Boardroom pay and the pretence of shareholder governance

by Peter Parry

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In my *Examination of boardroom Pay*, published by the UK Shareholders' Association in March 2015, I looked at the general concerns surrounding directors' pay. This paper looks at a specific aspect of how directors' pay is presented in the report of the Remuneration Committee which forms part of the Annual Report. The reason that this is important for shareholders is because most FTSE100 companies provide:

Details of what the chief executive and other directors actually earned during the year

A performance criteria pay chart which shows for varying levels of performance the likely amount that individual directors will earn over the coming year.

The governance systems on pay are supposed to function on the basis that shareholders will vote on directors' pay at that annual meeting and thus ensure effective control over the levels of pay awarded. However, as we shall see, there is a significant disconnect between what shareholders are often led to believe directors will be paid during the coming year, based on the performance criteria pay chart and what they actually end up receiving.

The analysis for this article uses information contained in the annual report for the house builder Taylor Wimpey where in 2014 Pete Redfern, the Chief Executive, earned a total of £5.8m. Taking 2013 and 2014 together he earned a total of £12.5 million. Taylor Wimpey is a good example to use because the Remuneration Report is clear and well-presented and is easy to analyse. The Company Secretary was prompt in providing answers to my queries. Taylor Wimpey is also very similar to many other FTSE 100 companies in terms of the way in which it presents information on boardroom pay.

£12.5m over two years.....How did the CEO end up getting so much?

The Annual report for 2014 shows that Pete Redfern's remuneration over the last two years comprised the following elements:

Table 1. **Composition of Taylor Wimpey CEO's pay 2013-2014**

Component	**2013** £'000	**2014** £'000
Fees and salary	£749	£768
Benefits	£30	£43
Short term incentive award	£1,018	£1,043
Long term incentive plan	£4,747	£3,770
Pension	£180	£185
TOTAL	**£6,724**	**£5,809**

It is interesting to note that 'fees and salary' (basic salary) makes up just 12 – 15% of total pay while around 60% of the whole package in each year is accounted for by long term incentives (LTIPs). As with so many other FTSE companies, these LTIP awards typically take the form of share options and 'performance shares'.

In many respects Taylor Wimpey's Remuneration Report is good, in that it gives plenty of detail about directors' pay and its composition. It also gives plenty of information about the performance criteria that directors have to meet to achieve their bonus targets. One may disapprove of the levels of pay but the remuneration report scores well on information disclosure. But just how helpful is some of this information for shareholders who are supposed to control directors' pay by monitoring and voting on proposed pay awards?

Lies, damned lies and statutory requirements!

The 2014 Annual Report gives a Performance Criteria Pay Chart showing the pay that Pete Redfern and two other directors can earn over the coming year (ie this year, 2015) depending on their performance. For Pete Redfern the Pay Chart shows the following information:

Table 2. **Performance Criteria Pay Chart 2015**

	Below target	**Target**	**Maximum**
% of remuneration accounted for by:			
LTIP		16%	42%
Bonus		31%	31%
Salary	100%	53%	27%
Total Remuneration £'000	**£1,030**	**£1,946**	**£3,816**

From this shareholders might think that the maximum amount that Pete Redfern can earn in 2015 is £3.8m. This is significantly less than the £5.8m that he earned in 2014. So does this mean that the Company is starting to get the CEO's pay under control? The answer to this is, no! If we look at the Performance Criteria Pay Chart in the previous year's (i.e. 2013) Annual Report we can see that this is far from being the case.

Table 3. **Performance Criteria Pay Chart 2014**

	Below target	**Target**	**Maximum**
% of remuneration accounted for by:			
LTIP		16%	42%
Bonus		31%	31%
Salary	100%	53%	27%
Total Remuneration £'000	**£962**	**£1,829**	**£3,601**

This suggested that Pete Redfern might earn a maximum of £3.6m in 2014. In fact, we know that he earned £5.8m. If we look back to the 2012 Annual report a similar picture emerges. The Performance Criteria Pay Chart suggests that Pete Redfern might reasonably have expected to earn about £1.7m for 'Target' performance and that the maximum he could possibly have earned given spectacular performance would be £3.5m. But, as we know, he was paid £6.7m in 2013 - almost double what we might have expected from the information given in the 2012 Annual Report.

So has Pete Redfern's remuneration always been significantly higher than shareholders might have expected? The 2012 Annual report shows his total pay took a sudden leap in 2013 as the table below shows.

