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**DO THE BENEFITS OF THE CURRENT UK  
REGULATORY/COMPLIANCE REGIME REGARDING  
REMUNERATION COMMITTEES' DETERMINATION OF  
EXECUTIVE PAY AND ITS DISCLOSURE JUSTIFY THE  
OBLIGATIONS IMPOSED?**

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## ABSTRACT

*This paper examines the applicable regulatory/compliance regime concerning RCs' determination of executive pay and its disclosure. It hypothesises that although the results of UK regulation have been very beneficial overall (i.e., the benefits do indeed justify the obligations imposed), particular UK corporate governance failures regarding executive pay have arisen due to the combination of the applicable regulatory regime with other factors. It finds that in respect of accountability and transparency very considerable progress has been made; however, regarding the pay-performance linkage in particular much remains to be done concerning 'rewards for failure', the need for a longer-term time horizon and LTI design generally.*

*Although this paper concludes that its hypothesis is correct, six recommendations are made for future improvement regarding (i) regulation, (ii) institutional shareholders, (iii) remuneration committees, (iv) remuneration committee advisors/in-house executive compensation HR specialists, (v) remuneration package design, and (vi) corporate ethics/behaviour. The goal of improvement is well worth striving for because corporate governance failure on executive pay harms the concept of responsible capitalism and the success of companies on which UK jobs and taxes depend.*

Key words. *executive pay: pay regulation: pay disclosure: 'rewards for failure': remuneration committees: remuneration consultants: institutional shareholders: corporate ethics.*

## TABLE OF CONTENTS

|   | <b>Page</b>  |
|---|--------------|
| <b>ABSTRACT</b> _____   | <b>(iv)</b>  |
| <b>TABLE OF CONTENTS</b> _____                                    | <b>(v)</b>   |
| <b>LIST OF ABBREVIATIONS</b> _____                                | <b>(vii)</b> |
| <b>CHAPTER 1: Introduction and scope</b> _____                    | <b>1</b>     |
| <b>CHAPTER 2: UK regulatory framework</b> _____                   | <b>4</b>     |
| 2.1 Agency issues _____   | <b>4</b>     |
| 2.2 UK executive pay regulation: 1979 – 2014 _____                | <b>6</b>     |
| 2.2.1 Review: 1979 – 1992 _____                                   | <b>10</b>    |
| 2.2.2 Review: 1992 – 2003 _____                                   | <b>11</b>    |
| 2.2.3 Review: 2003 – 2014 _____                                   | <b>14</b>    |
| 2.3 Remuneration committees' determination of executive pay _____ | <b>18</b>    |
| 2.4 Executive pay disclosure regime _____                         | <b>19</b>    |
| <b>CHAPTER 3: Comparative perspective</b> _____                   | <b>21</b>    |
| 3.1 Key features of comparative exercise _____                    | <b>21</b>    |
| 3.2 USA _____   | <b>21</b>    |
| 3.3 EU _____  | <b>23</b>    |
| 3.4 Germany _____   | <b>25</b>    |
| 3.5 France _____  | <b>25</b>    |
| 3.6 Japan _____   | <b>26</b>    |

|  | <b>Page</b>  |
|--|--------------|
| <b>CHAPTER 4: Findings and discussion</b> _____  | <b>28</b>    |
| 4.1 Introduction to findings on UK regulatory regime applicable to executive pay _____             | <b>28</b>    |
| 4.2 Findings: Remuneration committee determination of executive pay _____                          | <b>30</b>    |
| 4.3 Findings: Regime for disclosure of UK executive pay _____                                      | <b>34</b>    |
| 4.4 Findings: Institutional shareholders _____   | <b>35</b>    |
| 4.5 Findings: Psychology of performance-related pay _____  | <b>40</b>    |
| 4.6 Findings: Remuneration committee advisors/in-house executive compensation HR specialists _____ | <b>42</b>    |
| 4.7 Findings: Benefits -v- obligations of UK regulatory regime _____                               | <b>44</b>    |
| <b>CHAPTER 5: Conclusions and recommendations</b> _____  | <b>46</b>    |
| 5.1 Conclusions _____  | <b>46</b>    |
| 5.2 Recommendations _____  | <b>50</b>    |
| <b>BIBLIOGRAPHY</b> _____  | <b>(i)</b>   |
| UK/EU legislation _____  | <b>(ii)</b>  |
| Reports, Reviews, Codes and Guidelines _____   | <b>(iii)</b> |
| Books _____  | <b>(v)</b>   |
| Articles _____   | <b>(vi)</b>  |
| Online Sources _____   | <b>(x)</b>   |

