Policy matters; but how much when it comes to directors' pay?

by Peter Parry

Over the last fifteen months I have been researching directors' pay for Eric Chalker as UKSA's Policy Director. One of the things that Eric very much wanted was an UKSA policy on directors' pay. However, I began to discover that setting a 'one-size-fits-all' policy was far from easy.

As the title for this piece attempts to convey, the whole area is fraught with ambiguity. It is not much help making vague statements about the need for CEO pay to be 'reasonable' or recommending that UKSA members vote against 'excessive pay awards'. What is considered 'reasonable' or 'excessive' varies from person to person.

Similarly, trying to devise a policy statement based on benchmarks stating that CEO pay for a company with a given level of turnover or market capitalisation should be within a specified range also seemed unhelpful. Elsewhere in this issue John Hunter has raised the question prompted by Bob Dudley's pay at BP. He questions whether a CEO who is trying to turn round a struggling business going through one of the worst periods in its history is worth more than the CEO of a similar business cruising along making steady profits under a cloudless sky in calm seas. You may still think that Bob Dudley's £14m pay was too high but the point that John raises is of fundamental importance in the debate about directors' pay.

Advisory and binding votes – how much real power do they give shareholders?

This leads on to another aspect of policy on directors' pay: the binding vote on remuneration policy. Every three years shareholders have the opportunity to vote on a company's pay policy for its directors. While this requirement, introduced under the coalition government when Vince Cable was in charge at BIS, is welcome its real impact in achieving effective governance over pay is limited. Policies tend to be framed in broad and often vague terms – particularly where it is attractive for the company to have plenty of 'wiggle-room'. Companies, therefore, often talk about the need to have remuneration policies that will 'enable the company to attract and retain the best talent' or 'world-class leaders'. There will usually be references to paying a 'highly competitive' basic salary and further incentives based on a short term bonus plus long term incentive awards (LTIPs), which can often be as high as 300% or more of basic salary. Various performance metrics such as earnings per share

(EPS) and total shareholder return (TSR) along with other measures may also be stated. These policies look plausible but mean little. Consequently the binding vote on pay policy is of limited value in asserting shareholder control over pay.

What share holders need is a binding vote on the implementation of the pay policy (not just an advisory vote). The vote also needs to be on the implementation of the policy for the *coming* year; not the one that has just gone and for which the pay has already been awarded. This means telling shareholders what the performance metrics are for the coming year and, most importantly, what the specific targets are that are to be achieved. While these changes are vital to ensure effective shareholder oversight of pay, they will take time to achieve.

Role of the remuneration committee

Although the debate about directors' pay has been ebbing and flowing for at least the last twenty years, the latest round of rebellions has put the spotlight on the role of the remuneration committee and, in particular, that of the chair. At BP there have been calls for Dame Anne Dowling, the chair of the remuneration committee, to resign. One corporate governance manager at a big UK investment house commenting on BP was quoted in the FT as saying: 'She (Dame Anne Dowling) was not listening to shareholders – it was really that simple'.

It seems that fund managers in general are taking a closer interest in the way in which remuneration committees perform. Commenting on Sir Martin Sorrell's £70m pay package at WPP one fund manager has said: 'Remco (remuneration committee) people have been consistently unimpressive at WPP. Sir John (John Hood, Chair of the WPP remco) had his critics at BG, so he is one we are watching closely'.

Simon Walker, director at the Institute of Directors has commented 'Remco chairs need guts. You need to be able to stand up to the executives and use your common sense'. The remcos are made up of non-executive directors specifically because it is their primary role to be independent and represent the interests of the shareholders - not to act as acquiescent stooges to the executive directors. Shockingly, the AstraZeneca annual remuneration report for 2015 openly states: '*Performance measures are recommended by the CEO and determined by the Remuneration Committee'.* This is in clear contravention of the FRC's UK Corporate Governance Code which states: *'No director should be involved in deciding his or her own remuneration'.*

Making the most of existing powers

If we want meaningful policies they need to address specific issues on pay – a series of well-aimed rifle shots rather than a scatter-gun approach. One place in which we can start is by recommending that if UKSA members do not like a company's pay policy and / or its implementation they should certainly vote against it at the AGM but, more importantly, they should also vote against the re-election of the chair of the remuneration committee and all members of the committee itself who are standing for re-election. These people are supposed to be independent non-executives looking after our interests as shareholders. If we do not believe they are doing their job in this respect they should not be re-elected. This is an important power that shareholders already have and one which we should be making much better use of in future. In the meantime, I would ask all TPI readers to let me and the UKSA board have their views on how we can best go about framing a meaningful and workable policy on directors' pay.

Peter Parry