Executive Remuneration Working Group Interim Report
High Pay Centre Response May 2016

Executive Remuneration Working Group Interim Report - High Pay Centre Response

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution. We welcome the Investment Association's intervention on the issue of Executive Remuneration, and agree with the sentiment expressed in the Independent Working Group's interim report that the system for determining Executive Remuneration is broken.

In setting up the working group the Investment Association has recognised the need to test opinion on this issue from across a wide range of stakeholder groups, and we appreciate the opportunity to contribute to this important initiative.

Executive Summary

The Investment Association set up the Executive Remuneration Working Group in late 2015 to assess whether the current structure of remuneration, and in particular its complexity, was inhibiting company management from acting in the best long-term interests of companies and their investors. In the context of assertions carried in the introduction to the group's interim report – that the approach to executive pay is "not fit for purpose" – this appears to be a narrow focus. In our view there needs to be a fundamental rethink if the model is not fit for purpose. Changing structures is not enough. This rethink starts with asking the question: "what is remuneration is for?" The governance and design or structure of remuneration should be supportive of and complementary to the purpose of remuneration. Problems related to the current pay governance regime are second order concerns.

The High Pay Centre encourages the ERWG to adopt the following remedies in its final report:

- Fix the flaws in the 2013 UK pay regulations
- Return to the principle that reward follows performance
- Realign the governance of remuneration with the legal financial governance framework.
- Stop accepting discounting as an appropriate basis for pay negotiations
- Remove all formal obstacles to the use of retrospective discretion by remuneration committees
- Require the involvement of representatives of the genuine long term economic interest in a company in the process for determining executive pay

Objective

The objective of remuneration policy should not be to attract, retain and motivate. This mantra is discredited and has even been abandoned by the FRC which dropped the phrase when revising the UK Governance Code in September 2014.

The objective of remuneration policy should be to reward. Putting reward at the centre of remuneration policy has implications. The most far reaching of these implications is the tacit acceptance that a person cannot be rewarded unless they have delivered something worth rewarding. This is a significant alteration of the chronology that informs the current pay model under which remuneration has an arbitrary relationship to the governance schedule by which shareholders are expected to control it. Moreover making executive pay outcomes mainly dependent on variable share based pay that is subject to achievement of future performance conditions places executive pay outside of the reach of the guiding principle which informs every other employees pay. **Companies pay employees in arrears for services that have already been delivered.**

Governance

Once the objective has been established to reward something that has already been delivered, the governance regime must be designed to support that objective. It is not by accident that the UK legal regime explicitly links the provision of financial information (the accounts) with the purpose of giving shareholders reliable intelligence to enable them to exercise their powers to reward those to whom conduct of the company's affairs has been confided. This explicit link was established in case law under the Caparo ruling in 1990.

Only by retaining a link to the accounts can remuneration be part of the legal framework provided by the Companies Act, which has a deliberate and intentional stewardship purpose.

This position is rooted in the financial governance framework provided by law which by default gives shareholders voting rights. The schedule for exercising voting rights was by original design intended to be complementary to the schedule provided by law for statutory reporting obligations and the ongoing related obligation to maintain accounting records that demonstrate solvency at any time. We think it is helpful to consider pay as a distribution. The connection between voting rights and distributions is premised on empowering shareholders as a group to manage the obvious risks which distributions pose to the invested capital. It is generally unlawful to make distributions from capital (excepting particular circumstances at Investment Trusts following recent changes).This reflects the moral hazard involved where shareholders enjoy limited liability and creditors pick up the tab.

The default position of the law also recognises that in order to reward the directors it is first necessary to establish that the source of that reward is genuine. Adoption of the audited accounts at a general meeting of shareholders precedes payments from those accounts.

The default legal position also recognises that there is an inherent conflict of interest in directors deciding on their own remuneration. Default company law intends shareholders to exercise control over directors pay in the context of prior adoption of audited accounts in order to get around this obvious conflict. However, on unitary boards executive directors perform services which are supplementary to their function as directors. The supplementary services provided by executives are contracted and the acceleration in quantum paid to executives over the last 20 years comes from this contracted entitlement. It should be noted that the default vote on directors pay is an

unambiguous vote on quantum. Shareholders are approving an explicit aggregated maximum amount which may be paid to board members. Unlike the clear disclosure which corresponds to the default vote on directors fees, the disclosure corresponding to the vote on directors pay for contracted is far more opaque. For contracted service pay there is no vote on a quantified maximum. (See section on Transparency later in this document).

