

## Executive Remuneration: Discussion Paper. Response form

Please send your response by: 25 Nov 2011

About You	
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I am responding on behalf of (please tick)	
	<b>Yourself : Quoted company</b>
	<b>Other company</b>
	<b>Investor or investment manager</b>
	<b>Business representative organisation</b>
✓	<b>Investor representative organisation</b>
	<b>Non governmental organisation (NGO)</b>
	<b>Trade Union</b>
	<b>Lawyer or accountant</b>
	<b>Other (e.g. consultant or private individual)</b>

As requested in §125 we can tell you that our members are all private individual shareholders and we are financed solely by their subscriptions. In the time available we have not been able to canvass the whole membership for their views but this response has been agreed by a representative group and is consistent with UKSA's general policy as set out in our manifesto which has been distributed to the whole membership.

## Introduction

*References to paragraph numbers in the discussion paper are prefixed by §.*

Before answering the questions we draw attention to three material factors not mentioned in the paper:

### Shareholders are not owners

The discussion paper rightly makes much mention of shareholders, but also the problem of engagement in §58, mainly in connection with overseas shareholders. It is clear from the way arguments are presented that the authors assume 'shareholders' are beneficial owners, or those with an incentive to behave like beneficial owners. In fact it is clear that we are now witnessing a fundamental breakdown of corporate governance because most institutional shareholders (fund managers, nominee account providers, traders, sources of capital, providers of advice) have no incentive to act as beneficial owners. This means they have no reason to take a strong line on remuneration. It follows that some of the recommendations in the discussion paper are desirable as applied to owners but not as applied to shareholders.

*(References: 1. Our own publication: 'Responsible Investing', available at [http://www.uksa.org.uk/publications/responsible\\_investing](http://www.uksa.org.uk/publications/responsible_investing)*

*2. The final report of the Walker Review paras 5.16 –5.20*

*3., 'Are institutional investors part of the problem or part of the solution?' by Stephen Davis and Ben Heineman, – A paper showing that many of our problems are equally to be found across the Atlantic available at:*

*[http://millstein.som.yale.edu/sites/millstein.som.yale.edu/files/80235\\_CED\\_WEB.pdf](http://millstein.som.yale.edu/sites/millstein.som.yale.edu/files/80235_CED_WEB.pdf)*

*4. The Future of Finance – The LSE Report – Chapter 3 by Paul Woolley)*

As regards the question of overseas ownership, no doubt the Department is aware of the work done by Richard Jenkinson of JunctionRDS who asserts that the official figures understate the proportions held by private investors and overstate the overseas holdings. We understand that the FRC is pursuing this work with a view to reaching a conclusion on its validity.

### Shareholder committees

UKSA supports the idea of shareholder committees elected by beneficial owners to represent their interests. They provide a solution to many of the governance

problems identified in this response, including in all cases where we refer to approval/consultation with beneficial owners.

A blueprint for a committee of private shareholders is the substance of the 'Protection of Shareholders Bill', a private members bill presented to parliament by Bill Cash MP which had its first reading on 17 March 2009

## **The ethical dimension**

Directors and senior executives are (or should be) community leaders as well as business leaders. Now, particularly, we are in need of community leadership to either reverse or justify the increasing gap between the haves and the have-nots.

If business is to remain a socially acceptable part of society the rewards of its leaders need to be more than just economically justified: they need to be seen to be equitable. Otherwise respect will continue to turn to distrust and finally contempt, as is already happening to some extent as shown by the anti-capitalist demonstrations.

We agree with the comments in §81/82 concerning the likely impact of the 'narrow pool'. But deficiencies in the system of rewarding directors are caused by a breakdown in the governance chain.

We note that the discussion paper accepts as a fundamental principle that substantial performance-related rewards are desirable. However, we suggest that this concept needs careful examination. Traditionally, performance-related remuneration is mostly used in dull routine conveyor-belt type tasks where some financial incentive is important to encourage continued effort. At the other extreme we have the true entrepreneurs who take great risks in setting up their own businesses with the possibility of substantial rewards if they are successful. The people we are dealing with here are not such entrepreneurs but one might reasonably expect that they are self-motivating individuals who would be putting their very best into the job whatever the shape of the rewards structure. The idea that they may need a strong result-related incentive to get out of bed is comparatively new and should not be taken for granted.