## **LIST OF ABBREVIATIONS**

|      |  |
|------|--|
| ABI  | Association of British Insurers                                |
| AGM  | Annual General Meeting   |
| BIS  | Department of Business, Innovation and Skills                  |
| CEO  | Chief Executive Officer  |
| CFO  | Chief Financial Officer  |
| CRD  | Capital Requirements Directive                                 |
| DB   | Defined Benefit  |
| DC   | Defined Contribution   |
| DFA  | Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 |
| DRR  | Directors' Remuneration Report                                 |
| EC   | European Commission  |
| ED   | Executive Director   |
| EPS  | Earnings Per Share   |
| EU   | European Union   |
| FCA  | Financial Conduct Authority                                    |
| FRC  | Financial Reporting Council                                    |
| FSA  | Financial Services Authority                                   |
| GFC  | Global Financial Crisis 2007/2008                              |
| HPC  | High Pay Commission  |
| ICGN | International Corporate Governance Network                     |
| IPPR | Institute for Public Policy Research                           |



Candidate Number: 140993

|              |   |
|--------------|---|
| <b>ISS</b>   | Institutional Shareholder Services                                    |
| <b>IVIS</b>  | Institutional Voting Investor Services                                |
| <b>LTA</b>   | Lifetime Allowance  |
| <b>LTI</b>   | Long-term Incentive   |
| <b>NAPF</b>  | National Association of Pension Funds                                 |
| <b>NED</b>   | Non-executive Director  |
| <b>OECD</b>  | Organisation for Economic Co-operation and Development                |
| <b>PIRC</b>  | Pensions Investment Research Consultancy                              |
| <b>RC</b>    | Remuneration Committee  |
| <b>RREV</b>  | Research Recommendations Electronic Voting                            |
| <b>SOX</b>   | Sarbanes-Oxley Act 2002   |
| <b>SRD</b>   | Shareholder Rights Directive  |
| <b>STI</b>   | Short-term Incentive  |
| <b>SYSC</b>  | Senior Management Arrangements, Systems and Controls                  |
| <b>TSR</b>   | Total Shareholder Return  |
| <b>TW</b>    | Towers Watson   |
| <b>UCITS</b> | Undertakings for the Collective Investment in Transferable Securities |
| <b>UKCGC</b> | UK Corporate Governance Code  |
| <b>UKSC</b>  | UK Stewardship Code   |
| <b>VC</b>    | Voluntary Code of Conduct for Remuneration Consultants                |
| <b>WW</b>    | Watson Wyatt.   |

## CHAPTER 1

### 1. INTRODUCTION AND SCOPE

Executive pay in the UK excites the interest of academics, politicians, regulators, the media, company investors/institutional shareholders, business leaders, the working population and the country at large. The rise in UK executive pay levels since the 1980s is widely condemned by most such groups – as being out of line with pay growth amongst the workforce generally and not being appropriately linked to performance (so-called ‘rewards for failure’).

Although this paper covers two aspects of UK executive pay in particular – namely, the applicable regulatory/compliance regime regarding RCs’ determination of executive pay and its disclosure – in order to provide the appropriate setting for review and recommendations for future reform it necessarily includes certain other executive pay areas. The context within which the various aspects are reviewed and considered is ‘agency theory’, and whether benefits arising from regulation justify the obligations imposed.