Who are we talking about?

Despite the provenance of the excessive remuneration the shareholder vote provided by law remains explicitly on directors pay not executive pay. The interim report's language is, however, unclear when describing the group of people whose pay is deemed worthy of review. The title of the group indicates a review of "executive" remuneration and there are references to "executive" pay throughout the report. Despite this, the report fails to define "executive". In the "Background" section the report talks about poor pay design inhibiting company "management". In the section on "reward for failure" the report refers to departing "directors". A reference to "executive directors" appears in the "key proposals" section. Without clarity about who these reforms are aimed at there is a possibility that companies which choose to adopt any of the proposed changes will themselves be unclear about the group's intentions. For example, one company may choose to change their CEO's pay arrangements and another may choose to change the arrangements for all participants in share-based incentive schemes. We would suggest the group considers using the existing definition of senior executives provided by Section 96B of the Financial Services & Markets Act 2000, which defines a senior executive as a person discharging managerial responsibilities (PDMR).

These distinctions are not simply a matter of semantics: they have implications for the governance of remuneration.

In the governance regime that has evolved shareholders do not actually have a vote on the pay of the governing body. Under the mandatory accounting standards which European companies are obliged to adopt companies must identify the key decision makers for the group. IAS 24 requires disclosure of amounts paid to the key decision making group, while UK law provides shareholders with a vote on directors' pay. These two groups are often different. The key decision making group often includes executives who do not sit on the board and are not accountable to shareholders directly by a vote on their appointment.

A vote on directors pay is common sense in a situation where the directors bear ultimate responsibility as the key decision makers. However, this is no longer always the case. Shareholders arguably bear some of the costs of this responsibility via the premiums paid for directors and officers liability insurance, but more importantly the key decision making body can no longer be assumed to be the board. We are even starting to see FTSE 100 companies where the group CEO doesn't sit on the board (e.g. Antofagasta).

The current regime allows a related party transaction which is not subject to scrutiny and accountability.

Ownership of the issue

The working group's interim report suggests that shareholders have lost ownership of the issue. This conflicts with the stated intentions of the 2002 and 2013 UK pay regulations, which sought to deliver shareholder control over directors' remuneration.

- *"I am bringing forward legislation to strengthen the powers of shareholders through a binding vote on pay."*
- *"The government's reforms will provide shareholders with new powers to hold companies to account"*
- *Rt Hon Vince Cable June 2012*

We think ownership of this issue is critical. One question that has yet to be fully addressed by the group's work is: who should own this issue? The interim report states clearly that there is a public interest at stake and that some form of public ownership of this issue is legitimate. How is this to be achieved?

We welcome recognition that executive interests need to be aligned with the company and not solely with shareholders. However, the universally stated aim of remuneration policy at FTSE 100 companies is to align executive interests with those of shareholders. The December 2015 High Court decision in favour of Lloyds TSB directors who had recommended the HBOS takeover reaffirmed that directors owe a fiduciary duty to the company and not generally to the shareholders. This is a vital difference. There is an obvious asymmetry in directors having legal duties to act in the long term interests of a company for the benefit of its members whilst some shareholders fail to commit capital for more than a few seconds and some executives discount the value of remuneration unless it is short term. Once understood by remuneration committees this should change their starting point when thinking about the objectives for their 2017 director's remuneration policy.

Transparency

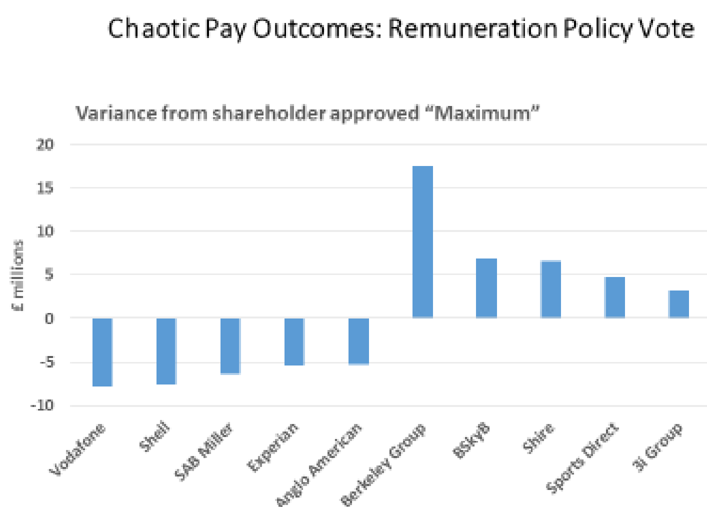
Transparency has been the weapon of choice for many years in trying to address perceived problems with the way directors are paid. It is often said that the increase in disclosure surrounding executive pay has created an opportunity for easily comparing pay at one company with its peers, and that this benchmarking has driven the escalation in levels of executive pay.