## **Questions**

### **Role of shareholders**

1. Would a binding vote on remuneration improve shareholders' ability to hold companies to account on pay and performance? If so, how could this work in practice?

Yes	No
Yes	

Comments
<p>We believe that shareholders should have the absolute right, collectively, to limit the amounts that the directors of their companies can award themselves from the shareholders' funds.</p> <p>However, there are practical problems as quite rightly identified in the paper with simply giving binding effect to the existing annual vote on remuneration. It should be useful to see how these have been overcome in Norway, the Netherlands and Sweden – see §66.</p> <p>One way forward would be an occasional vote to set the maximum annual value of boardroom remuneration to which the directors can commit the company for current or future years. This single figure of a maximum annual value would cover the assessed value of all commitments by way of salary, bonus, deferred bonus, other benefits, long-term incentives, share options and pensions, and of any exit fees for departing directors. The shareholders would have to set the limit to allow enough headroom for the company to run its business with sufficient flexibility and yet low enough to provide a meaningful constraint. There is a precedent in the practice of specifying, in the articles of association, the maximum total amount of fees that may be paid to board members in any one year. A resolution in General Meeting is required when they need to change this figure. Currently the maximum covers only directors' fees while salary, performance fees etc paid to executive directors are outside the agreed maximum. .</p>

2. Are there any further measures that could be taken to prevent payments for failure?

Comments
<p>Yes. New directors' contracts of employment and any significant changes to directors' contracts of employment should be approved by beneficial owners before becoming binding or, at least, the commitments on termination of the engagement. This is the natural conclusion of the weaker suggestion in §70 and obviates all legal problems. Those who argue that this is unworkable have never worked in business: it is entirely normal for commitments to be undertaken with an understanding on both sides that a) higher approval is needed but b) that approval can be delivered.</p>

3. What would be the advantages and disadvantages of requiring companies to include shareholder representatives on nominations committees?

Yes	No

Comments
We do not think changes in the method of <i>selection</i> of directors would address the pay problem.

### Role of remuneration committees

4. Would there be benefits of having independent remuneration committee members with a more diverse range of professional backgrounds and what would be the risks and practical implications of any such measures?

Yes	No
Yes.	
Comments	
<p>It seems likely that giving a voice to people who are not so closely involved with the directors in other ways would be beneficial. However, they would need to have some responsibility and not just be unaccountable 'wise men'. Hence they would need to represent the beneficial owners or some wider ethical standard.</p> <p>This is an area where responsible private investors could play a role. They have knowledge, a financial interest in performance and, if retired, no longer any financial interest in raising general remuneration levels (§84).</p>	

5. Is there a need for stronger guidance on membership of remuneration committees, to prevent conflict of interest issues from arising?

Yes	No
Yes.	
Comments	
<p>The concept of 'independence' needs to be strengthened. No director setting the pay of other directors is truly independent. Further, committee members who are beneficial owners, preferably with a long-term focus, will always be more effective than those that aren't.</p> <p>In this connection we note that you do not refer to the terms of reference of remuneration committees. However, one of our members with long</p>	

experience of running a FTSE company, recently retired, has told us:

- The pay of directors and senior executives in his company increased at a greater rate than that of mid-level executives ('pay creep'), as was common with other companies
- The Chairman of his Remuneration Committee was well aware of this but felt unable to act to control it because
  - a) The rules governing the function of Remuneration Committees emphasised the primary need to attract, retain and motivate able executives, and only secondarily noted the need for moderation in executive pay.
  - b) Selecting the appropriate peer group for comparisons was as much an art as a science. Remuneration consultants were likely to choose an upper level peer group - as less likely to cause undue aggravation with executives - and emphasised the need to pay at least average to retain good people. If only good people are retained - which is as it should be – this, of course, leads to an attempt to pay everyone above average.
- He was told that many other Remuneration Committee Chairmen felt the same way and that the system resulted in larger increases than they felt comfortable with over the long term.
- The complexity of pay packages made it much more difficult to determine outcomes from awards. Whether that was the intention of remuneration consultants or an accidental consequence is open for discussion.

