Executive pay:

An analysis of the Government's reforms

JUNE 2012

On Wednesday 20 June, Vince Cable announced details of government plans aimed at tackling excessive executive pay. This briefing outlines the key features of the announcement and FairPensions' response.

THE GOVERNMENT'S PACKAGE OF REFORMS

Binding votes

- The government confirmed its intention to introduce binding shareholder votes on future pay policy in addition to the current advisory vote on company remuneration reports.
- The government had originally proposed an annual binding vote on future pay policy and a separate binding vote on exit payments ('golden goodbyes') of over one year's salary.
- Instead, binding votes will now be held every three years, although companies will have to hold a binding vote if they wish to change their pay policy in the intervening years.
- The policy must cover the company's approach to exit payments, and when a director leaves, companies must publish a statement to shareholders detailing the payments they have received. However, there will be no separate vote on individual exit payments.
- The binding votes will require a simple majority to pass (50%), rather than the 75% 'super-majority' which had been floated.
- Companies will be legally obliged to make payments only within the limits of the policy agreed by shareholders.
- The annual advisory vote on the implementation of remuneration will remain. If a company loses the advisory vote, it will automatically trigger a binding vote on policy the following year.

Transparency

The government also announced a number of changes to the content of company remuneration reports, including:

- A single total figure of remuneration for each director
- Detail on directors' performance against criteria for 'long-term incentive' plans
- Detail on variable pay (i.e. bonuses) awarded that year and on exit payments (i.e. golden goodbyes) awarded that year
- Chart comparing company performance and CEO pay
- Information about use of remuneration consultants.

Next steps

The government will now implement these measures through:

- amendments to the Enterprise and Regulatory Reform Bill
- revised regulations on remuneration reporting

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ANALYSIS OF THE PROPOSALS: Q&A

What will be the impact of the binding vote?

- Vince Cable has said that the triennial binding vote will create “a real, lasting and binding control on pay”[1].
- There is agreement across the political spectrum that the high pay problem is not restricted to a few ‘bad apples’ but extends across Britain’s biggest companies: the median total remuneration of FTSE 100 CEOs rose an average of 13.6% a year between 1999 and 2010.[2]
- Yet shareholder defeats on remuneration are still a rarity. Even in this year’s so-called ‘Shareholder Spring’, only two FTSE 100 companies (or five FTSE 250 companies) have suffered defeats.[3]
- It is therefore doubtful whether, without more, this package will deliver the sea-change in pay practices which the government says is needed.

Why does the final package differ from the government’s original proposals?

- The three-year binding vote has been justified as encouraging companies and investors to think long-term.
- However, this argument was not made in the government’s consultation on binding votes, nor was this option consulted on.
- Reports suggest that this announcement reflects a compromise reached with company and investor organisations which had originally opposed a binding vote altogether.[4]
- This dynamic is concerning. The government’s approach has always rested on giving shareholders the tools to rein in excessive pay. The fact that it appears to have toned down its plans because of reluctance from shareholders themselves to be given these tools suggests that this approach may be flawed.

What more should be done?

- FairPensions believes that if shareholders are to be relied upon to hold companies to account, government must also introduce measures to enable shareholders themselves to be held to account.
- We agree with the government that this year’s ‘Shareholder Spring’ was prompted largely by public debate about executive pay and the scrutiny this generated of shareholders’ voting decisions.
- Experience suggests that shareholders may not have the appetite to continue taking a robust line on executive pay when this scrutiny dies away.
- Government must therefore embed accountability mechanisms which enable ordinary savers, whose money is managed by institutional shareholders such as pension funds, to hold their agents accountable.
- This should include mandatory public disclosure of investors’ voting records (see box overleaf).

Voting disclosure

- In his oral statement, Vince Cable said that the government would "consider further action if the number of investors volunteering to disclose their voting records does not continue to increase."
- FairPensions welcomes this and continues to believe that mandatory voting disclosure requirements are already justified by the slow pace of voluntary improvements.
- The statement quoted evidence that "up to three quarters" of institutional investors already disclose their voting records.
- However, the research in question, authored by the Investment Management Association[5], in fact applies only to the subset of investors who have signed up to the UK Stewardship Code and who responded to the IMA's survey. The proportion of all investors disclosing is likely to be significantly lower.
- Moreover, the IMA's total disclosure figure includes investors who only provide summary statistics (e.g. on the number of votes cast for and against management in a given year), which gives no insight into their voting on particular issues or at particular companies.
- Research by PIRC suggests that, even among Stewardship Code signatories, the proportion disclosing full voting information is in fact just 21%.[6]
- Analysis of the reasons given for non-disclosure offers little hope that these firms will begin disclosing in the near future. According to the IMA research, disclosure levels only improved by 4% in 2010-11.

Further reading

- **Vince Cable's oral statement:** http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm120620/debtext/120620-0001.htm#12062086000003
- **BIS guide to government proposals:** http://www.bis.gov.uk/assets/biscore/business-law/docs/d/12-900-directors-pay-guide-to-reforms.pdf
- **FairPensions briefing on Queen's Speech:** http://www.fairpensions.org.uk/sites/default/files/uploaded_files/press/QueenSpeech2012.pdf
- **FairPensions briefing on 'Your Say on Pay' campaign:** http://www.fairpensions.org.uk/sites/default/files/uploaded_files/YourSayOnPay_May2012.pdf

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For our other briefings on executive pay please see www.fairpensions.org.uk/policy

ABOUT FAIRPENSIONS

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers. RI generally involves shareholder engagement with companies to ensure that environmental, social and corporate governance (ESG) risks with the potential to affect long-term financial returns are monitored and managed. We also work with policymakers to improve transparency and accountability to savers, and to remove regulatory barriers to RI.

1. House of Commons Hansard, 20 June 2012, C865
2. http://www.bis.gov.uk/assets/biscore/business-law/docs/e/11-1287-executive-remuneration-discussion-paper.pdf
3. FTSE 100s: Aviva, WPP. FTSE 250s: Pendragon, Cairn Energy, Centamin.
4. E.g. http://www.ft.com/cms/s/0/c7fad26a-b17f-11e1-bbf9-00144feabdc0.html#axzz1yRbvqSjk
5. http://www.investmentuk.org/research/stewardship-survey/
6. http://www.pirc.co.uk/news/voting-disclosure-revisited

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