We are not supportive of ever-increasing volumes of disclosure. We are, however, in favour of improvements in the way pay is accounted for. Disclosing something and accounting for it are two different things.

We do not think that the misuse of disclosure is inevitable. It is misuse that had driven the escalation rather than the disclosure itself. Transparency should always enable accountability, but multi-period incentive schemes frustrate this transparency. This problem becomes even more acute when awards are made in anticipation of future performance. Shareholders are now expected to exercise control by voting on estimated values spread over multiple future financial periods rather than giving a verdict on the audited financial statements, including the realised value of pay distributed to the executives from the accounts they have been presented with. Typically staff costs for listed companies overwhelmingly comprise fixed pay. Fixed pay adheres to accounting periods. Most

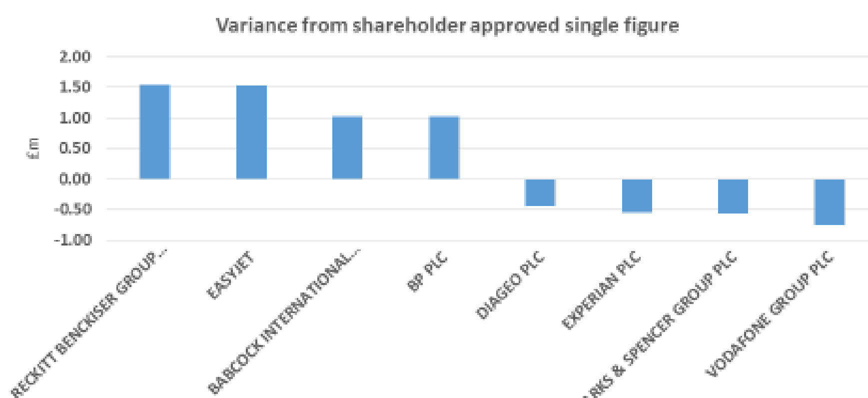
employees are paid in arrears, and their pay is received after their services are delivered, not before. **Variable executive pay that is yet to be realised means that executive pay is premised on a different principle to the principle which informs other employee pay**.

The following charts illustrate how shareholder approval of amounts paid (backward looking vote) and amounts yet to be paid (forward looking vote) can be illusory. This points to flaws in the 2013 UK pay regulations. The 2013 regulations require disclosure of a projected maximum for individual executive directors under shareholder approved remuneration policy. The maximum need only be projected for one year, while the policy is extant for three years. **The High Pay Centre would like to see a projection of maximum which aligns with the period for which policy applies**. Those who wish to argue that projections beyond one year are not meaningful must consider why it is possible for companies to project their "viability" for longer than one year (a new FRC requirement following a review of "going concern") but not possible to project maximum remuneration for longer than one year.



Source: Annual Reports. Sample of 76 companies in FTSE 100 at date maximum approved

Chaotic Pay Outcomes: Remuneration Report Vote



Source: Annual Reports. Sample of 50 companies in FTSE 100 at date of disclosure of revised single figure

Another problem that makes variable share based pay less accountable is the growing use of adjusted financial performance measures (APMs). A recent study completed by PwC into the use of APMs by FTSE 100 companies found that 95% of the FTSE 100 adjust their GAAP profit figures, and that adjustments almost always have a favourable impact on profit. PwC reported that 28% of adjustments could not be categorised due to the vague nature of the description intended to allow shareholders to reconcile back to GAAP figures. This is a good example we think of how the current pay model is not fit for purpose. Most FTSE 100 companies use some form of profit measure in their matrix of pay performance conditions, yet the accounts which comply with mandatory accounting standards do not inform the figures which executive pay is based on. This represents a dislocation between the financial governance framework and the executive pay model. Worse still, this dislocation is generating lots of disclosure which would be unnecessary if the mandatory accounts served the purpose of informing shareholders' decisions about reward. This extra disclosure doesn't even satisfy the skewed objective set out for it. Improvements in this disclosure will serve to improve compliance with ESMA guidelines on how to disclose APMs, but will not address the fundamental issues which make the executive pay model unfit for purpose. It is our hope that the Working Group is looking beyond compliance.

