

# LEADING OR LAGGING?

WHERE DOES THE UK STAND IN THE INTERNATIONAL  
DEBATE ON TOP PAY?

## About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

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## Executive summary

Since the launch of the High Pay Commission in 2010, there has been a vigorous public debate on high pay and inequality.

On one side, the way in which the growth in executive pay has outpaced the incomes of ordinary workers and the performance of the UK's top businesses, has prompted government action. However, attempts to curb the pay of leading company executives have been criticised by some as 'anti-business.'

PricewaterhouseCooper's 2013 analysis of executive pay trends in the UK warned of *'the impact that a continuous executive pay furore has on the image of the UK as a place to do business and a place to work as an international executive.'*<sup>1</sup>

In this context, it is worth examining international policy measures on executive pay, in order to identify whether these fears are justified. The UK was a pioneer in introducing an advisory shareholder vote on executive remuneration in 2002, and is set to bring in a tri-annual binding vote this year. However, shareholder 'say on pay' is now planned or operational, in the US, EU and Switzerland. Other countries have now gone much further than the UK in developing other innovative mechanisms for tackling perceived unfair and disproportionate levels of executive pay:

> **France** is introducing a maximum 20:1 pay ratio between highest and lowest paid employees in all companies in which the state owns a greater than 50% stake.

> **Germany** has imposed salary caps on bailed-out businesses, and empowered supervisory boards, including workers representatives, to set executive pay.

> **Switzerland** has banned 'golden parachute' and 'golden hello' payments, supported with the threat of jail.

> The **USA** has also restricted salaries at bailed-out businesses, and is committed to publishing pay ratios between the highest and median earners within a company.

Japan was the only country covered by our analysis that has not gone further than the UK in addressing excess pay. However, cultural differences ensure that Japanese executives do not demand the higher pay levels in the West. There are fewer million pound executive pay packages at all Japanese listed companies, than the number of bankers earning over £1 million at Barclays, one single UK bank.

It is very difficult to argue that Barclays employs more talented or important individuals than the entire Japanese economy. Unless measures are taken in the UK to make executive pay fairer and more proportionate to the efforts and talents of the wider workforce, we risk creating serious levels of resentment and inequality, as well as widespread distrust in business and economic stagnation .

Leading or Lagging? Where does the UK stand in the international debate on top pay?

## Introduction Executive Pay debate in the UK

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	Shareholder 'say on pay'	Pay ratio	Pay cap for Bailed-out Banks	Employee 'say on pay'	Other pay constraint
<b>France</b>	Binding vote forthcoming, as part of EU proposals	20:1 maximum ratio for state-owned companies	Ban on options grants for bailed out companies, plus ban on all bonuses not agreed prior to bailout	✗	EU Bankers Bonus cap
<b>Germany</b>	Forthcoming, as part of EU proposals	✗	€500,000 salary cap, plus ban on bonuses until Government repaid	Pay policy set by supervisory board comprised 50% employee representatives	EU Bankers Bonus cap
<b>Switzerland</b>	Forthcoming, following March 2013 referendum	✗	✗	✗	Ban on golden hello & golden parachute payments
		(But 12:1 cap subject to forthcoming referendum)			
<b>USA</b>	Annual advisory vote implemented as part of Dodd Frank Act	Planned publication as part of Dodd-Frank Act	€500,000 salary limit as part of the TARP programme, plus requirement for bonuses to be paid in stock	✗	✗
<b>UK</b>	Tri-annual binding vote forthcoming as part of Enterprise & Regulatory Reform Bill	✗	✗	✗	EU Bankers Bonus cap (but widely acknowledged that UK Government was sole opponent of cap)

Since the launch of the High Pay Commission in 2010, there has been a vigorous public debate on high pay and inequality.

Academic studies have demonstrated the extent to which a tiny, super-rich elite holds a rapidly increasing share of the UK's wealth. Public opinion across the political spectrum has become inflamed by details of the huge pay packages awarded to bankers and business executives, while the economy has stagnated, banks have collapsed, the stock market has remained below peak levels and the wages of ordinary workers have been frozen.

In response, the Government has introduced the Enterprise and Regulatory Reform Act, due to be passed in Autumn 2013, which will give shareholders a tri-annual binding vote on the executive pay policy at all UK-listed companies. Listed companies will also have to publish a 'single figure' detailing the likely amount paid to their lead executive, as recommended by the High Pay Commission.

At the same time, however, various lobby groups and vested interests have sought to characterise the pay debate as 'anti-business.' Further recommendations, such as the publication of the pay ratio between the highest and lowest/median pay packages at a company, or elected employee representation on company remuneration committees have been rejected by the Government following strong opposition.

PricewaterhouseCooper's 2013 analysis of executive pay trends in the UK warned of 'the impact that a continuous executive pay furore has on the image of the UK as a place to do business and a place to work as an international executive.'<sup>2</sup>

The CBI have suggested that the debate around high pay represents 'the corrosive voice of anti-business sentiment.'<sup>3</sup> In a Daily Telegraph article headlined 'anti-business anger is a threat to UK prosperity' the journalist Allister Heath claimed that 'we still like entrepreneurs – but only as long as they work for struggling start-ups. Once they make it into the one per cent (of top earners) we turn on them like hyenas devouring wildebeest.'<sup>4</sup>

The clear inference from these articles is that we risk driving so-called wealth creators overseas. It is a contentious argument on a number of levels. Firstly, it is debateable whether or not our prosperity depends on a small pool of irreplaceable talent, as opposed to the collective skills and efforts of the workforce as a whole. Secondly, the myth of an international market for executives has been comprehensively debunked by the High Pay Centre's report Global CEO Appointments: A very domestic issue, which shows that just 0.4% of the world's biggest companies poached their CEO from an international competitor.<sup>5</sup>