In the UK the process by which RCs determine executive pay (and its subsequent disclosure) is highly regulated via legislation, listing rules and self-regulation contained in institutional investor codes and guidelines. However (with the exception of certain financial services – specific aspects), board/senior executive pay is not specifically regulated on matters such as basic salary levels, STIs and LTIs, together with the size/level of the remuneration package overall. Having said this, the direction since 1980 has been for publicly-quoted companies to be subject to very considerable regulatory and other constraints on executive remuneration packages. The charge was originally led by institutional shareholders, but detailed legislation has followed in its wake.

Accordingly, the UK regime is not one where RCs can simply pay what they want to EDs (and senior management) and without disclosure to and, indeed, the voting approval of shareholders in certain cases. For example, LTIs using newly-issued share capital have always required shareholder approval and since 2002 there has been a shareholders' annual advisory vote on the DRR. Annual election for directors were introduced in 2010 and now a binding vote has been added for remuneration policy (the advisory vote is 'backwards looking', whereas the binding vote 'looks forward'). So the UK is a highly regulated environment, yet criticisms of executive pay grow apace.

This paper's hypotheses that although the results of regulation have been very beneficial overall (i.e., the benefits do indeed justify the obligations imposed – with the important caveat that certain recommended future improvements are set out), particular UK corporate governance failures regarding executive pay have arisen due to the combination of the applicable regulatory regime with other factors. Brian Main's 2007 publications show the challenges entailed in RCs original responsibility for policing the probity of the pay determination process now being supplemented by their far more demanding role as key players in the strategic human resource management of companies, together with the influence of institutional shareholders channelling RCs down 'tramlines' of remuneration package design (which can replicate unwelcome aspects of fund managers' own incentive arrangements).<sup>1, 2</sup> Top FTSE boardroom/executive pay has massively increased (but so has the size, complexity and globality of companies), whilst the motivational psychology of incentive pay has been insufficiently taken into account.

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<sup>1</sup> Brian Main, Calvin Jackson, John Pymm and Vicky Wright 'The Remuneration Committee and Strategic Human Resource Management' (2007) *Corporate Governance: An International Review* 16 (3) 235-238 Accessed 12<sup>th</sup> June 2014.

<sup>2</sup> Brian Main, Calvin Jackson, John Pymm and Vicky Wright 'Questioning the Remuneration Committee Process' (2007) Working Paper  
<<http://homepages.ed.ac.uk/mainbg/Files/questioning%20the%20remuneration%20committee%20process%20-%202021%20feb%202007.pdf>> Accessed 12<sup>th</sup> June 2014.

RCs have struggled in effectively discharging the duties they are now charged to perform. The way in which RCs operate, the tasks they need to carry out and the stakeholders they perform for must satisfy, have all combined to make RCs' role far more demanding and, some would argue, almost impossible to perform in a way that successfully reduces criticisms of executive pay.

This paper concludes its hypothesis is correct. UK pay regulation over the past 35 years has been greatly beneficial and justifies the obligations imposed. On accountability and transparency 'UK PLC' has seen very considerable corporate governance improvements; however, in respect of performance-linkage in particular much remains to be done regarding 'rewards for failure', the need for a longer-term time horizon and LTI design generally.

Set out in this paper are six recommendations for future improvement concerning (i) regulation, (ii) institutional shareholders, (iii) remuneration committees, (iv) remuneration committee advisors/in-house executive compensation HR specialists, (v) remuneration package design, and (vi) corporate ethics/behaviour. It seeks to be the first step in a process requiring further work to be undertaken. The goal is well worth striving for because corporate governance failure on executive pay aspects harms the concept of responsible capitalism and the success of companies on which UK jobs and taxes depend.

Chapter 2 of this paper reviews the UK regulatory framework for executive pay regulation – it covers both RCs' determination of executive pay and the subsequent disclosure of pay/remuneration policies and packages. Chapter 3 deals with the comparative perspective, looking at the position respectively in the USA, EU, Germany, France and Japan. The paper then continues with Chapter 4's findings and discussion arising out of the material in Chapters 2 and 3, respectively. Finally, Chapter 5 contains conclusions and six recommendations based on the foregoing review and analysis.

