Excessive executive remuneration and rewards for failure in the boardroom are of growing concern to pension savers. The Government is looking to companies’ shareholders to use their votes to signal the need for restraint in top pay and to secure better alignment of management’s incentives with the long-term interests of savers.

During 2012, hundreds of thousands of votes on companies’ remuneration proposals will be cast by asset managers on behalf of pension trustees and individual savers. Trustees should be confident that their asset managers are engaging with companies on pay and using their votes in an intelligent, informed manner. Oversight of managers in this domain is part of trustees’ fiduciary duty to beneficiaries.

This briefing provides trustees with simple questions they can ask their asset managers in order to develop confidence in the voting and engagement activities undertaken on their behalf. In compiling this briefing, FairPensions has consulted a number of experts on executive remuneration and has drawn on institutional best practice guidance.

Questions to ask asset managers on executive remuneration

Company Annual General Meeting (“AGM”) season, when votes are cast on remuneration plans and other proposals, is a particularly busy time for asset managers and is most intensive from April through to July. It will help all parties if pension funds let their managers know as early as possible in 2012 that executive pay is an issue of particular interest to them.

Certain remuneration practices have a particularly poor reputation amongst shareholders and have become a by-word for unjustifiably rewarding senior executives. These include:

- Weak linkage to strategy with single performance criteria for incentive plans
- Transaction related bonuses and “Golden Hellos” (recruitment incentives)
- Moving the performance goal-posts on incentive plans
- Variable pay which has the potential to be more than 200% of base salary
- Repeatedly refusing to engage in good faith with shareholders about remuneration whilst ignoring strong votes against remuneration proposals

See page 3 for additional detail on each of the above

Pension funds should ask asset managers to explain how votes were cast, and why, where these practices feature in a company’s remuneration proposal.

Flagging such practices with managers at the start of AGM season will encourage closer attention to them as votes are cast and will assist managers in providing thoughtful explanations later in the year.
Why vigilant oversight of asset managers by pension funds is needed on pay

Recent and historical voting data on remuneration proposals suggest that trustees should not assume their asset managers will use the vote to challenge poor practice in executive remuneration. This is a key area of corporate governance where it makes sense for trustees to seek explicit clarification from managers on how votes have been cast and why.

Shareholders of UK companies have had a ‘Say on Pay’ since 2002. Just 18 remuneration proposals have been rejected by a majority of investors since then despite the escalation in executive pay over that period.¹

With some notable exceptions, asset management firms have shown themselves reluctant to vote against or even abstain on companies’ pay proposals.² In 2010, a mere 9% of remuneration reports recorded a vote against of 20% or more; less than 4% recorded a vote against of 30% or more.³

Given the growth in public and political concern about high pay, asset managers’ reticence to challenge mis-alignment and to take a more robust voting stance on executive pay is curious.

Trustees might ask asset managers the following:

1) What engagement with companies will the manager be undertaking to ensure that remuneration proposals are aligned with corporate strategy and that executives will not be paid more than is necessary to attract, retain and motivate them?

2) On what basis would the asset manager withhold support for a remuneration proposal?

3) What does the asset manager regard as an appropriate quantum of total pay for the median chief executive of a FTSE 100 company?

4) With reference to the Corporate Governance Code, what does the manager regard as an appropriate ratio between the remuneration of directors and the median pay of UK based workers in the same companies?

High pay: Why all the fuss?

Manifest and MM&K have prepared a data series drawing on disclosures in annual reports. The 12 year trend data to 2010 shows the FTSE 100 index had not increased over that period. Total CEO pay had grown by 323% whilst Average UK earnings grew by 54%.⁴

There are positive recent signs that some remuneration committees are taking notice of investor and public disquiet over executive awards. We expect many remuneration proposals in 2012 to reflect the growing call for restraint. Nevertheless, history suggests that certain firms are astonishingly insensitive to external pressure. It is therefore essential that asset managers maintain close scrutiny of remuneration proposals and engage pro-actively with remuneration committees.

¹ http://www.pirc.co.uk/sites/default/files/AGM%20primer.pdf
³ Op Cit 1
⁴ Data sourced through Manifest and MM&K

Remuneration policy is seen by many investors as a litmus test for wider corporate governance practices. It encompasses board effectiveness, oversight, strategy, and risk management.