6. Would there be benefits of requiring companies to include employee representatives on remuneration committees and what would be the risks and practical implications of any such measures?

Yes	No
	No
Comments	
In fact it could be damaging. 'Employees' would either be manager class – and therefore interested in raising the general level of managerial/directorial pay – or lower paid, which would introduce a political process into what should be an economic and ethical one. There is also a serious problem in putting employees in the position of potential conflict with their managers. We think the Dutch position is of interest in that employees are involved in appointments but not allowed to be appointed themselves.	

7. What would be the costs and benefits of an employee vote on remuneration proposals?

Comments
The costs would be trivial (vote online). The vote needs to be non-binding and therefore have no legal status, which would obviate quibbles about control and precisely who qualifies. There would be some benefit from the moral pressure that an adverse vote (relative to previous votes i.e. indicating that disapproval was increasing) would place on the Remuneration Committee.

8. Will an increase in transparency over the use of remuneration consultants help to prevent conflict of interest or is there a role for stronger guidance or regulation?

Yes	No
Yes and yes	
Comments	
Remuneration consultants, their method of appointment and the way they report are fundamental to the problem. They are appointed by people whose economic interest is in generating high remuneration in a socially acceptable way, and their reports are not public. In short they are conflicted and they operate in secret (§97). The consequence of their expertise is manifest in the complex remuneration structures now common.	

### Structure of remuneration

9. Could the link between pay and performance be strengthened by moving away from TSR and EPS as the key measures of performance?

Yes	No
Yes. See also answer to Q 12.	
Comments	
<p>However there is a more fundamental issue. A recent report questions whether there has been any link at all between pay and performance. This raises the question of whether there are any mechanistic measures that reliably measure and reward a senior director's contribution to the overall performance of a collective enterprise.</p> <p>(Reference 'What are we paying for? Exploring executive pay and performance' published by the High Pay Commission 5 September 2011)</p>	

10. Should more companies be encouraged to adopt vesting periods of more than three years?

Yes	No
Yes.	
Comments	
The reasons in §111 apply. In fact, if it is believed that motivation by money is important, this is essential. The longer term decisions are the important ones and there is a great need to get away from incentives that emphasise short term results.	

11. Should companies be encouraged to reduce the frequency with which long-term incentive plans and other elements of remuneration are reviewed? What would be the benefits and challenges of doing this?

Yes	No
Yes.	
Comments	
Plans that are frequently reviewed are in effect options against the shareholders (things go well and we cash in, things go badly and we review the plan).	

12. Would radically simpler models of remuneration which rely on a directors' level of share ownership to incentivise them to boost shareholder value, more effectively align directors with the interests of shareholders?

Yes	No
Yes.	
Comments	
The simplest and best way of 'aligning with the interests of shareholders' is for directors to <i>be</i> shareholders. But they need to be obliged to continue to hold the shares at least for a reasonable period had elapsed after the end of the employment. One possibility would be to establish trust funds with rules similar to pension funds so that the shares could <i>never</i> be sold except under drawdown-type	



arrangements.

13. Are there other ways in which remuneration - including bonuses, LTIPs, share options and pensions – could be simplified?

Yes	No
Yes.	
There is certainly a need for greater simplification, as mentioned in the discussion paper. The nearer it can get to simple basic salary, the better but certainly the enormous complications that exist at present need to be drastically reduced.	

14. Should all UK quoted companies be required to put in place claw-back mechanisms?

Yes	No
Comments	
It's an attractive idea, but we are not sure how it could be made to work unless something like the trust fund provision (Q12) is in place.	

### Promoting good practice

15. What is the best way of coordinating research on executive pay, highlighting emerging practice and maintaining a focus on the provision of accurate information on these issues?

Comments
It might be useful to encourage the annual publication of lists of the total remuneration of all directors of FTSE 100 companies. Also, more research

purporting to support published positions should be made publicly available, without fee, for scrutiny. Too much 'research' of dubious quality supports the positions of those who fund it. As a minimum the funding of the research should be revealed.

We are unable to find any research, publicly available without fee, that supports the contention that there is a connection between pay and performance.