BIS | Department for Business Innovation & Skills

Executive Pay: Shareholder Voting Rights Consultation Response Form

The closing date for this consultation is 27 April 2012

Please return completed forms to:

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Name of respondent

FairPensions

Please state whether you are responding as an individual or representing the views of an organisation by ticking the appropriate box below:

	Business or business representative organisation
	Investor or investor representative organisation
	Government or regulator
	Lawyer
	Remuneration consultant
	Other professional advisor
	Trade union or employee organisation
	Individual
x	Other (please describe) Non-government organisation

Question 1: The Government proposes to require an annual binding vote on remuneration policy. What are the costs and benefits of this approach?

Costs:

We make no comment on costs except to reiterate the government's point, made in para 68 of the consultation document, that companies and shareholders will likely seek to engage more effectively prior to the vote in order to arrive at an acceptable package and thereby avoid the consequences of a defeat. The aggregate costs associated with rejection of remuneration reports might therefore be expected to be low.

Benefits:

A binding vote on future remuneration policy should realise some of the benefits of a binding vote on the remuneration report as a whole, which we supported in our previous response. By requiring companies to take shareholder dissent more seriously, this measure has the potential to help bring down excessive pay which does not reflect company performance, thereby improving returns to savers and morale among employees. Perhaps more importantly, enabling more effective oversight of incentives at the top could help improve alignment of interests and

thereby generate larger benefits in terms of improved long-term performance which exceed the amounts involved in the remuneration packages themselves.

Although we support the proposal for a binding vote, we are sceptical that this will by itself "address the shortcomings of the current advisory vote" (para 5). The potential benefits of this measure will only be realised if a) shareholders show a willingness to vote down unacceptable remuneration proposals, and b) companies show a willingness to take seriously shareholder dissent short of an outright defeat. If this does not materialise, the binding vote will not create the additional incentives for engagement prior to the vote which the government rightly hopes for. There may therefore be a need for supplementary measures to tackle the underlying deficiencies in engagement and voting behaviours on both sides. This is explored further below, particularly in our response to Q6.

Question 2: In the event that a company fails the binding vote on remuneration policy, the Government proposes that it maintains its existing policy or returns to shareholders with amended proposals within 90 days. What are the costs and benefits of this approach?

Costs:

We agree with the government that this proposal carries a risk of companies choosing to continue with a policy which shareholders find unacceptable. As the consultation paper notes, rejection of the remuneration report will only occur in extreme circumstances – which may well include a failure by the company to respond to shareholder dissent short of a defeat in previous years. In such circumstances, allowing the company to fall back on its existing policy would seem particularly problematic.

We would also query whether the sanction suggested in para 70, of shareholders using their votes on the re-election of directors to put pressure on the company, is realistic. Voting directors off the board is both a blunt instrument and an extreme rarity; shareholders may have other valid reasons for not wishing to exercise this 'nuclear option'. If it is not practical to impose an absolute requirement on companies to hold an EGM and propose a new policy, further consideration may therefore need to be given to alternative sanctions to prevent these perverse consequences. For example, the Corporate Governance Code could be amended to require the chair of the remuneration committee to resign that position in the event that the remuneration report is defeated. This would provide both a sanction and a mechanism for change short of removing directors from the board altogether. Alternatively, a right of action for shareholders, which as para 71 notes already exists in relation to some other types of unauthorised expenditure, may indeed be necessary to guard against failure to heed the results of a binding vote.

Question 3: The Government proposes that directors' service contracts and other arrangements should, if necessary, be amended to take account of the new requirement to seek shareholder approval of remuneration policy. What are the costs and benefits of this approach?

This provision would seem to be a logical and necessary corollary of a binding shareholder vote on remuneration policy. However, we have no further comment to make about costs and benefits since this falls outside our area of expertise.

Question 4: The Government proposes that remuneration packages offered to in-year recruits should be confined by the limits and structures set out in the agreed remuneration policy. What are the costs and benefits of this approach?

