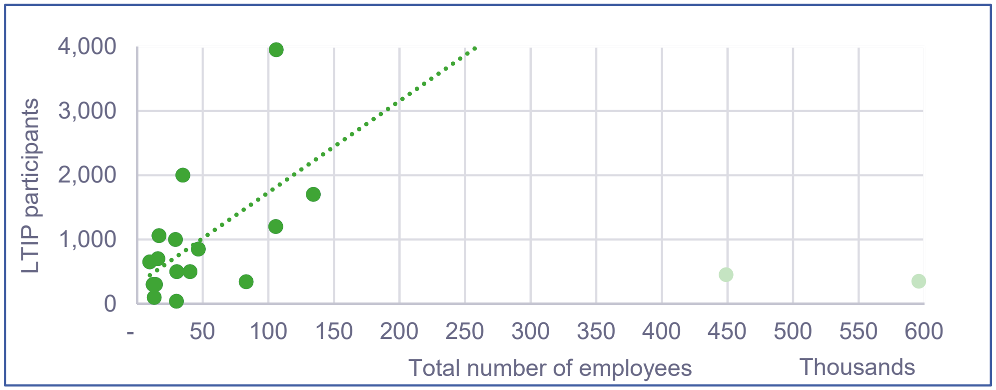
16% of participants focus on key markets

16% of participants follow a local market approach

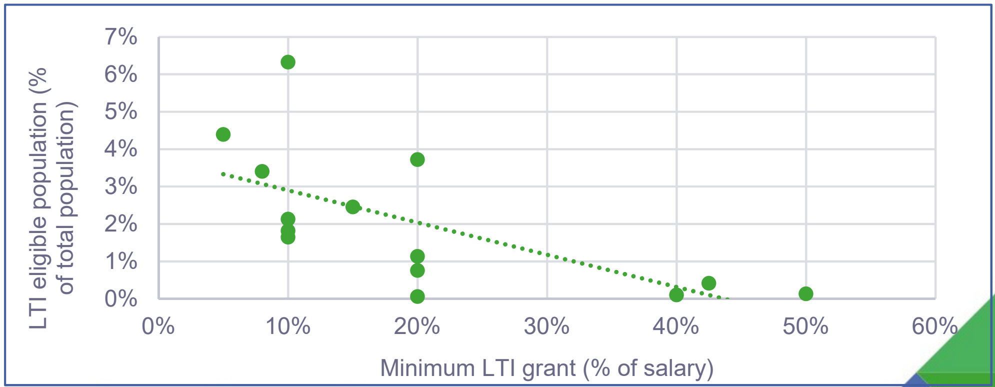
- Majority of companies have a policy that is jurisdiction agnostic; however, this often results in LTI grant levels lagging behind in critical markets and too high in others, particularly where LTIs are not even valued by the workforce

Eligibility is not a function of scale or business complexity

- Our research tells us that business model, size or profitability are not meaningful drivers of LTI participation
- "**Managed inertia**" - if an organisation usually invites a number of people to participate in LTI then it appears to stick with that number – irrespective of business cycle, corporate change or strategic pivot
- We see, however, some correlation between the size of an organisation and eligible population
- We further note that organisations who have fewer participants in the plan tend to have a higher minimum level of LTI grants



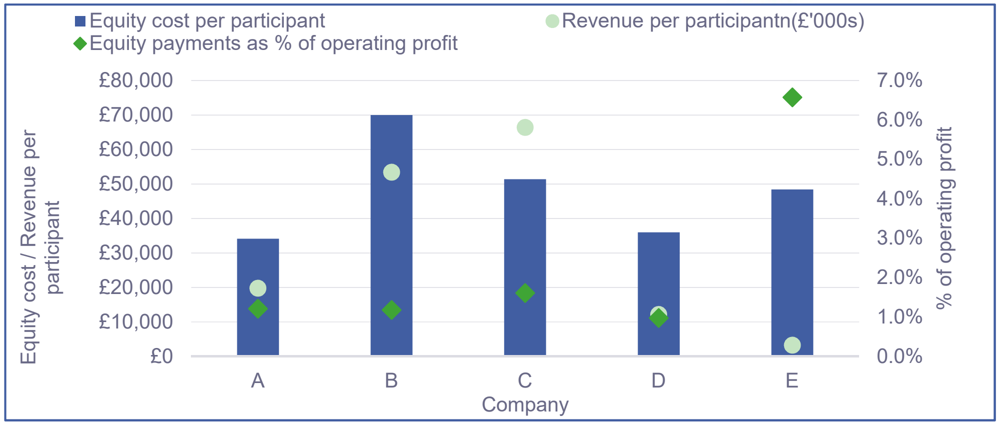
Median LTI participation level is **1.8%** of the employee population. If we exclude one company offering LTI to majority of the workforce on a voluntary basis, the median participation level is **1.7%**