The interim report correctly recognises that there is an opportunity to put executive pay back on the same footing as other employee pay by suggesting that share awards are made based on past performance. The High Pay Centre would go further. The default position would be that contracted services other than services performed as a director would be paid entirely in cash. Shares would only be permissible where there was corresponding salary sacrifice. Alignment with shareholder interests is preserved as executives are at liberty to purchase shares in the market on similar terms to other investors. Under the new EU blanket ban on dealings in the run up to the announcement of results, executive share dealings are arguably less complex than under the Model Code. Executives would continue to participate in employee share schemes which deliver a personal tax advantage to participants where monthly subscription is from pre-tax income.

The suggestion in the interim report that companies need to report on the use of discretion by their remuneration committees makes clear that companies have failed to comply with an explicit

provision introduced into law in 2013. The Large & Medium Sized Companies & Groups (Accounts & Reports) (Amendment) Regulations 2013 Part 3 Para 12 states that companies must disclose *"where any discretion has been exercised in respect of the award, particulars must be given of how the discretion was exercised and how the resulting level of award was determined".* The tolerance of non-compliance with legal minimums characterises the lack of control over executive pay and the consequent lack of remuneration committee accountability.

The working group might consider reminding companies that, unlike the FRC's voluntary code, UK law is not comply or explain.

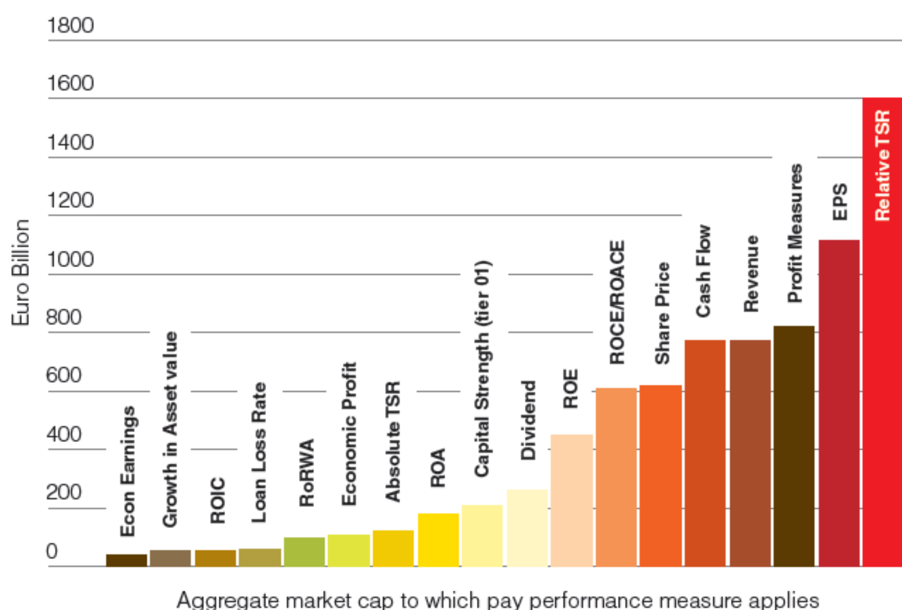
The High Pay Centre strongly supports the recommendation that companies disclose the whole fee paid to the firm which provides remuneration consultancy rather than just the remuneration consultancy fee. In our 2015 report "Are Remuneration Consultancies Independent?" we provided evidence that the absence of this disclosure distorts the relationship between companies and providers of services to the remuneration committee.

Provider to the remuneration committee	Disclosed fees £	Signatories to the RCG*	Used by remuneration committee and fee disclosed	Used by remuneration committee but no fee disclosed	Also used for other work but no fee disclosed	Also used for other work and fee disclosed
Deloitte	2107288	Y	15	0	15	0
Towers Watson	1130033	Y	11	4	14	0
PWC	904220	Y	8	1	8	0
Aon Hewitt/NBS	564606	Y	3	1	2	0
Kepler	483021	Y	6	0	0	0
Gerrit Aronson	140000	N	1	0	0	0
Linklaters	136174	N	4	0	1	0
Alithos	95750	N	4	0	0	0
KPMG	72000	Y	1	1	0	0
FIT	21883	Y	1	0	0	0
Slaughter & May	2500	N	1	1	0	0
EY	0	Y	0	1	1	0
Hay	0	Y	0	1	1	0
Mercer	0	Y	0	1	1	0
MM&K	0	Y	0	0	0	0
Patterson	0	Y	0	0	0	0
Strategic	0	Y	0	0	0	0
Freshfields	0	N	0	1	2	0
Herbert Smith	0	N	0	1	0	0
Clifford Chance	0	N	0	1	0	0