Costs:

It might be argued that this will restrict companies' ability to negotiate effectively and thereby to secure talent in competition with overseas companies who are not thus restricted. However, given that negotiations would only be restricted by the terms of the remuneration policy – and companies are unlikely to propose, or shareholders to demand, a policy that unduly restricts the company's ability to attract talent – such an objection would seem largely unfounded.

Benefits:

We agree that this proposal is sensible but would note that the benefits outlined in para 80 of the consultation paper are not guaranteed: as noted in para 79, shareholders may approve a remuneration policy that gives total freedom to companies in negotiating pay deals with external hires. Whilst we do not suggest that shareholders' flexibility in this respect could or should be curtailed, this is another area where cultural change among institutional investors will be a necessary condition for the success of the policy. One possible measure to improve the effectiveness of this aspect of the proposals might be to require details of the remuneration package granted to new hires to be included in the relevant year's retrospective remuneration report, regardless of the degree of flexibility afforded by the remuneration policy.

Question 5: The Government proposes that the report on future remuneration policy should provide more details on how approved LTIPs will operate for directors in that particular year. Do you agree with this approach?

Yes. It is widely acknowledged that LTIPs have been a significant factor both in the increasing complexity of remuneration packages and in driving up overall levels of remuneration regardless of company performance. Improving shareholder oversight of LTIPs therefore has an important contribution to make to the government's overall objective of ensuring transparency and accountability in setting remuneration.

Question 6: The Government proposes to increase the level of shareholder support that should be required to pass the vote on future remuneration policy. Do you agree with this approach and if so, what would be an appropriate threshold?

The argument for a 75% threshold appears to be largely pragmatic rather than principled, resting on the low likelihood of remuneration reports being defeated at a

50% threshold. We agree that this presents a problem for the success of the binding vote: if, as in 2011, no FTSE 100 company faces the prospect of a defeat, it is difficult to see how the binding vote would generate behavioural change compared to the current situation under the advisory vote. However, we would suggest that this fundamental problem cannot be resolved simply by raising the threshold. For example, one reason the 50% threshold is rarely reached is the general unwillingness of many shareholders to vote against management, with levels of dissent on remuneration remaining low (albeit, as the paper notes, higher than for other types of resolution). If the threshold were raised without this underlying cultural issue being tackled, one might expect levels of dissent to simply recalibrate accordingly.

Avenues which the government could explore to help secure the success of its proposed policy on binding votes, in the absence of a higher threshold, might include:

- **Sanctions associated with levels of shareholder dissent** short of a majority, as currently proposed in relation to the advisory vote (see response to Q7).

- Changes to the way **abstentions** are recorded. In our experience, the failure in law and practice to distinguish between a considered abstention and a failure to vote contributes to high votes in favour of management. When FairPensions co-ordinated shareholder resolutions on oil sands at BP and Shell in 2010, one prominent asset manager told us that they would be voting against, although they supported the substance of the resolution, because they had a policy of not supporting shareholder resolutions, yet would not abstain because they felt it was important to "use their vote". This is despite the Stewardship Code's explicit recognition of abstention as a valid voting decision. As the consultation paper notes, the ability to ignore abstentions also allows companies to present a higher degree of shareholder support for their remuneration proposals than in fact exists.

- **Improving transparency and accountability** of shareholders themselves to the people whose money they manage, in order to ensure that the accountability which the government is seeking to engender at company level extends to shareholders as well. Institutional shareholders may be principals in relation to directors, but it is vital to remember that they are agents in relation to their beneficiaries. In our experience, beneficiaries often find it extremely difficult to hold their agents to account due to an endemic lack of transparency. Government could exercise the reserve powers in section 1277 of the Companies Act 2006 to introduce **mandatory voting disclosure**, either for all votes cast or specifically in relation to votes on remuneration.