Table 4. **Taylor Wimpey CEO Total Remuneration 2011 -2014**

	2014	**2013**	**2012**	**2011**
Total remuneration £m	£5.809	£6.724	£1.837	£1.771

Thus, it was only from 2013 that fairly aggressive share option and 'performance share plans' put in place in 2008 (and approved by the shareholders at the time) started paying out. Superficially, the logic of this sounds simple, but let's just take a closer look at how it all works.

Effective governance and statutory requirements for reporting on pay… Who designed this?

In March 2015, I wrote to Taylor Wimpey and the Company Secretary promptly responded with the following fulsome explanation:

The pay scenario chart, looking forward to the year in question, and the pay table published the following year, looking back at the year in question, have different constituents.

The former shows what an Executive Director's LTIP reward would be, if maximum vesting was achieved, when that LTIP vests. That is three years' hence, at the end of the LTIP performance period, and not the following year. The following year, we report pay, benefits, pension and STIA (bonus) all as per the pay scenario chart forecast published the preceding year, but the one remaining element of that year's cash receipts – LTIP vesting – relates to an LTIP awarded three years earlier, whose three year performance period has just ended.

Thus there is a disconnect between the elements in the 2014 pay scenarios as forecast in the 2013 Annual Report, and the element included in the reporting of the cash actually received from the Company during 2014 as reported in the 2014 Annual Report. The LTIP in the former (the pay scenarios chart for 2014 in the 2013 Annual Report) is the 2014 LTIP award that may vest in 2017 and be reported in the cash earnings for 2017; whilst the LTIP in the latter (the pay table for 2014 in the 2014 Annual Report) includes the value of the LTIP awards from 2011 (part) and 2012 (part) that vested during 2014, as described on page 79.

During the three year performance period of the awards made in 2010 and 2011 but vesting and paid out in 2014, the shares awarded increased in value on the Stock Exchange by 192% (2011 LTIP award shares) and 161% (2012 award).

In reporting terms, the methodology to be used for each of the scenario chart for a year and the single figure reported for the same year, are prescribed by statute, and thus give rise to the apparent inconsistency you have identified.

Did you understand all that? No….? Well, I'm not sure that I do either. I sort of get the gist of it but the complexity of the whole arrangement means that it is nigh on impossible to understand what Pete Redfern's total remuneration is going to be in any given year – even if we assume for the sake of simplicity that he will achieve or exceed his most stretching performance targets for the coming year. I suspect that even he may not fully understand it.

One other point to note is the comment by the company secretary that Taylor Wimpey is following a reporting methodology which is prescribed by statute. In other words, if the information is presented in a way that is misleading (and which also strikes at the heart of effective governance), it is not the Company's fault. This is a matter of concern to the UK Shareholders' Association, which was taken up unsuccessfully with the previous Secretary of State for Business (Vince Cable) and is likely to be raised again with his successor (Sajid Javid).

Conclusions

Two good reasons for analysing the Taylor Wimpey remuneration report are:

- The obvious discrepancy between what shareholders are being led to believe Pete Redfern can earn and what he has actually earned over the last two years.
- The relative clarity of much of the information presented.

Other companies use a similar system of publishing an 'estimate of future potential reward opportunities' for executive directors along with a single total figure of (actual) remuneration. In the case of Babcock International Group, for example, these two figures look to be more closely aligned. In 20014/15 Peter Rodgers, the CEO, earned £4.16m compared to a maximum projected of – yes, you've guessed - £4.16m. Bill Tame, the CFO earned £2.078m compared to a maximum of £2.438. Bear in mind that these estimates of the maximum payments are just that – estimates of the absolute maximum that they could earn given a spectacular performance. The estimated pay for on-budget performance for Peter Rogers and Bill Tame would have been £1.571m and £958,000 respectively. Clearly, there are serious questions that need to be asked about the setting of performance targets if the 'stretch' targets are consistently being achieved or exceeded. In the case of Taylor Wimpey the base-level, on-budget and stretch targets are fairly clearly set out. In the case of Babcock there is, in my opinion, much less clarity.

The full review that I have done of Taylor Wimpey's remuneration report can be accessed on the 'Current Papers' tab of the UKSA website. In the meantime, it is clear that the system of governance which is supposed to allow shareholders to monitor and control director's pay is fundamentally flawed. Even in the case of Taylor Wimpey (whose approach to remuneration reporting scores well on comprehensiveness of information and clarity of layout) statutory compliance seems to allow and even require the publication of information that is patently misleading. In other cases in which companies are publishing less information – particularly on the performance targets against which bonus payments have been made – it is almost impossible to tell what is going on and whether handsome pay awards made to directors are anything like justified.

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