http://highpaycentre.org/pubs/are-remuneration-consultants-independent

Flexibility

One of the weaknesses in the current approach to executive pay is the extent to which companies have crowded around the same structures despite their very different business models. We agree with the interim report's assertion that "companies should move away from a one size fits all remuneration model". Some evidence of this crowding is provided in our 2015 report into the use of performance metrics for incentive schemes at European listed companies.



http://highpaycentre.org/files/Metrics_Reloaded.pdf

Shareholding Guidelines

Requiring minimum share ownership levels, even if the level is at the discretion of a remuneration committee, says nothing about whether an executive has sufficient "skin in the game" with regard to a particular incentive grant. If the level of subscription were to be disclosed (number of shares) compared with the level of reward for each grant, it would be possible for shareholders to assess the consequential downside risk and the degree to which this is aligned with the shareholder experience. This misalignment is made worse by the inclusion of dividend equivalent payments (DEP) as part of the value reported on within the single figure. Shareholders would not qualify for a dividend if they bought shares after the ex div date, so why is dividend entitlement assumed for executives prior to vesting date? Employee share ownership schemes typically require salary sacrifice. There is no good reason why executives cannot continue to participate in such schemes on the same basis as other employees. Further share schemes are superfluous if the objective is to align executive and shareholder interests.

Discount

The interim report asserts that executives routinely "discount or reduce the value ascribed to deferred pay once deferral periods are deemed to be too long". One of the benefits claimed for the group's proposed switch to restricted stock grants based on achievement of prior performance is the cessation of this discounting. This assertion is not new of course, and the working assumption that participants in long term incentive plans discount the value of awards was tested in PwC's revealing paper Making Executive Pay Work: the psychology of incentives.

The interim report proposes a remedy to discounting, although slightly confusingly then also describes the potential for remuneration committees to reduce award values as discounting.

What is absent from the report, however, is a challenge to the assumption that demand for a larger award to compensate for the uncertainty of deferral will always be satisfied. While the group is correct to identify discounting as a driver of demand for increased awards it fails to make a case to help remuneration committees resist such demands.

The time value of money principle which underpins investment decisions is not transferable to payment for contracted services. The risks involved are not equivalent. Investors risk losing invested capital while executives' risk is that superior performance is not properly recognised. It is this perfectly natural desire for recognition that LTIPs are attempting to satisfy. In its authoritative study into the psychology of incentives PwC concluded that the key motivation of a long term incentive plan is recognition. We would like to see evidence that remuneration committees are thinking more laterally about recognition in order to introduce rewards that break the cycle of ever increasing quantum.

The High Pay Centre's preference would be for the working group to encourage remuneration committees to stop accepting discounting as the basis for pay negotiations, rather than legitimising discounting by guaranteeing the value of share grants.

Payment for Failure

The working group is right to look to discretion to solve this problem. However, the circumstances under which a remuneration committee would need to exercise discretion can be made narrower via clear contractual provisions within schemes. In order to define failure a committee must also define success, and too often success is perceived to be achievement of formulaic targets.

Our report on pay for performance "Metrics reloaded" included a case study of how formulaic targets can result in perverse outcomes if discretion is not applied. The study looked in detail at the perverse outcomes from the operation of annual bonus schemes at the large listed UK banks in 2013.

The Competition and Markets Authority had announced that it would be conducting an investigation into competition in the UK retail banking market. In launching the probe the head of the CMA had stated that many customers were dissatisfied by the banks. In contrast all the major retail banks had made annual incentive awards and nearly all paid more in bonus than the previous year despite the fact that each included a customer satisfaction measure amongst the performance measures.

http://highpaycentre.org/files/Metrics_Reloaded.pdf P17/18

Discretion has the benefit of being applied retrospectively. This coincides with the legal financial governance framework.