Thirdly, the argument put forward by PwC, CBI and the Telegraph that the UK pay debate is somehow 'anti-business' suggests that most other countries accept the

<sup>1</sup> Pricewaterhouse-Cooper's, 2013: A year for restraint – the outlook for executive pay, 2013, p7

<sup>2</sup> Ibid

<sup>3</sup> Daily Telegraph, Anti-business talk harms economy, CBI warns Cameron, 11 February 2012 via <http://www.telegraph.co.uk/finance/newsbysector/industry/9076445/Anti-business-talk-harms-economy-CBI-warns-Cameron.html>

<sup>4</sup> Daily Telegraph, Anti-business anger is threat to UK prosperity, 10 July 2012 via <http://www.telegraph.co.uk/finance/comment/9390180/Anti-business-anger-is-threat-to-UK-prosperity.html>

<sup>5</sup> High Pay Centre, Global CEO Appointments: A very domestic issue, 2013, p5

## Analysis

### International policy on high pay

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unconstrained growth of executive pay, and that the concern about excess pay and inequality in the UK is somehow unique.

Anecdotally, this seems unlikely. There have been major protests in America as part of the Occupy Movement, for example, and a recent youtube video on wealth inequality in that country has attracted more than 5 million viewers.<sup>6</sup> In Europe, the French President Francois Hollande's 75% 'supertax' on French millionaires has been widely reported, as has the EU's cap on bankers' bonuses.

To provide a more detailed picture of the international debate on high pay, we analysed the pay debate and emerging policy framework in the following relevant economies:

#### > **The European Union (with particular focus on France and Germany):**

The EU is the world's largest single market. It comprises the UK's closest geographic neighbours, many of whom share similar histories of economic development to the UK. As the two other largest economies in the UK, France and Germany are particularly relevant comparators.

> **United States of America:** The world's largest economy and home to more major corporations than any other country.

> **Japan:** The world's second largest advanced economy, and also home to a high number of multinational corporations

> **Switzerland:** A major financial centre and home to a high number of large corporations, Switzerland is conveniently located in a timezone

where the working day overlaps with both Asia and North America, and is a member of the European Economic Area, with access to the single market, but not subject to some EU regulations. Thus, it is frequently cited as an alternative home for British corporations and wealthy individuals.

These five countries do not provide an exhaustive account of the debate on executive pay. A wider review might include other G7 economies Italy and Canada, for example, or banking centres such as Hong Kong or Singapore. Some of the most innovative means of tackling excess executive pay have originated in Holland, which capped bankers bonuses in 2010, or Australia, where executives must face re-election if more than a quarter of shareholder votes are cast against a company's remuneration report for two years in a row.<sup>7</sup>

They do, however, cover the most relevant comparators, and provide a strong sense of whether UK action on pay is strong or weak by international standards.

The claim that measures to curb executive pay might render the UK 'uncompetitive' or 'anti-business' would appear absurd if these measures proved weaker or less effective than similar policies designed to constrain soaring executive pay in the countries covered by our analysis.

#### European Union

##### Cap on bankers bonuses

In March 2013, the EU accepted proposals from the European Parliament to introduce a bankers bonus cap, limiting bonuses to 100% of salary, or 200% if approved by a 'supermajority' of shareholders.

The UK is also subject to the bonus cap, but it has been widely reported that the Coalition Government is the only one out of 26 EU countries to have opposed the plan, and has attempted to dilute it over the course of negotiations.<sup>8</sup>

The proposed EU bonus cap has generated a number of individual legitimate concerns, but together these are often contradictory.

For example, some arguments suggest that banks will seek to circumvent the cap by increasing bankers' basic salaries, while others have claimed that banks will move their headquarters outside the EU. But these arguments cannot both be true. They claim respectively that the cap will be ineffective; and that it represents a threat to business.

There is undoubtedly a need to safeguard against high salary increases resulting from the bonus cap. However it will not be a simple process for banks to switch from pay packages comprised of basic pay plus bonus payments ostensibly

dependent on performance, to packages of equivalent total size but with the whole amount guaranteed as basic pay. The removal of the theoretical alignment of bankers pay and shareholder value would be much less likely to win shareholder approval. Banks would also lose much of the cover and complexity they use to obscure or justify high pay – it is currently possible to argue that controversial pay awards are contingent on performance targets being met, but this would no longer be possible if pay was shifted from bonuses to basic salary.

The threat of a banker exodus from London as a result of the bonus cap may also be exaggerated. It is questionable whether a significant number of bankers would leave London, a dynamic, vibrant city to which many have family or property ties, to other financial centres, often on different continents, which have many social or cultural drawbacks to counter the potential pay increases they might offer.

The school of thought that suggests the bonus cap will drive bankers overseas actually takes a dim view of their motivation, and one that is contrary to much of the evidence base. A PwC survey of company executives (not all from the financial sector, but likely to share characteristics with highly-skilled, competitive bankers) found that they were much less interested in their financial rewards in terms of their absolute value, rather that they see them as a proxy for recognition, particularly in relation to their peers.<sup>9</sup>

<sup>6</sup> Youtube, Wealth Inequality in America, via <http://www.youtube.com/watch?v=QPKKQnijnsM>  
<sup>7</sup> Financial Times, Dutch banks agree bonus code, 9 September 2009 via <http://www.ft.com/cms/s/0/62fc6228-9d52-11de-9f4a-00144feabdc0.html#axzz2QdcLCdFo> and Financial Times, 'Two-strikes' pay rule hits Australian boards, 20 November 2011 via <http://www.ft.com/cms/s/0/10eca75c-1377-11e1-81dd-00144feabdc0.html#axzz2QdcLCdFo>

<sup>8</sup> BBC, Osborne in battle to weaken EU bankers' bonus cap plans, 5 March 2013 via <http://www.bbc.co.uk/news/business-21665429>  
<sup>9</sup> PricewaterhouseCoopers, Making Executive Pay Work: The Psychology of Incentives, 2012, p25

Despite this evidence, some in the financial services sector have spoken out against the bonus cap. However, changes to standard working practices across an industry are rarely universally welcomed. It would be unusual if bankers did not resist attempts to alter their pay structure, regardless of the merits of the idea.

