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

ICAS (The Institute of Chartered Accountants of Scotland)

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
✓	Other (please describe): Professional body for accountants

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

Costs:

Although we support greater engagement of shareholders in the design of remuneration we have some concerns over the practicalities of the proposal.

We reaffirm our previous response to the Department of Business Innovation and Skills‟ (BIS) discussion paper "Executive Remuneration‟ (November 2011) that:

"*We are not convinced that a binding shareholders vote on remuneration would improve their ability to hold companies to account on pay and performance. We also question how practical it would be to introduce such a measure in practice*".

We reaffirm agreement with the following comment in the BIS discussion paper[1]:

"*Given that shareholders who are particularly dissatisfied now have the additional option of voting against the annual re-election of the remuneration committee chairman, some stakeholders have questioned whether a binding vote is really necessary*".

A combination of safeguards exist including: (i) the advisory vote (which ensures there is a strong reputational risk inherent in the remuneration report being defeated), (ii) the UK Corporate Governance Code requirement for annual re-election of directors (where shareholders could register dissatisfaction via voting against the re-appointment of the Chairman of the Remuneration Committee or directors who do not appear to be performing).

We believe that together these safeguards provide the opportunity for shareholders to express their views on a company's executive remuneration policy.

We also believe that it would be very difficult to determine what aspect of the remuneration proposals a negative vote related to without a further detailed consultation of shareholders which may reveal different areas of disagreement between different shareholders. This would be impractical.

A potential administrative burden to this proposal relates to the cost and timing of an AGM or EGM. An AGM often takes place 4 or 5 months into the financial year whereas a remuneration policy is normally set and takes effect at the start of the financial year. Para 56 of the Consultation Paper (CP) states that the binding vote would:

"…*approve variable remuneration… and… performance related pay for the year ahead*".

This is understood to relate to the current year, which leaves significant uncertainty until the remuneration policy is approved – on what annual measures would executive directors be incentivised on up to the AGM? If the remuneration policy were defeated, would directors resign and how would this leave the remainder of the board and shareholders? The uncertainty over pay could make the UK less

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[1] http://www.bis.gov.uk/assets/biscore/business-law/docs/e/11-1287-executive-remuneration-discussion-paper (paragraph 65)

attractive and competitive for international executives. It would be more practical to retain the advisory vote in these circumstances.

If the AGM vote on remuneration relates to the following year, our understanding is that this would be too early in the calendar to formulate decisions on senior executive remuneration.

There is a risk that shareholders may be less inclined to register discontent against a company's remuneration policy if the outcome is binding. Indeed, investors may be more inclined to outsource governance matters to proxy agencies given the likely volume of consultations which would undermine the purpose of the process.

Another risk is that companies may be discouraged from following a 'non-standard' approach to remuneration if they believe there is a risk that this may not be fully understood by shareholders within a relatively short space of time between publication and the vote, and be voted down. There is a risk that this could be damaging to the future of some businesses in the UK.

Some companies have a significant number of overseas investors, smaller organisations and individual investors. Engaging with these groups can be more complicated. Responses can be patchy and finding common ground across different views can be difficult. In contrast, institutional investors are more likely to have arrangements in place to engage with companies to comply with good practice in the UK Stewardship Code 2010[2]. For the proposal to work effectively, shareholders will also have to engage more effectively and more speedily than may sometimes be the case.

A mix of a binding vote and advisory vote on the design and implementation of remuneration policy increases complexity rather consistency. Some concern has been raised by our members that the binding vote would cover a variety of points which complicates consultation[3]. Consistency and simplicity is preferable for more effective implementation.

The CP para 49 notes:

"*small but significant number of cases where a large proportion of shareholders withhold support for remuneration*…"

Further clarification of the definition for remuneration policy (given the intention to redraft SI 2008/410) and anticipated illustrative binding vote questions for the shareholder ballot would be helpful.