Holding Periods

None of the suggested structures outlined in the interim report addresses alignment of executive pay with stakeholders other than shareholders that have a genuine long term interest in the company. Asset owners such as pension funds, whose interests are not dictated by shorter term priorities such as mandate renewal, have a genuine long term interest in meeting the longer term liabilities of their fund. Permanent employees contribute years of service in return for a secure income which matches their mortgage commitments and a pension beyond retirement. These horizons are much longer term than the typical 3 year vesting period plus 2 year holding period for share schemes.

The working group suggests that the practice of discounting the value of deferred awards by executives undermines the benefit of increasing holding periods from their current norm. We have outlined above that discounting by executives should not be tolerated by remuneration committees. However, in a scenario where payment follows delivery of superior performance and does not try to anticipate performance in advance the need for deferral, and the assumption that an executive will discount from future to present value, goes away. We consider that holding periods are not needed where remuneration policy aligns with the long term economic interests of stakeholders by paying out once the full financial impacts of executive decisions are known. In some cases this may be several years after the decision is taken.

Alternative structures

For the purposes of paying executive directors the replication of the model used for paying fund managers hasn't worked. Linking pay to a benchmark-beating model for measuring individual director performance has served no economic purpose.

We welcome the working group's recognition that companies have been rewarding volatility rather than long term performance. Share based schemes which use performance metrics tied to share price such as TSR are the main driver of this volatility. The long run share price trend may be down, but there may be intervening periods of upswing where LTIPs are rewarding that part of a short run gain even though there is insufficient gain to counter the losses outside of that measurement period. LTIPs using relative TSR performance are designed to deliver rewards at sub-economic performance. Executives are being paid huge sums despite achieving returns less than the cost of capital. This misalignment is one of many that afflict the current executive pay model.

The representation of those with long term interests in the determination of pay outcomes is not satisfied by the current system. Shareholders as a class cannot be assumed to have long term interests. The average time over which shares are now held can be measured in minutes given the prevalence of algorithmic trading.

Even if the objective of remuneration policy becomes "reward" rather than "attract, retain, motivate" as we have suggested, there remains a risk that the behaviour which policy aims to reward is relatively short term and is misaligned with long term economic interest.

One possible solution is participation by employees. Employees are able to provide an anchor to long term interest which is currently absent from the pay determination process. There are a number of ways in which this could be achieved and companies should be free to choose. We applaud the group's assertion that companies should have licence to remunerate executives in accordance with their own unique circumstances or business model.

Employees, including executives, already participate in employee share schemes. Such schemes might cumulatively build up a notifiable interest in the business in order to develop their role as anchor investors whose interests are properly aligned with the longer term interests of the business. For this device to work towards giving employees a voice in determining executive pay outcomes some dilution would need to be suffered by existing shareholders. However, this dilution would be well within the annual limits recognised by institutional shareholder dilution guidelines.

The straightforward inclusion of employees on remuneration committees might also provide an input from stakeholders with a long term economic interest. Some business models may be more suited to this solution than others. Some of the practical obstacles to changing the composition of committees are addressed in a recent TUC paper. These include the extent to which a group's employees are geographically diverse and the universal governance best practice code requirement that committees comprise solely independent directors.

In looking at the first of these problems the High Pay Centre has observed that most FTSE 100 companies fail to disclose separately their number of UK employees. This is despite the fact that the Companies Act s411 allows directors to choose how to segment the data required about the number of employees. Only 22 companies from a sample of 72 did so. Of the companies which disclosed the number of UK employees 16 out of 22 employed a majority of their employees outside the UK.

% of all employees represented by UK employees

Company	UK employees as % all employees
ANTOFAGASTA	0.08
SHIRE PLC	6.00
WPP	10.73
VODAFONE GROUP PLC	11.81
ASTRAZENECA PLC	11.81
WOLSELEY PLC	16.41
TUI GROUP	19.63
EXPERIAN PLC	21.82
PRUDENTIAL PLC	23.20
ASHTEAD GROUP PLC	23.62
BUNZL PLC	24.08
LONDON STOCK EXCH GROUP PLC	31.18
ASSOCIATED BRITISH FOODS PLC	34.20
NATIONAL GRID PLC	40.12
ROLLS-ROYCE HOLDINGS PLC	45.94
AVIVA PLC	54.73
IMPERIAL TOBACCO GROUP PLC	65.83
LEGAL & GENERAL GROUP PLC	76.06
BT GROUP PLC	81.40
MARKS & SPENCER GROUP PLC	89.90
TAYLOR WIMPEY PLC	98.05
UNITED UTILITIES GROUP PLC	100.00