Therefore, criticism of the EU proposals from 'producer interests' should be treated with a degree of scepticism.

### Shareholder 'say on pay'

EU Commissioner for Regulation Michel Barnier has confirmed that the Commission will shortly put forward EU legislation giving shareholders a binding vote on remuneration for approval by member states.<sup>10</sup>

The precise details of the proposals are not due to be confirmed until late 2013, but measures based on similar principles have been put forward as part of the UK Enterprise and Regulatory Reform Bill, and have already come into force in the Netherlands. France and Germany have hinted at support for the EU proposals.<sup>11</sup>

<sup>10</sup> Reuters, Europe moves towards Swiss style executive pay curbs, 6 March 2013 via <http://www.reuters.com/article/2013/03/06/us-eu-pay-idUSBRE9250WM20130306>

<sup>11</sup> Ibid

<sup>12</sup> Guardian, Aviva pay revolt shows we can make a difference on City's culture of excess, 8 May 2012 via <http://www.guardian.co.uk/comment-isfree/2012/may/08/aviva-pay-revolt-andrew-moss>

<sup>13</sup> High Pay Centre, Paid to Perform: What do we want our business leaders to achieve?, 2013, p20

There is no doubt shareholder 'say on pay' is critical to tackling the runaway growth in executive pay that has caused so much anger over the past decade. Even where shareholder votes are non-binding, as is currently the case in the UK, they have brought the issue of executive pay to public prominence, and forced the resignation of CEOs whose pay packages were believed to be disproportionate to their achievements, such as Andrew Moss of Aviva and Sly Bailey of Trinity Mirror.<sup>12</sup>

Ostensibly, it is shareholders money that is used to pay executives their lavish awards, and it is they who gain or lose money depending on the performance of the company (although this argument neglects the critical stake that other constituencies, such as employees, customers and Governments, have in the success of major businesses). Therefore, there is a clear practical and moral basis for shareholders to play a role in setting executive pay levels.

It is questionable, however, whether or not this will be sufficient to tackle the problem of excess pay. A growing proportion of shareholders operate internationally, with a large portfolio of holdings in different countries, and neither the time nor the inclination to scrutinise pay packages at each company in which they invest. Foreign investors are also less likely to be interested in the socio-economic consequences of rising executive pay in other countries.

The average length of shareholding in the UK has declined to just seven months, down from two years in the 1980s, and five years in the 1960s.<sup>13</sup> Again, this reduces the incentive of shareholders to take an interest in executive pay arrangements, if they are intending to sell their stock in the near future, and are not affected by the long-term impact of decisions on pay.

Furthermore, shareholders voting decisions are generally delegated to the institutions managing their holdings. Essentially, it is fund managers, rather than shareholders,

**table 1 A Percentage of total market value of UK quoted shares by sector of beneficial owner 1963 to 2010<sup>14</sup>**

Sector	1981 (%)	1990 (%)	1994 (%)	2000 (%)	2004 (%)	2010 (%)
Rest of the world	3.6	11.8	16.3	35.7	36.3	41.2
Insurance companies	20.5	20.4	21.9	21.0	17.2	8.6
Pension funds	26.7	31.7	27.8	17.7	15.7	5.1
Individuals	28.2	20.3	20.3	16.0	14.1	11.5
Unit trusts	3.6	6.1	6.8	1.1	1.4	6.7
Investment trusts	–	1.6	2.0	1.3	2.5	2.1
Other financial institutions	6.8	0.7	1.3	2.8	8.2	16.0
Charities	2.2	1.9	1.3	1.4	1.1	0.9
Private non-financial companies	5.1	2.8	1.1	1.5	0.6	2.3
Public sector	3.0	2.0	0.8	-	0.1	3.1
Banks	0.3	0.7	0.4	1.4	2.7	2.5
Total	100	100	100	100	100	100

who have their 'say on pay.' As highly-paid financial services professionals, fund managers sympathies and worldview are likely to be very similar to the executives they are supposed to hold to account. Therefore, they are more conditioned to levels of executive pay that an ordinary person with a pension plan or insurance policy would find shocking, and less interested in challenging enormous pay packages.

This is reflected in the experience of 'say on pay' to date. In the UK, only two FTSE 100 companies lost the vote on their remuneration report in 2011.<sup>15</sup> In the Netherlands, it was

four years before the first executive pay packages, at Philips and Royal Dutch Shell, were rejected by shareholders.<sup>16</sup>

These trends suggest that while the introduction of 'say on pay' across Europe is a welcome and necessary development, complementary measures will be needed to realise the public's hope of more proportionate executive pay.

<sup>14</sup> State of Pay, p21  
<sup>15</sup> High Pay Centre, The State of Pay: One year on from the High Pay Commission, 2012, p18  
<sup>16</sup> Wall Street Journal, Say-on-Pay Rules Expand Globally, 5 March 2013 via <http://mobile.blogs.wsj.com/cfo/2013/03/05/say-on-pay-rules-expand-globally/>

## France

### Super tax on the super-rich

In addition to the bonus cap set at EU level, France plans to introduce a 75% 'supertax' on all incomes over £1 million following the election of President Francois Hollande in 2012.