## CHAPTER 2

### 2. UK REGULATORY FRAMEWORK

#### 2.1 Agency issues

Brian Main states: ‘the problems of creating incentives for the top managers of an enterprise where ownership is widely dispersed (...) gained the label of separation of “ownership from control”.’<sup>3</sup> He cites Adam Smith<sup>4</sup> in respect of the former proposition and Adolf Berle and Gardiner Means regarding the latter<sup>5</sup>, and states that: ‘the dominant theoretical approach to the modern version of this problem is agency theory, which points to the use of an appropriately designed reward mechanism as a way of aligning the interests of the directors with those of the owners’<sup>6</sup> – the first aspect being attributed to Michael Jensen and William Meckling<sup>7</sup> and the second to Kevin Murphy.<sup>8</sup> Main cites<sup>9</sup> Jensen and Murphy: ‘agency theory predicts an optimal contract will tie the agent’s expected utility to the principal’s worth; therefore agency theory predicts that CEO compensation policies will depend on changes in shareholder wealth’.<sup>10</sup>

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<sup>3</sup> Main, note 1, 3.

<sup>4</sup> Adam Smith *An Inquiry Into the Nature and Causes of the Wealth of Nations* (The University of Chicago, 1976), 264.

<sup>5</sup> Adolf Berle and Gardiner Means *The Modern Corporation and Private Property* (Macmillan Co, 1932), 25.

<sup>6</sup> Main, note 3.

<sup>7</sup> Michael Jensen and William Meckling ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) *Journal of Financial Economics*, 3 (4) 305 – 360.

<sup>8</sup> Kevin Murphy ‘Executive Compensation’ in Otley Ashenfelter and David Card (eds.) *Handbook of Labour Economics* (McGraw–Hill, 1999).

<sup>9</sup> Main, note 3.

<sup>10</sup> Michael Jensen and Kevin Murphy ‘Performance Pay and Top-Management Incentives’ (1990) *Journal of Political Economy*, 98 (2) 225 – 264.

Ian Gregory-Smith states: 'the extensive academic literature on the growth of executive compensation has tended to polarise around one of two positions: the rents-capture view and the optimal contracting approach'<sup>11</sup>. He cites Lucian Bebchuk<sup>12</sup> and Jesse Fried<sup>13</sup> as propounding the former position, stating: 'CEOs can subvert the compensation-setting process through their 'capture' of the remuneration committee', which can only be controlled by shareholders via 'withholding consent to egregious proposals and/or by constraining these proposals in anticipation of a stockholder vote'.<sup>14</sup> In contrast, Gregory-Smith states: 'the optimal contracting view suggests that CEO compensation is determined by the operation of the market for managerial talent'<sup>15</sup>. He cites Xavier Gabaix in respect of the latter<sup>16</sup> – noting that Gabaix's research work carried out both before and since the GFC comes to the same conclusion.<sup>17</sup>

There are here, therefore, two very different views of executive pay: the rents-capture theory holds that shareholders can usefully employ their votes to control managers, whereas the optimal contracting view propounds that the market determines pay levels and shareholder involvement can be 'at best meddlesome and at worst disruptive'.<sup>18</sup>

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<sup>11</sup> Ian Gregory-Smith, Steve Thompson and Peter Wright 'Say or Pay in the UK: Modest effect, Even After the Crisis' (*VOX EU* 24<sup>th</sup> March 2014) <<http://www.voxeu.org/article/controlling-uk-executive-pay>> Accessed 27<sup>th</sup> May 2014.

<sup>12</sup> Lucian Bebchuk and Jesse Fried 'Executive Compensation as an Agency Problem' (2003) *Journal of Economic Perspectives*, 17 (3) 71 – 92.

<sup>13</sup> Lucian Bebchuk and Jesse Fried *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press, 2004).

<sup>14</sup> Gregory-Smith, note 11.

<sup>15</sup> Gregory-Smith, note 11.

<sup>16</sup> Xavier Gabaix and Augustin Landier 'Why has CEO Pay Increased so Much?' (2006) National Bureau of Economic Research Working Papers <<http://www.nber.org/papers/w12365>> Accessed 17<sup>th</sup> June 2014.