High Pay Centre April 2016: based on latest reported employee figures in annual reports by a sample of 72 companies in FTSE 100 at April 2016

For these companies, ensuring global employee representation on a remuneration committee is a challenge, although we believe that recent developments in technology and regulation have changed the viability of this proposed solution. In particular, work done by Ken Charman's Foresight Group on behalf of Unilever plc provides the group with a platform to consolidate all reward data for all 175,000 employees on a daily basis. It is not hard to see how this technology might also serve as a platform for facilitating employee representation in a group with thousands of employees spread across multiple countries.

For companies that employ all or nearly all employees in the UK another recent development might alter the equation when it comes to facilitating employee representation. Regulation 7 of the proposed new Gender Pay Gap rules requires companies to publish the number of UK employees (in quartiles, by gender). The requirement to report a median should lead to companies having administrative systems capable of easily identifying each individual employee across their income distribution. Once established this may form a platform for communication for the purposes of employee representation.

Other models already exist for facilitating company communication with a distributed population. Where trade union collective bargaining agreements are in place these mechanisms are ideally placed to act as a conduit for arranging employee representation on committees. Listed investment trusts with a large trust holding also have experience in soliciting the views of individual retail investors with regard to voting intentions at general meetings. Alternatively, many companies already have in place an employee engagement function (or "pulse" survey) which provides an employee engagement score to inform the metrics used in bonus schemes.

Companies have been encouraged by the voluntary governance code since 1995 to give regard to pay elsewhere in the company when setting executive pay. This has been largely ignored. In 2013 new UK pay regulations stipulated that companies must report as to whether they have consulted with employees when setting executive pay. It is disappointing to note that this too has been ignored by some companies. The regulations are clear that disclosures should provide some explanation as to how wider conditions are taken into account. Despite this clarity many companies fail to explain how employee pay was taken into account when setting directors' pay. A government report on compliance with the new regulations, published in March 2015, cited evidence that some companies made no statement or mention at all of the consideration of workforce pay in setting directors' pay, whilst a significant proportion of companies in the sample failed to say how pay elsewhere in the workforce was taken into account.

The working group should now encourage formal employee representation in the executive pay setting process. The process for doing this need not be prescriptive.

Shareholder engagement

We support the drive for simplicity. However, the working group should make clear that the benefit of simplicity follows from better line of sight for executives and proper alignment of pay with the financial governance framework, not from the more parochial argument that complexity costs too much to understand.

The interim report assertion that there are two distinct perspectives, investor and governance, is worrying. The failure to integrate these functions within asset management firms is long standing. A 2004 report on UK voting impediments by Lord Myners to the Shareholder Working Group found that *"there are concerns that, on occasion, those responsible for voting issues are presented to the issuers as the institution's voice on the issue, when they might not necessarily represent the views of the portfolio manager or analyst responsible for establishing the position, and with whom the issuer's management have been encouraged to communicate. This can and does cause confusion within issuers: within the investing institution the left hand appears to be disconnected from the right hand."*

The latest TUC fund manager voting survey shows that every mainstream asset manager which responded had indeed voted on the sample of pay resolutions chosen for the survey. https://www.tuc.org.uk/sites/default/files/Fund_Manager_Survey_2015.pdf. However, each of the managers also reported that they had no contact with one or more (sometimes all) of the companies relevant to the pay resolutions in the six months prior to the vote. It is inconceivable that the managers failed to participate in analyst calls and investor days held by the sample companies, all of which published financial results in the six months prior to the vote. The engagement by financial analysts at fund managers is not seen as relevant to the pay vote by institutional investors. This is despite the fact that **executive pay can and does form an item that is material to the accounts of several FTSE 100 companies**. We believe this illustrates a disconnect within fund management firms. Remuneration has become an ESG issue dealt with by ESG teams, and has become divorced from financial analysis, even though executives are employees and employee costs are perhaps the most significant cost or distribution borne by most businesses.

Let us be clear. We do not regard shareholder votes as prima facie evidence of fund managers having engaged with this issue. The limited scope of the shareholder vote and the laxity of some of the prescribed disclosures allow the vote to be used as a flag of convenience which gives the appearance of tackling excessive pay, while preserving the culture which informs it.

Ends