The French supreme court ruled the measure unconstitutional in December 2012, but the President remains committed to introducing the tax despite ongoing controversy.<sup>17</sup> Hollande wants to ensure that those with the highest income contribute more while France is attempting to eliminate its fiscal deficit.

<sup>17</sup> BBC News, Hollande vows to revive French supertax, 1 January 2013 via <http://www.bbc.co.uk/news/world-europe-20881383>

<sup>18</sup> Sky News, French Tycoon denies attempt to avoid 75% tax, 8 September 2012 via <http://news.sky.com/story/982610/french-tycoon-denies-attempt-to-avoid-75-percent-tax>

<sup>19</sup> Guardian, Jean Michel Jarre denies London tax move, 2 January 2013 via <http://www.guardian.co.uk/world/2013/jan/02/jean-michel-jarre-denies-london-tax-move>

<sup>20</sup> Bloomberg, Test of French Millionaire Tax Is What Hollande Gets in Return, 25 September 2012 via <http://www.businessweek.com/news/2012-09-25/test-of-french-millionaire-tax-is-what-hollande-gets-in-return>

<sup>21</sup> Guardian, France's keen to pay more tax as PM Fillon announces 'rigour package' 24 August 2011 via <http://www.guardian.co.uk/world/2011/aug/24/wealthiest-french-citizens-ask-to-pay-more-tax>

<sup>22</sup> Robert Tannenwald, Jon Shure and Nicholas Johnson, TAX FLIGHT IS A MYTH Higher State Taxes Bring More Revenue, Not More Migration, Center on Budget and Policy Priorities, 2011

Critics of the French 75% tax rate have argued that it will simply drive the super-rich abroad. Certainly, there have been anecdotal news stories of French high earners including Gerard Depardieu, Bernard Arnault and Jean-Michel Jarre seeking to avoid the tax. However, as with the EU bankers bonuses, there is a strong argument that fears the increased tax may drive the super-rich overseas are unfounded.

Though Arnault's application for Belgian citizenship prompted considerable outcry across France, he subsequently claimed that the move was not for tax purposes, and that he intended to continue paying tax in France.<sup>18</sup> Jarre has also stated that his reported move to the UK related only to a new company he plans to establish in London, and that he too would remain a French taxpayer.<sup>19</sup> Of course, Arnault and Jarre's denials should not necessarily be taken at value, but they do suggest that fears of an exodus of French millionaires have been exaggerated.

Another French business leader, Xavier Huillard of the Vinci construction company has said *'France is in an exceptional situation which requires exceptional measures, so it's very natural that everybody contributes, and that those who can contribute more than those who can't.'*<sup>20</sup> In 2011, sixteen prominent French business leaders signed a petition calling for higher taxes on the rich, to ensure fairness in a difficult economic climate.<sup>21</sup>

More generally, research from the Centre and Budget and Policy Priorities in America suggests that tax rates do not affect internal or external migration rates to a significant degree.<sup>22</sup> They reviewed a series of academic papers looking at the income tax rates in different US states, finding no compelling evidence that higher taxes caused residents to move away or that lower taxes attract new residents.

For example, when New Jersey introduced a wealth tax on incomes of over \$500,000 dollars in 2004, a maximum of 70 people left the state

as a result of the changes over the following three years, costing up to \$16.7 million in tax revenue, but the \$3.7 billion in additional revenue raised by the new tax dwarfed this amount.<sup>23</sup> Similarly, though critics suggested that a 2008 millionaires tax in Maryland resulted in a reduced number of people filing tax returns for incomes over \$1 million, closer examination revealed that most of these people remained registered as taxpayers in the state – their incomes had declined as a result of the recession and stock market crash.<sup>24</sup>

This seems to contradict the view that the French super tax will drive wealthy taxpayers overseas, and fail to raise significant money.

### Maximum pay ratio

All companies in which the French state holds a greater than 50% stake will cap their executive's pay at twenty times that of their lowest-paid employee. The 20:1 pay ratio will apply both to new employees, and existing business leaders, and will effect over 50 businesses, including includes major companies such as Areva and EDF, whose CEO Henri Proglio will see his salary fall by 70% from circa €1.6 million.<sup>25</sup>

The pay ratio follows a related measure introduced by President Sarkozy in 2009, banning bonuses and stock options at any company receiving support as part of the post-financial crisis bail-out.<sup>26</sup>

The choice of a 20:1 limit is somewhat arbitrary measure, and it is too early to judge its success (though executives such as Proglio have willingly complied). As it will initially only apply to state-owned companies, it will serve as an example for most executive pay packages, rather than a firm limit.

Opponents of pay ratios have suggested that they will add an additional layer of complexity and bureaucracy in terms of the work required to calculate the ratio. There is also the question of contracted staff, such as cleaners, who are often amongst the lowest-paid workers. If they are not included in the ratio, it becomes a less effective mechanism for achieving fairer levels of pay. If they are, this adds a further complication to the process.

Nonetheless, It is perhaps the sense of unfairness that generates the most public anger around the issue of high pay – the feeling that some executives have managed to capture a share of rewards so many times that of ordinary workers, and that this isn't proportionate to how hard they work, or how demanding their jobs.

In this respect, the pay ratio establishes an important symbolic principle regarding sensitive and proportionate pay structures at major French companies that is currently lacking in the UK.