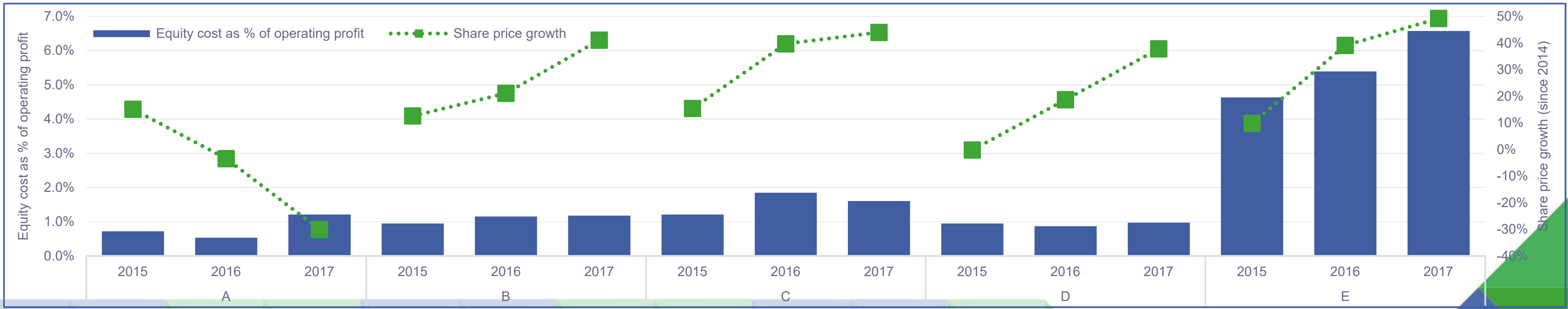


The median minimum LTI award is **20% of salary**, although minimum LTI grants range between 5% and 50% of salary

LTI cost is not a driver of LTI practice

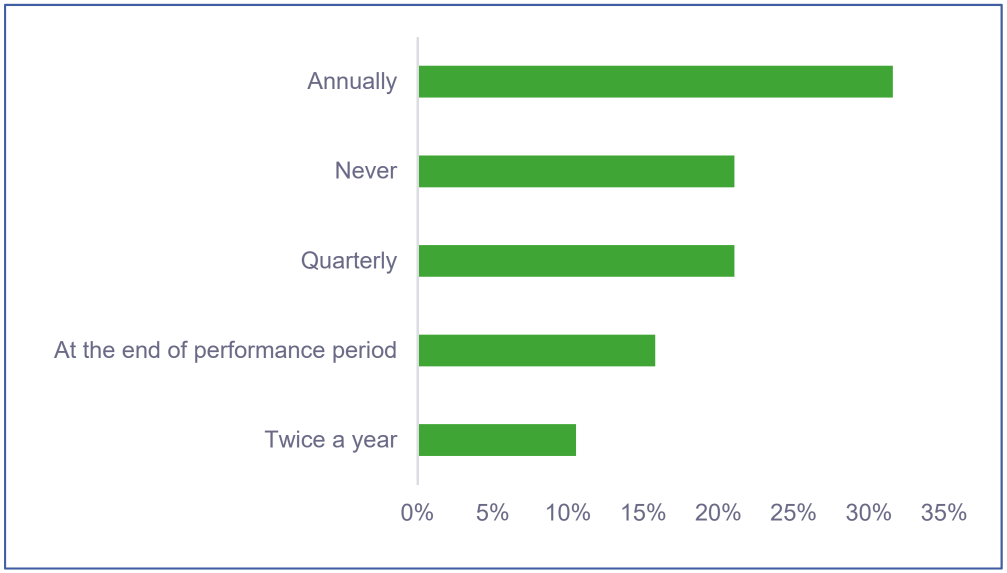
- The programme cost is often not front of mind – particularly where cost is held centrally and not reflected in local business unit budgets
- The impact of share dilution on EPS is low on the agenda and share sourcing policy generally is informed by historical decisions
- On median, the annual equity cost is 1.2% of operating profit across 5 survey participants that disclose value of executive share-based payments
- We see some significant variances between the equity cost as % of operating profit across companies with comparable growth in share price, suggesting that the link between the executive and company performance may not be as strong as previously believed