NAPF

I believe we should be pro-business, anti-greed. The quantum of executive pay is excessive and must be reduced.

Michael Darrington, former MD of Greggs
Good and bad practice: What to look out for

What shareowners want to see are demonstrable links between strategy, performance and pay. They want remuneration proposals which avoid undue complexity. Some, not all, shareowners have become very unhappy about absolute levels of reward. For others, a greater concern is the way that growth in total executive pay consistently outpaces pay elsewhere in firms.

The expert advice taken by FairPensions to define ‘contentious’ remuneration practices has resulted in the following list of issues which we believe deserve particular attention by trustees, pension providers and their asset managers:

**Single performance criteria for incentive plans** encourage an overly narrow focus by executives. In particular, total shareholder return and earnings per share are market measures not intrinsic measures of firm value. A mixed scorecard (transparently weighted) that reflects the nature of the business and its key risks is better practice. Executive attention on a company’s key environmental, social and governance risks is more likely to be achieved where remuneration is designed to encourage it.

*Companies where this issue featured recently in remuneration proposals: Home Retail, AGA, French Connection, ANZ Bank, Dimension Data Holdings.*

**Transaction bonuses** are one-off bonuses usually granted for the completion of a major transaction. They are contentious for two reasons. Firstly, many shareholders view them as a gratuitous reward to executives for doing their job rather than for exceptional performance. Secondly, they can incentivise corporate activity which is not in shareholders’ economic interest.

*Companies where transaction bonuses have featured in recent remuneration proposals: Cairn Energy (withdrawn after an investor outcry), Daily Mail General Trust, UMECO and Xstrata.*

**“Golden Hellos”** (or recruitment incentives) may be justifiable where stretching, early performance targets are in place for executives joining a firm but are not reasonable in the absence of appropriate performance targets.

*Companies where a contentious “Golden Hello” has recently featured in remuneration proposals: Unilever, ITV, Marks and Spencer, Lloyds.*

“Forcing Executives to focus on one aspect of performance may incentivise management decision-making that distorts judgement and long-term benefit”

Simon Walker, Director General, Institute of Directors
Moving the performance goal-posts on incentive plans often results in reward for failure or mediocrity.
Companies where this issue featured recently in remuneration proposals: Bellway Homes, Robert Walters.

Variable pay with the potential to be 200% or more of base salary frequently results in excessive individual payouts and an undue focus by executives on the same short-term financial metrics that incentivise asset managers. Asset owners with long time horizons will want to maintain emphasis on the totality of responsibilities reflected in the base salary.
Companies where this issue featured recently in remuneration proposals: BT, BG Group, Henderson Group, Schroders.

Ignoring shareholder sentiment on remuneration is clearly unsatisfactory. Where a company’s remuneration proposals received less than 75% shareholder support in 2011, trustees may want to know how managers have cast their votes this year.
Companies where this was a recent problem include: Aberdeen Asset Management, ICAP, Thomas Cook, TUI Travel, BAE Systems, St Modwen

As noted above, FairPensions recommends that pension funds notify asset managers as early as possible in AGM season that trustees and officers would like to see explanations at the end of the season on how votes were cast where these practices featured in 2012 remuneration proposals.

The practices above are by no means an exhaustive list of potential concerns. The NAPF’s Corporate Governance and Voting Guidelines provides a useful additional checklist of problem practices including: Increases in base salary in excess of inflation; insufficiently demanding performance targets; guaranteed, pensionable or discretionary annual bonuses; insufficient disclosure on the scope of annual bonuses and performance conditions; ex-gratia and other non-contractual payments; and unwarranted use of discretion by remuneration committees.

If you have any questions related to this briefing please contact Catherine Howarth.
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About FairPensions

FairPensions is a registered charity established to promote responsible investment practices by institutional investors. FairPensions champions greater transparency and accountability to the millions of people whose long-term savings are managed by trustees and other agents.

We are supported financially by leading charitable foundations and count amongst our member organisations a growing number of NGOs and trade unions. Over 8000 individuals support our work both by taking action directly to advance responsible investment and through personal donations. Further information can be found at www.fairpensions.org.uk

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