<sup>23</sup> Ibid p8

<sup>24</sup> Ibid, p3

<sup>25</sup> Bloomberg, France to Cap CEO Pay at State-Owned Companies Like EDF and Areva, 30 May 2012 via <http://www.businessweek.com/news/2012-05-30/france-to-cap-ceo-pay-at-state-owned-companies-like-edf-areva>

## Germany

## Employee say on pay

Germany boards operate a system of 'co-determination' comprising a management board with day-to-day responsibility for the company, and a supervisory board, providing strategic oversight. The supervisory board is divided equally between shareholder representatives and elected representatives of the company workforce.

Historically, decisions on executive pay were delegated to a separate remuneration committee. However since 2009, the supervisory board has had responsibility for setting levels of executive pay, meaning that elected employee representatives now have a say in their bosses' pay.<sup>27</sup>

Support for employee representation on remuneration committees has gained considerable support in the UK in recent years, and was adopted as a policy by the Labour Party following the final report of the High Pay Commission in 2011.

Contrastingly, UK business leaders have expressed trenchant opposition to the idea. The German experience provides a useful context to this debate

Employee 'say on pay' has had no adverse effect on the country's economy, nor has it yet achieved drastic cuts to levels of executive pay, though these remain, on average, lower than in the UK and USA.<sup>28</sup>

The example of Volkswagen provides an illustrative example of how pay policy has worked in Germany since supervisory boards assumed responsibility for setting pay in 2009. Following outrage at CEO Martin Winterkorn's €18.7 million pay package in 2011, his was reduced by 20% in 2012,

despite achieving record profits.<sup>29</sup> The supervisory board also agreed a €5 billion threshold for profits, below which bonuses will not be paid to executives.

Volkswagen, and six other companies on the DAX 30 index of Germany's biggest listed firms, have also introduced a series of non-financial performance measures, meaning that executive pay will be judged against criteria such as employee engagement, customer satisfaction and environmental objectives.<sup>30</sup>

These core indicators are a critical guide to a company's long-term sustainable success, yet are often ignored in favour of financial measures based on profits and share price. Bank of England Director Andy Haldane and financial journalist Anthony Hilton have both argued that executive incentives linked to unreliable financial performance measures created a pernicious culture of risk-taking and under-investment in the run-up to the

recent financial crisis, encouraging businesses to pursue wildly speculative activities that proved immensely damaging in the long-term, in order to boost short-term gains.<sup>31</sup>

Giving employees, who are likely to place a higher premium on the company's ability to support their jobs over the long-term, a 'say on pay' is a key means of combatting this effect.

Employees also bring an alternative perspective to deliberations on pay. In the UK, remuneration committees are currently dominated, almost exclusively, by people from a similar background to the executives whose performance they are supposed to judge. Nearly half UK remuneration committee members are current or former lead executives, while 90% have a business or financial background.<sup>32</sup>

Employee representatives have a different idea of what constitutes company success; they are not conditioned to accept multi-million pound pay packages as normal; and they are well-placed to identify how a huge pay increase for the senior executives may effect morale across the wider workforce.

Therefore, executive pay packages are much less likely to damage a company's reputation and productivity if elected employee representatives are allowed to have their input.

## 'Rewards for failure' - pay caps for bailed-out banks

A number of pay-related conditions were attached to the German 'Special Fund Financial Market Stabilization,' for businesses in receipt of Government support in 2009. These included a salary cap of €500,000 for board members, plus a ban on bonuses that were not contractually required, and a ban on 'compensation upon termination' or 'golden parachute' payments.<sup>35</sup>

The stringent conditions on pay attached to the German bail-out stand in stark contrast to the UK, where public anger was inflamed in 2013 by the news that over 100 bankers at the nationalised RBS and LloydsHBOS had received pay packages worth over £1 million.<sup>33</sup>

The German experiment has not been entirely successful. In 2010, Der Spiegel noted that 68 bankers across the bailed-out banks were still in receipt of pay packages in excess of the €500,000 cap, because the cap only applied to members of the management board.<sup>34</sup>

Despite this, the use of a regulatory cap has limited the capacity of the bailed-out bank chiefs to award their most prominent employees enormous pay packages. In the UK, it is the multi-million pound packages awarded to Antonio Horta Osorio and Stephen Hester, the Chief Executives of bailed-out banks LloydsHBOS and RBS, in particular, which have caused the greatest public outrage.

<sup>31</sup> Andrew Haldane, Wincott Annual Memorial Lecture, 24 October 2012 via <http://www.bankofengland.co.uk/publications/Documents/speeches/2011/speech525.pdf> and Evening Standard, Anthony Hilton: Executive bonuses damage growth, 13 December 2012 via <http://www.standard.co.uk/business/business-news/anthony-hilton-executive-bonuses-damage-growth-8412544.html>

<sup>32</sup> High Pay Centre, The New Closed Shop: Who's deciding on pay?, 2012, p7

<sup>33</sup> The Scotsman, Lloyds to reveal £1m payments to over 20 staff, 25 March 2013 via <http://www.scotsman.com/the-scotsman/business/lloyds-to-reveal-1m-payments-for-over-20-staff-1-2855463>

<sup>34</sup> Der Spiegel, 500,000 Euro Limit Exceeded: State-Assisted German Banks Still Pay Fat Salaries, 4 October 2010 via <http://www.spiegel.de/international/business/500-000-euro-limit-exceeded-state-assisted-german-banks-still-pay-fat-salaries-a-721154.html>

<sup>35</sup> Mayer Brown, Summary of Government Interventions: Germany, 2009 via [http://www.mayerbrown.com/public\\_docs/0272fin\\_Summary\\_Government\\_Interventions\\_Germany.pdf](http://www.mayerbrown.com/public_docs/0272fin_Summary_Government_Interventions_Germany.pdf)