Overall, we are not convinced that the evidence is sufficiently compelling to support a one-size fits all approach. Our understanding is that public companies are increasingly seeking to engage with shareholders on remuneration proposals. There is also growing evidence of shareholder and public opinion resulting in proposed pay

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[2] http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf

[3] CP para 56 & 96.

packages being changed. Examples to date include: RBS, Barclays (pending), Cairn Energy[4] and Citigroup in the US[5].

Our preference is for a proportionate, rather than a one-size fits all approach. This would be to retain the advisory vote, maximise the use of existing safeguards, but to tighten the consequences for those companies which do not engage effectively with shareholders and respond adequately to significant shareholder dissatisfaction.

Escalation measures could include a subsequent binding vote or a complaints process for shareholders. A tiered approach can help to encourage positive improvement without penalising those companies who are already taking positive steps.

Benefits:

Whilst we support stronger shareholder engagement and say on executive remuneration, we believe that a binding vote is out-weighed by the costs and risks set out above.

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:

A 90 day period to amend the policy and return to shareholders would involve reformulating policies and further shareholder engagement prior to formal approval at an EGM. Concern has been raised by our members that the timescales are not sufficient.

This also leaves a problem as to what to do in the meantime – continue to go ahead with what you have and then retrofit a new as yet undecided solution? In practice this would be difficult and not sensible as it could distract attention from the business while leading executives are attending to this issue. Perhaps a prompt market statement could help. An example is Barclays response to shareholders following criticism of the Chief Executive's remuneration[6].

Benefits:

We agree with the principles of:

- Strengthening accountability for those setting the remuneration policy;
- Improving engagement with shareholders on executive remuneration;
- Providing an incentive for companies to avoid entering into an agreement which could conflict with the remuneration policy agreed with shareholder; and

[4] http://www.guardian.co.uk/business/2012/jan/24/cairn-energy-drops-plan-chariman-shares
[5] http://www.reuters.com/article/2012/04/17/us-citi-vote-idUSBRE83G15U20120417
[6] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9227091/Bob-Diamonds-17.7m-remuneration-package-at-Barclays-is-out-of-order-says-IoD-chief-Simon-Walker.html

- Ensuring that compensation arrangements for executives are set appropriately and in line with the company's strategy as this is important for achieving on-going stability.

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?

Costs:

Our understanding is that it is relatively unusual to amend service contracts of existing executive directors for good practice developments due to the costs required to compensate directors for this. Not only is there a 'buy-out' cost in compensating individuals for changes which are to their disadvantage (which may result in a widespread incidence of this generation of executive directors receiving compensation from shareholders' funds); there would also be additional costs incurred through external fees and time in amending documentation.

Benefits:

Service contracts need to reflect any new requirements.

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:

Whilst we agree strongly with the principle of reducing pay ratcheting through external recruitment packages and there is evidence to demonstrate that this has been a contributory factor, we have a concern that formally legislating on this matter may have unintended consequences which impact on the ability of companies to recruit from a broad talent pool.

There may be circumstances where it is necessary to recruit outside normal policy in order to ensure that the best candidates are recruited. For example, the appointment of a CEO and new directors for a company operating internationally, will be in a global market place.

The Remuneration Committee are responsible for and the best informed to make this decision which is then confirmed by the full Board. Where the company has decided to proceed with a departure from current remuneration policy we support greater transparency for the company to demonstrate to shareholders that the decision has been made in the long-term interests of shareholders, investors and other stakeholders.

Benefits:

We agree with the principle that new recruits should be remunerated consistently with the agreed remuneration policy to reduce the risk of pay ratcheting and for the

the Remuneration Committee to maintain flexibility as set out in paragraph 60 of the CP. We also support the principle set out in a recent letter to the Daily Telegraph from investors[7]:

"*5 Appropriateness – executive remuneration should reflect a company's distinct goals and not be dominated by over-reliance on peer pay comparison which can encourage excessive remuneration escalation*".

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?

Do you agree?

Yes.

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?

Do you agree?