<sup>17</sup> Xavier Gabaix, Augustin Landier and Julien Sauvagnat 'CEO Pay and Firm Size: An Update After the Crisis' (February 2014) *The Economic Journal*, 124 (574), F40–F59.

<sup>18</sup> Gregory-Smith, note 11.

Gregory-Smith's finding is that the UK's original say-on-pay legislation (i.e., an annual advisory vote of shareholders – on the DRR for the previous financial year) had 'a relatively modest effect on executive pay.' Until this year's AGM Season, US and UK companies were on the same playing field in that under both regimes there was an annual backwards looking advisory vote. However, the UK has now moved to a binding vote on remuneration policy (looking forward three years, in normal circumstances), plus continuing with a non-binding vote looking back on how remuneration policy has actually been implemented. Presumably, rents-capture proponents would view the new UK position as being a significant improvement - with 'optimal contracts' devotees maintaining it will make matters worse.

## **2.2 UK executive pay regulation: 1979 -2013**

In 1979 a Conservative government came into power, heralding 'Thatcher's Britain'. The subsequent 35 years can be split into three periods: 1979 – 1992, 1992 – 2003 and 2003 – 2014. The first, 1979 – 1992, was a sort of 'pre-lapsarian world' before the Cadbury Report's (1992) Code of Best Practice 'comply or explain' regime.<sup>19</sup> The middle period, 1992 – 2003, saw the Greenbury (1995)<sup>20</sup> and Hampel (1998)<sup>21</sup> Reports on directors' pay and corporate governance, respectively – with listed company directors' pay disclosure requirements introduced in 1995 and the introduction in 2002 of the annual advisory vote on the DRR, then the Higgs Report (2003) on NEDs.<sup>22</sup> The final period,

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<sup>19</sup> The Cadbury Report 'Report of the Committee on the Financial Aspects of Corporate Governance' (Gee Publishing, 1992).

<sup>20</sup> The Greenbury Report 'Report of a Study Group Chaired by Sir Richard Greenbury' (Gee Publishing, 1995).

<sup>21</sup> The Hampel Report 'Committee on Corporate Governance' (Gee Publishing, 1998).

<sup>22</sup> The Higgs Review 'Review of the Role and Effectiveness of Non-executive Directors' (2003) ([www.dti.gov.uk/cld/non\\_exec\\_review](http://www.dti.gov.uk/cld/non_exec_review)).

2003 – 2014, covers the GFC, the Walker Review<sup>23</sup> (2009), the FSA Remuneration Code<sup>24</sup> (first issued in 2009) and the binding vote on remuneration policy introduced for this year's AGM Season.

The 35-year period has seen the process by which executive pay is determined by RCs, and its disclosure, move from very modest disclosure stipulated in the Companies Acts, formal RC structures being in place in only a minority of companies, plus self-regulation via institutional shareholder guidelines and listing rule requirements, to the current position where disclosure of pay now takes the form of a 'single overall figure' for directors' remuneration, RCs being universally in place, plus corporate governance codes and listing rules. There are additionally EU remuneration rules (particularly those applicable to the financial services sector), together with the full panoply of institutional shareholder guidelines (e.g., the ABI<sup>25</sup>, NAPF<sup>26</sup>, PIRC<sup>27</sup> and IVIS/RREV<sup>28</sup> - the Investment Affairs Division of the ABI, covering remuneration guidelines, has recently been transferred to the Investment Management Association, but for the purposes of this paper all references to the ABI's remuneration guidelines will continue to be referred to as ABI).

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<sup>23</sup> The Walker Review 'A Review of Corporate Governance in UK Banks and Other Financial Industry Entities' (2009) <[http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/walker\\_review\\_information.htm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/walker_review_information.htm)>.

<sup>24</sup> The FSA Remuneration Code (2009) [www.fca.org.uk](http://www.fca.org.uk).

<sup>25</sup> ABI 'Principles of Executive Remuneration' (2013) <<https://www.ivis.co.uk/guidelines>> Accessed 19<sup>th</sup> June 2014.