<sup>26</sup> CNN, France to ban bonuses for bailed out firms, 26 March 2009 via [http://edition.cnn.com/2009/WORLD/europe/03/26/france.bonuses.banks/index.html?\\_s=PM:WORLD](http://edition.cnn.com/2009/WORLD/europe/03/26/france.bonuses.banks/index.html?_s=PM:WORLD)

<sup>27</sup> High Pay Centre, Seminar Report: How employees set executive pay in Germany, 27 March 2012 via <http://highpaycentre.org/blog/seminar-report-how-employees-set-executive-pay-in-germany>

<sup>28</sup> Ibid

<sup>29</sup> Reuters, Volkswagen CEO to take 20 percent pay cut in 2012, 17 February 2012 via <http://www.reuters.com/article/2013/02/17/us-volkswagen-ceo-salary-idUSBRE-91G05O20130217>

## Switzerland

### Public driven changes

In March 2013 an emphatic 68% of Swiss voters endorsed a referendum proposal on executive pay constraints.

The proposals put to the electorate are based on the 'shareholder say on pay' principle operating in the Netherlands, and planned for the UK and the rest of the EU. But in addition to giving shareholders a binding vote on executive pay, the Swiss measures will ban 'golden hello' and 'golden parachute' payments – large awards given to executives when they join and/or leave a company. Strikingly, any executive found to be in breach of the new laws after they have come into effect will be liable for a prison sentence!<sup>36</sup>

The Swiss pay reforms are unusual, in that they incorporate both a passive 'free' market solution to the problem of excess pay, in the shape of the shareholder vote, which merely facilitates the opportunity for shareholders to block egregious pay awards; and an active interventionist measure, in directly banning 'golden parachutes' and 'golden hellos.'

The use of 'golden parachute' and 'golden hello' payments is subject to considerable controversy. Given that executives already receive a generous pay package for doing their job, both in terms of basic salary and bonuses, the need for further rewards or incentives is questionable.

There is also the matter of perverse incentives. 'Golden parachutes' awarded to a departing executive might encourage them to drive the company value downwards in order to encourage a takeover attempt from a rival. 'Golden Hello' packages are, of course, no kind of a reward or incentive for performance beyond accepting a job. They also act as a mutually nullifying force against Long-Term Incentive Plans (LTIPs) and loyalty bonuses. Firms can use them to compensate a new executive for any future payments they might lose out on as a result of leaving their previous employer, meaning that the incentive provided by a 'golden hello' or an LTIP is weakened, but the executive still gets to enjoy a massive pay award.

Therefore, the clampdown on 'golden hello' and 'golden parachute' payments is understandable.

The Swiss referendum was initiated under their system of direct democracy, after a public campaign, led by Thomas Minder, an independent MP and businessman. Once his petition had accumulated 100,000 signatures, it automatically triggered a public vote. The Young Socialist movement have used the same mechanism to force a further referendum on whether executive pay should be limited to 12 times the amount of the company's lowest-paid employee.<sup>37</sup>

At regional level, the cantons (administrative districts) of Zurich, Appenzell, Basel Landschaft and Schaffhausen have all endorsed

referendum proposals to scrap generous tax breaks for foreign citizens living but not working in Switzerland (currently, foreigners in Switzerland are only taxed on the value of their Swiss property, rather than their wealth or income).<sup>38</sup>

Together, the measures proposed and introduced in Switzerland offer a wide ranging response to the clear public anger directed at the runaway growth of top incomes, and the unjust and grossly disproportionate levels of wealth inequality.

If mainstream politicians, in any country, allow this sense of anger to fester, it will become increasingly likely to manifest itself in more extreme forms.

### The Dodd Frank Act

Again, the 'say on pay' measures contained in the Dodd Frank Act are based on the same principle as planned for the UK, Switzerland and the EU, however in America the annual shareholder vote is non-binding.

The Act also contains a provision requiring all companies to disclose the ratio between the pay of the CEO and the median salary for all company employees.<sup>39</sup>

### United States of America

As with Europe, the risk that shareholders are insufficiently informed, engaged or empowered

to take action on pay, particularly via their fund managers, applies to the US. In the first half of 2012, shareholders rejected just 49 out of 1856 US executive pay packages put to a vote.<sup>40</sup> An American website, 'Moxy Vote,' designed to enable individual shareholders to register their opinion on executive pay packages, shut down in 2012 claiming that fund managers were unwilling to vote according to the wishes of their clients as expressed via the site.<sup>41</sup>

Though the Act has undoubtedly improved companies' engagement with institutional investors on remuneration policy, Fabrizio Ferri of Columbia Business School suggests this has generally taken the form of discussions on the structure, rather than the total size, of pay packages – with performance-related pay forming an increasingly large component.<sup>42</sup>

As with the 20:1 maximum pay ratio in French state-owned companies, the US hopes to use pay ratios to address the perceived unfairness and lack of proportionality in executive pay awards. Though there is no limit to the ratio, it is hoped that the publicity and scrutiny arising from disclosure will force American CEOs to relate their own pay packages to those of their employees. A similar proposal was discussed in relation to the UK, but was not included alongside binding shareholder 'say on pay' in the Enterprise and Regulatory Reform Bill.

