

## **BEIS Select Committee Inquiry on executive pay: High Pay Centre response.**

### **About the High Pay Centre**

The High Pay Centre is an independent think-tank focused on the causes and consequences of high pay and economic inequality. We aim to produce high quality research and policy recommendations in order to support fairer pay practices, better corporate governance and more effective business performance. Our research and analysis is regularly featured in the media, while our policy recommendations – including binding shareholder votes on executive pay, mandatory publication of pay ratios and worker representation in corporate governance structures – have been supported by politicians of all parties.

This paper sets out our response to each of the four questions issued by the BEIS Select Committee in the ‘call for evidence’ on executive pay. The response is based on our ongoing analysis of the pay policies of UK-listed companies and the stewardship practices of institutional investors. We will be publishing a full review of FTSE 100 executive pay awards in partnership with the CIPD later this summer.

### **Question 1: What progress has been made on implementing the recommendations on executive pay by the previous Committee in its 2017 report on Corporate Governance?**

Many of the recommendations made in the Committee’s 2017 report have now been formally adopted as Government/regulatory policy.

For example, the Financial Reporting Council (FRC)’s proposed new corporate governance code introduces a requirement to report on how directors have fulfilled their responsibilities to all stakeholder constituencies. The FRC has also launched an initial review of the Stewardship Code, with a new draft code to be put forward for consultation later this year. The FRC itself is now subject to a review of its role and responsibilities, undertaken by Sir John Kingman.

The Committee suggested companies should consider the introduction of ‘Stakeholder Advisory Panels’ by identifying their key stakeholders and bringing them together as part of a formal and ongoing dialogue about how the company strategy affects its different stakeholder constituencies. Similar ‘stakeholder committees’ were endorsed by the Government in its proposed corporate

governance reforms as one of three options for introducing greater stakeholder voice into corporate governance structures.

These measures will boost shareholder, regulatory and stakeholder oversight of executive pay and demonstrate some progress towards the implementation of the committee's proposals. At the same time, there are other areas where we believe further action is required. Key proposals that have not yet been fully adopted are as follows:

*Policy - Stakeholder advisory panels*

The High Pay Centre is currently undertaking a project on the effectiveness of remuneration committees, where we have been meeting with business leaders and interviewing them about their corporate governance structures.

Many are interested in the proposed stakeholder committees or stakeholder advisory panels, but claim to already have works councils, customer focus groups or supplier forums that fulfill this role and do not feel that these need formalising in the corporate governance structure. In our view, these existing mechanisms are useful but would not raise the profile of stakeholder issues at the highest level of the company in the same way as a stakeholder committee or advisory panel.

*Policy - Stewardship Code guidance on engaging with companies*

The Committee rightly recommends that the FRC should set out more explicit standards for high quality engagement. It will be important to ensure this guidance should cover engagement between asset owners and asset managers, in addition to asset managers and their investee companies.

The current iteration of the Code is heavily focused on asset managers. But if asset owners fail to set long-term stewardship expectations of their asset managers, the commercial incentive for managers to be responsible stewards of the investee companies is reduced. Therefore, the new version of the Code should include more specific guidance for asset owners. They should be expected to question current and prospective asset managers regarding how they engage with investee companies; they should set out how they consider the long-term social and environmental impact of their investments; and they should explain how they consult with beneficiaries regarding their ethical or values-based investment preferences.

*Policy - disclosure of asset managers' voting records*

The Stewardship Code expects signatories to publicly disclose their voting records. In researching our response to this 'call for evidence', we looked at a sample of 20 stewardship code signatories (fifteen from 'tier one' and five from 'tier two'.<sup>1</sup>

All fifteen 'tier one' signatories in the sample committed to public disclosure of their voting records in their statements. However, only one of the five 'tier two' signatories did so. This suggests that significant numbers of asset managers are not declaring their voting records, despite the impact that AGM voting has on responsible business practices.

*Policy - alignment of bonuses with broader corporate responsibilities*

The use of performance metrics related to broader corporate responsibilities, such as workforce issues or environmental impact, in performance-related pay policies is still highly intermittent. Very many companies do not use these types of metrics at all. Those that do are often concentrated in particular industries (for example, bonus metrics related to health and safety records are commonplace in the extractive industries).

Even where these metrics are used, they typically form a very small proportion of the total pay package, around 5% - 20% of the annual bonus. The bonus usually represents a maximum of 200% of annual salary, much smaller than the long-term incentive plan (LTIP), which can be worth over 500% of salary.

*Policy - move from LTIPs to deferred share awards*

Restricted share awards, though far from perfect, could reduce total levels of CEO pay while also retaining some alignment of interest between executives and shareholders, and drastically reducing the complexity of pay policies.

Weir Group plc recently achieved shareholder approval to move from an LTIP to a restricted share award. This is a positive move, however it should be noted that the company's LTIP has not paid out since 2013. Therefore, though the maximum

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<sup>1</sup> Data taken from Investment and Pensions Europe, via <https://www.ipe.com/Uploads/j/z/r/IPE-Top-400-Asset-Managers-2017.pdf> and <https://hub.ipe.com/top-400/uk-asset-manager-tables-2017/10007231.article>. Sample based on the ten largest UK-headquartered asset managers (all tier one) plus the five largest international asset managers from both tier one and tier two.

possible pay-out has reduced, the Chief Executive will receive more in salary and deferred stock (assuming performance hurdles are cleared) than the £1.4 million paid out in 2017.

It would be a more tangible sign of progress if companies with a history of provocatively large LTIP payouts switched to deferred stock. We are not aware of any high profile companies (beyond Weir Group) doing so, despite wider scepticism regarding the value of LTIPs.