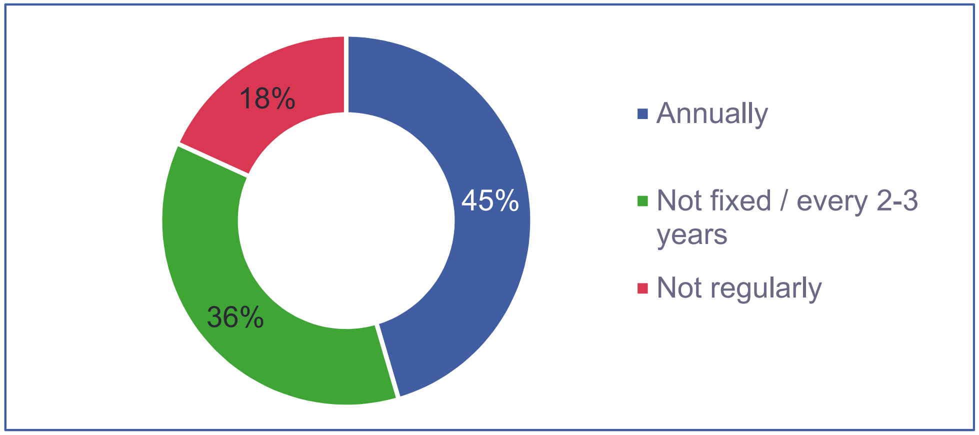
Communication is progressing – but at a snail's pace

- Widespread use of portals and modelling tools to enable participants to understand what wealth they may have tied up in a plan
- However, systems are not very intuitive and LTI participants do not access these on a regular basis
- The more granular question of communicating progress in year against performance targets presents a very different picture
- More often than not, the picture is communicated on or immediately prior to vesting (and not much more)



Market data is not key

- Participant driven market data remains king in the context of assessing and policing levels of base pay and bonus opportunity
- The reverse is the case with LTI opportunity
- Grant opportunity is infrequently assessed against market data, and where it is, there is real scepticism as to its accuracy and hence worth



All-employee equity remains very important

- All employee equity remains a key piece of overall employment proposition
- Benefits of such plans were articulated in a persuasive way by participants
- Rationale for below Board equity was not so clearly justified
- Concerns around global coverage of all-employee equity:
  - Respondents use UK centric approved share plans for their UK populations
  - Overseas participation remains limited

Future Work Now has not arrived in the world of LTI yet

- Today's workforce landscape is changing rapidly and we can expect tomorrow's workforce – its demographic spread and its range of backgrounds, habits, demands and expectations – to be likewise very different
- There is little out there to suggest that using LTI to support new agile working practices is catching on. In particular, none of the respondents used equity for contingent workers
- There is arguably an opportunity to focus on this aspect and steal a march on the competition. For example:
  - Is a one-year vesting timeline better suited to a business need today?
  - Why is three years' service viewed as a prerequisite to value accretion?

Future Work Now, LTI
EY’s new LTI model

1 Eligibility

Based on skill or capability, not role or hierarchy. A secondary gateway to eligibility will be based on an individual’s potential to develop new required capabilities. This link between reward and growth, or reward and learning, will become increasingly important.

2 Grant frequency

Grants will be made quarterly. Each grant will be pegged to a single date at the beginning of the quarter. This enables multiple grants during a year, but only four administrative start points.

3 Performance period

Not used.

4 Vesting schedule

Awards will vest daily during the vesting period — but will not be eligible to be withdrawn from the plan until the end of the totality of the vesting period. The aggregate vesting period will be timed to reflect the transformation horizon the business is working to.

Future Work Now, LTI
EY's new LTI model

5 Malus/Clawback

Will be applicable for all participating employees.

6 Quantum

Will be driven by demands of the local market and flexed to reflect the scarcity of the role.

Scarcity will be evidenced in real time through technology — not anecdotally. The award will be expressed as a number of shares and not as a % of salary.

7 Performance conditions

Will not be used. However, quantum of grant will be driven by capability growth or skills transfer. Focus will be to flex the size of the award at grant and not the outcome on vesting.

8 Type of awards granted

Will be a mix of Restricted Stock and Options. Employees will have a choice on the mix, using an agreed conversion rate between the two instruments.

Future Work Now, LTI
EY's new LTI model

9

Holding periods

Post vest holding periods will not be used.

10

Leavers

No good or bad leaver concept. The portion of an award that has already vested will be released at the end of the aggregate vesting period. The unvested portion of the award will be frozen at the date of leaving (but continue to track share price movements until the end of the vesting period). Should the employee return, the frozen value will be paid out over an agreed period thereafter.

Thank You

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Thank You

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