Mandatory pay ratio disclosure has not yet been implemented in the US, while the Securities and Exchange

<sup>36</sup> BBC News, Swiss referendum backs executive pay curbs, 3 March 2013 via <http://www.bbc.co.uk/news/world-europe-21647937>

<sup>37</sup> Wall Street Journal, Swiss to vote on Executive Pay, 20 March 2013 via <http://online.wsj.com/article/SB10001424127887324103504578372203886463598.html>

<sup>38</sup> Reuters, Swiss Parliament backs tax hike for wealthy foreigners, 13 September 2012 via <http://uk.reuters.com/article/2012/09/13/us-swiss-rich-idUKBRE88COJ620120913>

<sup>39</sup> Securities and Exchange Commission, SEC Adopts Rules for Say-on-Pay and Golden Parachute Compensation as Required Under Dodd-Frank Act, 25 January 2011 via <http://www.sec.gov/news/press/2011/2011-25.htm>

<sup>40</sup> CNBC, Does Shareholder activism accomplish anything?, 20 November 2012 via <http://www.cnbc.com/id/49885521>

<sup>41</sup> *ibid*

<sup>42</sup> CNBC, Does Shareholder Activism Accomplish Anything?, 20 November 2012 via <http://www.cnbc.com/id/49885521>



Commission continues to debate the precise guidelines for reporting in the face of intensive corporate lobbying.<sup>44</sup> However by passing the relevant votes in Congress and being signed into law by President Barack Obama, the pay ratio has already become closer to reality in the US than the UK.

<sup>43</sup> Guardian, Obama imposes \$500,000 ceiling on bailed-out bank bonuses 4 February 2009 via <http://www.guardian.co.uk/business/2009/feb/04/obama-bank-salary-cap>

### Bailed-out businesses

The US Government has imposed conditions on the pay of executives of those companies receiving funds as part of the Troubled Assets Relief Program (TARP), with a general limit of \$500,000 cash salary, plus restrictions on bonuses requiring them to be paid in stock, and deferred until all loans from the Government had been repaid.<sup>43</sup>

<sup>44</sup> US Securities and Exchange Commission, Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Pending Action, 2013 via <http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml>

<sup>45</sup> Special Inspector General for the Troubled Asset Relief Programme, Treasury Continues Approving Excessive Pay for Top Executives at Bailed-Out Companies, 2013 via [http://www.sigtar.gov/Misc/2013\\_SIG-TARP\\_Bailout\\_Pay\\_Report.pdf](http://www.sigtar.gov/Misc/2013_SIG-TARP_Bailout_Pay_Report.pdf)

<sup>46</sup> Ibid

<sup>47</sup> Guardian, Obama imposes \$500,000 ceiling on bailed-out bank bonuses

<sup>48</sup> University of Utah, New Study finds TARP recipients succeed, despite executive pay limits, 5 December 2012 via [http://unews.utah.edu/news\\_releases/new-study-finds-tarp-recipients-succeed-despite-exec-pay-limits/](http://unews.utah.edu/news_releases/new-study-finds-tarp-recipients-succeed-despite-exec-pay-limits/)

As with the German pay cap, the US cap applies only to executives. The Special Inspector General for TARP (SIGTARP) has criticised the fact that many of the 69 individuals affected have continued to receive pay packages worth millions of dollars, once potential stock options are taken into account.<sup>45</sup> Only 23 executives, though, have received payments worth over \$500,000 dollars in cash terms.<sup>46</sup> The very existence of a Government body monitoring executive pay at bailed-out companies demonstrates the US's concern about fair pay.

Undoubtedly, the fact that, if the TARP recipients repay Government debts and return to profitability, their executives will still receive huge payouts, highlights the limits of the cap as a statement of intent with regard to tackling inequality, or disproportionate distribution of pay. But given the huge pay packages that are commonplace

in America, reducing basic salaries to \$500,000 is a significant step. The strict link between pay and the recovery of Government funding is also likely to mitigate the public's sense of unfairness at the size of these awards.

Again this represents a stark contrast with the UK, where both Stephen Hester and Antonio Horta Osorio received basic pay in excess of £1 million, plus multi-million pound performance-related awards that can vest without the Government recovering its full investment in the banks.

The US pay cap initially proved controversial in 2009 when the measures were enacted. A fund manager claimed at the time that *'this is pure political grandstanding. If the limit has bite, it will be counterproductive and the unintended consequences will hurt the US as skilled and bright senior managers make choices.'*<sup>47</sup>

However, research from the University of Utah suggests that the pay conditions have had no effect on the performance of bailed-out companies, compared to the 35 organisations that were approved for bail-out funding but chose not to take up the offer (in some cases because of concerns about the pay restrictions).<sup>48</sup>

It is often argued that the UK Government needs to offer huge pay packages to the executives and bankers charged with returning bailed out UK companies to profitability. The evidence from the US suggests that this is an unnecessarily supine attitude, and that the UK Government could have asserted itself more

forcefully, to stop companies awarding executive pay packages worth millions of pounds with what is ultimately taxpayers' money.

## Japan

### Cultural regulation

Executive pay is lightly regulated in Japan, with a 2010 requirement for companies to disclose details of all executive pay packages earning over 100 million yen (\$1.1 million) the most significant measure implemented since the 2007 financial crisis.

Nonetheless, executive pay is generally acknowledged to be much lower than in Western countries. This is generally ascribed to cultural or societal pressures, rather than Government regulation

Japan represents a particularly interesting case study on executive pay. The levels of CEO pay are markedly lower than in other advanced economies, with the kind of multi-million pound/dollar packages commonplace at big UK or US companies are almost unheard of in Japan.