*Policy – disclosure of ‘people policy’ in corporate reporting*

While many companies pay lip service to the critical role that their workers play in determining the long-term success of the company, there is little meaningful reporting of employment models and working practices in annual reports.

Analysis in Autumn 2017 found that, for example, only 18% of FTSE 100 companies include information about staff turnover in their annual reports.<sup>2</sup> Just 7% report on use of agency or temporary workers. 21% provide concrete data on investment in staff training and development, while only 9% report internal hire rates and 5% report staff sickness rates.

Data such as these provide vital insights into the composition; stability; skills and capabilities; and morale levels of the workforce, helping stakeholders, including investors, to build a better understanding of the company’s long-term prospects. However, information of this nature remains largely absent in corporate reporting.

*Policy – worker representation on remuneration committees*

We have been long-standing advocates of this policy, which was first seriously advocated in the final report of the High Pay Commission in 2011. We believe workers on RemCos would bring ‘real world’ perspective to remuneration committee discussions, ensure that pay distribution throughout the organisation is properly considered and take a more challenging attitude to the attribution of company success to one individual or the need/appropriateness for very large pay awards.

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<sup>2</sup> Pensions and Lifetime Savings Association, *Hidden Talent: What do companies annual reports tell us about their workers? An analysis of the FTSE 100* via <https://www.plsa.co.uk/Policy-and-Research-Documents-library/Hidden-talent-An-analysis-of-the-FTSE-100>

Thus far, we are not aware of any major company appointing workers' representatives to their RemCo.

**Question 2: What improvements have been made to reporting on executive pay in the last 12 months?**

Remuneration reports remain around 20-25 pages long. We have argued that an approach to top pay that takes 25 pages to explain is too complex. Designing and reporting such complex pay arrangements is also a significant drain on company resources.

It would be a mistake to blame recent pay-related regulations for the length of remuneration reports, given that the regulatory requirements are the most useful information contained therein – for example, the single figure for CEO pay; historic executive pay; and the performance of the company relative to peer groups over 20 pages.

Pay reporting should cover what the executives are paid, what they have done in order to be paid that amount (ie the performance-related pay incentives and any discretion exercised by the RemCo) and what colleagues and predecessors have been paid by way of comparison. Some explanatory narrative can be useful but lengthy justifications of pay practices are not appropriate.

**Question 3: What steps have been taken by Remuneration Committees and institutional investors to combat excessive executive pay in the last 12 months?**

Our data to be published later this Summer will provide full analysis of the year-on-year change in FTSE 100 CEO pay. However, it is clear that there has not been a drastic change in RemCo practices this year. Very high CEO Pay awards such as the £47 million awarded by Persimmon or the £42 million at Melrose continue to cause controversy. Though pay policies reserve RemCos the right to exercise discretion and reduce pay awards from the level suggested by the terms of their pay policy, in practice this is rarely exercised and significant reductions made at the discretion of the RemCo are not commonplace.

Similarly, for shareholders, in the 12 months to the deadline for the Committee's 'call for evidence' (May 8 2018) only ten FTSE 100 companies experienced shareholder dissent of over 20% on a pay-related resolution at their AGM. In the previous 12 months, six companies experienced significant dissent in relation to their executive pay, while in the 12 months before that, 14 companies did so. No remuneration-related resolutions at FTSE 100 companies were defeated.

Given that levels of CEO pay has remained relatively constant over that period, this finding suggests that shareholders have not significantly escalated their efforts to combat excessive executive pay in the past 12 months, and that opposition to pay awards is limited to a minority of shareholders and is voiced only rarely.

This is highlighted by the Persimmon case, where three executives shared over £100 million in 2017, with further awards still to come under the terms of a controversial 2012 LTIP. The payments were triggered by an unexpected increase in company performance, driven by the 'Government's 'help to buy'

subsidy spurring growth in the housing market, and a failure to cap the maximum payout of the LTIP.

The size of the awards, in excess of ten times the average for a FTSE 100 Chief Executive, and the fact that performance was so clearly affected by Government policy rather than the actions of the executives, suggest that this was about as clear a case of an inappropriate pay package as one could imagine. Despite this, the vote on the award was approved by a majority of shareholder votes at the company AGM.

#### **Question 4: What further measures should be considered?**

The High Pay Centre is a long-standing advocate of worker representation on boards and remuneration committees. We do not think that existing measures go far enough in terms of forcing companies to consider the view of the workforce on the pay gaps within their organisation. Workers also bring a different perspective on pay awards to the majority of remuneration committee members, who are largely drawn from well-paid senior executive positions themselves and therefore may take a less critical approach to controversial pay awards.

Research from the International Monetary Fund (IMF) suggests that stronger trade unions generally result in lower levels of executive pay and more even pay distribution throughout organisations.<sup>3</sup> This suggests that efforts to promote unionisation and help make unions more effective would also have an impact on both problematically high and low pay.

Finally, the Government can exert influence over companies indirectly, through procurement procedures and taxation, as well as directly through policy procedures. Therefore, it is worth examining how procurement or business taxes

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<sup>3</sup> International Monetary Fund, Power from the People, 2015 via <http://www.imf.org/external/pubs/ft/fandd/2015/03/jaumotte.htm>

might differentiate between companies that pay a wage that enables a good standard of living to their lowest-paid workers and a fair and proportionate amount to their executives and those that do not.

The High Pay Centre will continue to carry out research and analysis on these topics over the coming months, and would be very happy to discuss our work with committee members in more detail. Please contact Director Luke Hildyard via [luke.hildyard@highpaycentre.org](mailto:luke.hildyard@highpaycentre.org) if this would be of interest.