No. We are not convinced that a level above 51% would be either fair or reasonable. A company can be taken over on the basis of a simple majority[8] yet it is proposed that 75% is required to pass the remuneration policy – this treatment is inconsistent and a stark contrast. The example precedent of a special resolution requiring a 75% majority is "*for matters that are less routine or of particular importance*" [9].

Remunerating staff, including executive directors for their work is in contrast, very much a routine process. A 75% majority is perceived as an unfair demand. There is also some concern that a high voting threshold could increase a company's vulnerability to minority pressure groups who could "hijack" the vote.

If so, what would be the appropriate threshold?

A clear majority (50%) is preferred for its fairness to as well as for consistency with other shareholding matters. Shareholder engagement can be improved using other mechanisms (see our response to questions 1 & 7) without resorting to unusually high voting levels.

Question 7: The Government proposes to require companies to explain how the results of the advisory vote have been taken into account the following

[7] http://www.telegraph.co.uk/comment/letters/9219614/Executive-remuneration-needs-to-be-kept-in-check.html
[8] Rule 10 Takeover Code http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf
[9] Consultation Paper - paragraph 93

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?

This proposal is supported. As a starting point for further consideration "significant" could represent 20% as identified in the Consultation Paper (paragraph 48).

We also support greater disclosure perhaps on the company website and referenced or summarised in the remuneration report on:

- The results of advisory votes (on the remuneration policy, variations and exit payments);
- Company responses to any "significant" objections (such as 20% dissent referred to in paragraph 48 of the CP);
- Abstention rates;
- Key trends such as increasing dissension votes or abstention rates
- The policy on performance related pay for executive directors, performance criteria and how this aligns with long term company value, targets and evaluation of directors' actual delivery and claw backs.

Where insufficient action is taken by the company to rectify the causes for shareholder dissension, a binding vote may the next level of enforcement.

The single figure for total pay will need careful consideration as some elements may include share valuations. We would be happy to assist BIS with this. Comparisons of executive pay to other dispersals need to be relevant. We are not clear on the purpose of a comparison with tax. More specific meaningful indicators are needed. Any indicators should aim to reflect longer term sustainable gains for the company.

Costs:

"Significant" shareholder dissent would need to be defined.

Benefits:

We support communication of this matter in a market statement as set out in the CP (paragraph 106).

Potentially, "significant" could capture more companies with dissenting advisory votes than a 75% binding vote (if it is based on 20%, being what is commonly viewed as significant in paragraph 48 of the CP). It focuses attention on actions being taken by companies to rectify issues where significant levels of dissenting votes have been received.

This is consistent with the principle of "comply or explain". It supports more effective engagement and communication.

Question 8: The Government proposes to give shareholders 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?

Do you agree?

No. Our preference is for exceptions to the remuneration policy to be included within the advisory vote.

There is a risk that by assuming "one size fits all", this proposal does not adequately reflect the fact that companies have differing remuneration structures. For example, some companies operate a different model where the base salaries of the executive directors are typically at or below the median of the wider market. Other benefits are then provided, such as a competitive pension benefit, so that ultimately, the overall package is market competitive, but with a different balance to the 'market median'.

This policy would essentially give a competitive advantage to those companies which operate a 'high base salary/ low benefits' policy.

There may be clear business reasons for operating such a policy and there is a concern that this policy could constrain companies in how they structure their remuneration to remain competitive in their markets.

The unintended consequences could include:

- Placing some companies at a competitive disadvantage to others which have a different model skewed more towards salary;
- The potential of deterring individuals from joining the board of those companies who operate like this due to inadequate protection in the event of severance;
- A reaction whereby executives demand that their salaries are set higher to compensate for adequate contractual protection (widening the gap between executive and workforce salaries); and
- A change in the terms of service contracts for existing directors could result in a significant one-off cost to "buy out" the contractual entitlements (as per question 3).

Would an alternative threshold be appropriate?

On an exception basis, those packages which are inconsistent with the remuneration policy.

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.

What should be the scope of the proposed legislative measures?

See the response to question 8.

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?

Costs:

See the response to question 8.

Benefits:

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?

Yes.

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?

Do you agree?

Yes.

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