According to research by PricewaterhouseCooper's, the requirement to disclose executive pay packages worth over 100 million yen only affected around 300 people across all Japanese companies.<sup>49</sup> To put this into perspective, in the UK in 2012, Barclay's Bank alone paid 428 of its employees over £1 million.<sup>50</sup>

Explanations for the much lower levels of top pay in Japan have focused on the country's stronger tradition of solidarity and humility, and the sense that prosperous companies succeed as a result of collective efforts rather than brilliant individual leadership. The Economist has noted that *'Japan Inc justifies its meagre salaries and modest pay-differentials by noting that they help to foster the country's vaunted team spirit.'*<sup>51</sup>

Similarly, a 2010 Businessweek feature contrasting Japanese executive pay with international comparisons noted that *'with wealth still considered unseemly in Japan, there is little pressure for salaries to rise,'*<sup>52</sup> Rewards as grossly at odds with the earnings of ordinary working people as in other parts of the world are morally unconscionable in Japan.

More recently, executives at a number of major Japanese companies, including Sony and Nomura, have undergone significant pay cuts as a result of poor financial performance, suggesting a much greater willingness to demonstrate a degree of sacrifice and awareness of public opinion that is not always apparent amongst their counterparts in other countries.<sup>53</sup>

Therefore, while Japan is something of a rarity in that it has not gone as far as the UK in seeking to curb executive pay growth, this is clearly because, unlike the UK, social/cultural pressures are holding down Japanese executive pay at a level much closer to what is publicly acceptable or proportionate.

<sup>49</sup> Businessweek, In Japan, Underpaid – and Loving it, 1 July 2010 via [http://www.businessweek.com/magazine/content/10\\_28/b4186014341924.htm](http://www.businessweek.com/magazine/content/10_28/b4186014341924.htm)

<sup>50</sup> BBC News, Barclay's 428 millionaires 'no surprise', 8 March 2013 via <http://www.bbc.co.uk/news/business-21713973>

<sup>51</sup> The Economist, Spartan Salarymen, 30 June 2010 via [http://www.economist.com/blogs/newsbook/2010/06/japanese\\_executive\\_pay](http://www.economist.com/blogs/newsbook/2010/06/japanese_executive_pay)

<sup>52</sup> Businessweek, In Japan, Underpaid – and Loving it

<sup>53</sup> Reuters, Nomura halves CEO pay in bid to close insider probe, June 2012 via [http://www.ft.com/cms/s/0/5a0e33ac-b235-11e2-a388-00144feabdc0.html#axzz2RrP3PLgi](http://www.reuters.com/article/2012/06/29/us-japan-insider-nomura-pay-idUSBRE85SOGT20120629; and Financial Times, Sony leadership to forgo bonuses after broken promise on profits, 1 May 2013 via <a href=)

## Conclusion – the UK, international laggard?

Our analysis suggests that there is near universal agreement on shareholder 'say on pay' as a necessary measure to constrain executive pay growth. This has already been adopted (on an advisory basis) in the US. The UK and Switzerland have committed to a binding shareholder vote, while the European Union has said it will put forward legislation to this effect later on this year.

In this respect, the UK deserves some credit – the advisory shareholder vote on executive pay introduced by the UK government in 2002 was a pioneering step that encouraged wider adoption of 'say on pay.' The US and other EU countries are behind the UK in terms of implementing a binding shareholder vote.

However, shareholders alone lack the capacity and political will to address the problem of unfair and disproportionate executive pay. Yet the UK remains relatively unique in not having proposed any serious supplementary measures to its 'say on pay' proposals. In Switzerland, golden parachute and golden hello packages have been banned, and the new measures backed up by the threat of jail! In Germany, the 'say on pay' has essentially been extended to employees by giving the supervisory board, including workers' representatives, the power to set executive pay.

France has introduced a maximum pay ratio for state-owned companies, and even in the US, where the 'free' market is more deeply ingrained into the political

culture, mandatory publication of pay ratios is planned, and a salary limit is in place for companies owned or bailed out by the state.

Japan is perhaps the one exception of the countries studied in this report, but there is no evidence to suggest that the magnanimity demonstrated by Japanese business leaders in refusing to demand the levels of pay afforded to European or North American executives will be replicated elsewhere without firm regulations.

It is open to debate whether any of these proposals represents a workable solution to the problem of excess pay. All the measures highlighted in this paper have been subject to criticism, though their proponents have, in turn, provided robust arguments as to why these criticisms are invalid. The different approaches demonstrate a lack of international co-ordination, despite the widely stated belief that excess pay is a global issue requiring global resolution (though the forthcoming proposals promised by EU Commissioner Michel Barnier may represent an opportunity to begin this process by harmonising measures at EU level).

As a Forbes Magazine columnist wrote in a March 2013 article discussing the EU bonus cap and the Swiss referendum on executive pay '*The issue here isn't really whether either of these measures is good or bad, whatever one's perspective, but that something proactive is finally being done.*'<sup>54</sup>

Excessive executive pay has provoked justified public anger across the globe in recent years. It damages businesses, by diminishing the morale of ordinary workers, and by creating, as the Salz report into the LIBOR manipulation scandal at Barclays argues, a reckless arrogance amongst the highly-paid. It weakens society, by enabling those who enjoy economic power to extract vastly disproportionate awards compared to those who do not.

The UK's comparatively weak response to the problem sends out a clear message about inequality, and whether or not the Government thinks highly visible and grossly disproportionate rewards for a tiny, privileged elite represent a problem. It would be complacent to assume that we are not creating real risks to social and economic stability if the perception is allowed to take hold that it does not.

<sup>54</sup> Forbes Magazine, Is the end of gigantic, unfair and absurd CEO pay near?, 18 March 2013 via <http://www.forbes.com/sites/richardfingar/2013/03/18/is-the-end-of-gigantic-unfair-and-absurd-ceo-pay-near/>