- **Addressing the conflicts of interest** which can hamper institutional investors from taking a robust approach to executive pay. For example, a 2011 article by governance expert Simon Wong cited anecdotal evidence that "the company secretary of a UK manufacturer reminded a fund manager who was intending to vote against the company's remuneration report that his firm was bidding for an investment mandate from the corporation's pension plan". It also notes that in financial conglomerates, "corporate or investment banking staff overtly or subtly

pressur[e] their asset management colleagues to avoid antagonising their clients by, for example, voting against the CEO's pay arrangements." Government could work with the FSA to ensure that its work on conflicts of interest encompasses voting and engagement, and to ensure that asset managers understand and accept their **fiduciary obligations**, which may require them to avoid such conflicts.

- The effects of fragmentation of share-ownership on the likelihood of a majority vote against management may be partially addressed by proposals for **differential voting rights** for long-term or stewardship investors, currently being considered by Professor Kay's Review of UK equity markets.

Question 7: The Government proposes to require companies to explain how the results of the advisory vote have been taken into account the following year and to issue a statement to the market sooner than this where there is a significant level of shareholder dissent. What are the costs and benefits of this approach?

Costs:

Companies will be best placed to comment on this but we would expect the direct costs of this proposal to be minimal.

Benefits:

This should help to ensure that companies take significant levels of dissent seriously and that the advisory vote has a real impact on remuneration practices. As per our response to Q6, if the government decides not to proceed with a 75% threshold for the binding vote on remuneration policy, it would seem consistent to impose the same requirement (i.e. for a statement to be issued to the market in the event that less than 75% of votes are secured) on the binding vote as is here proposed for the advisory vote. This would help to ensure, given the low likelihood of outright defeat of the remuneration report, that both the binding and advisory vote are effective in controlling excessive pay.

As suggested in Q2 in relation to the binding vote, we remain unconvinced that general powers of re-election are a sufficient sanction to ensure that the results of the advisory vote are heeded. One possibility would be to require the chair of the remuneration committee to resign that position if a majority vote were not secured (or perhaps if the report were defeated two years' running, in recognition of the lower status of the advisory vote compared to the binding vote on future remuneration policy).

Question 8: The Government proposes to give shareholder a binding vote on exit payments of more than one year's base salary. Do you agree with this approach or would an alternative threshold for requiring a shareholder vote be more appropriate?

We agree in principle with the introduction of a binding vote on exit payments, but have no comment to make about the appropriate threshold. We note that concerns have been expressed by some parties that a requirement to seek shareholder approval could make it difficult to remove underperformers in a timely fashion. We see no reason why this should be the case, since it is precisely where there is an urgent need to remove an underperforming executive that high exit payments are likely to be unjustified and unacceptable. If the company avoids making such payments it will still be able to remove the underperforming executive without triggering the need for a shareholder vote. Indeed, arguably this simply creates an additional, helpful incentive for companies to avoid making unjustifiable payments for failure. Just as the desire to avoid defeat in the binding vote on remuneration policy should encourage better engagement beforehand, this should therefore create a dynamic which assists with achieving the policy objective in question.

Question 9: The Government recognises that the circumstances under which a director leaves their post are complex and diverse and so invites feedback on the appropriate scope and breadth of the proposed legislative measures.

No comment.

Question 10: The Government proposes that directors' service contracts and other arrangements should be amended to take account of the new requirement to seek shareholder approval for exit payments over one year's base salary. What are the costs and benefits of this approach?

This provision would seem to be a logical and necessary corollary of a binding shareholder vote on exit payments. However, we have no further comment to make about costs and benefits since this falls outside our area of expertise.

Question 11: The Government notes that a small number of directors could be entitled to generous pension enhancements if their contract is terminated early. It proposes not to legislate to override these rights, owing to the rarity of such arrangements and the complexity of legislation that would be required. Do you agree with this approach?

No comment.

Question 12: The Government proposes to leave unchanged the existing requirement in company law (section 188 of the Companies Act) to get members' approval for notice periods of more than two years. Do you agree with this approach?

We do not have strong views on this proposal, but it would seem logical to bring the legal position into line with current best practice and with the proposals for a binding vote on exit payments above one year's salary. Failure to do this could potentially undermine the intent of the binding vote on exit payments, particularly given the general unlikelihood of an outright defeat.

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