<sup>26</sup> NAPF 'Corporate Policy and Voting Guidelines' (2013) <[https://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0352\\_%20NAPF\\_corp\\_gov](https://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0352_%20NAPF_corp_gov)> Accessed 19<sup>th</sup> June 2014.

<sup>27</sup> PIRC 'UK Shareholder Voting Guidelines' (2013) <<https://www.pirc.co.uk>> Accessed 19<sup>th</sup> June 2014.

<sup>28</sup> RREV 'UK Remuneration Committee Guidance' (2013) <<https://www.issgovernance.com/files/ISSRREV2013UKRemunerationGuidance.pdf>> Accessed 19<sup>th</sup> June 2014 and NAPF 'Corporate Governance Policies and Voting Guidelines' (2013) <<https://www.napf.co.uk/PolicyandResearch/DocumentLibrary/-/Media/Policy/Documents/0277corporategovernancepolicyandvotingguidelinesonNAPFdocument.ashx>> Accessed 19<sup>th</sup> June 2014.



As stated by Main in 2007: '[W]hile it is true to say that top executive pay remains unregulated in the UK, the same cannot be said for the process by which it is determined. The practices and procedures of the now near universal remuneration committees are carefully prescribed in self-regulating codes and institutional guidelines'.<sup>29</sup> This was finessed by Peter King: 'In the UK, there is no statutory limit on, or prescribed structure for, remuneration for executive directors (save that certain financial institutions are subject to the CRD and FSA Remuneration Code)'.<sup>30</sup>

Instead, companies are required to adhere to the UKCGC/UKSC 'comply or explain' regime. There are also legislative requirements on disclosure; for example, section 420 (1) of the Companies Act 2006 and the report disclosure requirements set out in section 422A of the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 SI 2013/1981.

The influence of institutional shareholders on UK executive pay package structure and determination remains very strong. Main stated in 2007: 'what truly distinguishes UK arrangements from those in the USA is the way that British institutional investors have been prepared to set about influencing the conduct (as opposed to the structure) of the committee'.<sup>31</sup> They continue to be prepared to 'red top' and vote against LTIs that do not conform to their guidelines regarding quantum, share dilution and performance measures. This has been ongoing for the past 35 years, reinforced by the introduction of the UKSC in 2011.<sup>32</sup>

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<sup>29</sup> Main, note 2,2.

<sup>30</sup> Peter King, Holly Gregory, Lauren Pau and Rebecca Grapsas 'Disclosure of Executive Remuneration in the UK: Recent Developments and US Comparison' (2012) < [www.practicallaw.com/corpgov-mjg](http://www.practicallaw.com/corpgov-mjg) > Accessed 12<sup>th</sup> June 2014.

<sup>31</sup> Main, note 2, 5.

<sup>32</sup> UKSC <<https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship>> Accessed 5<sup>th</sup> June 2014.

This paper addresses the executive pay/corporate governance of companies with a premium listing (most other quoted companies do in fact adhere to a greater or lesser extent with the relevant regime). 'Executive pay' refers to the individual pay components (e.g., basic salary, STI (annual bonus paid, LTI and pensions) and remuneration packages overall of EDs together with their direct reports (usually comprising the 'Operating Board' of publicly-quoted companies – for example, CEO, CFO, Business Heads, HR Director and General Counsel/Group Secretary). The Chairman and NEDs are also included, albeit that UK practice is broadly to pay such directors by way of a straight fee (as opposed to participation in STIs and LTIs or pension arrangements).

This paper focuses on London premium listed companies generally (i.e., it covers the full spectrum of industry sectors), but there is recognition of the fact that certain financial services ones are also covered by particular EU legislation (e.g., CRD IV and UCITS V) and/or the FCA Remuneration Code.

Any comparative international perspective of executive pay needs to take account of the differences between unitary board structures (e.g., USA and UK) and dual ones (e.g., Germany, Switzerland and Netherlands). It must also be noted that, although two territories may operate say-on-pay advisory votes (e.g., USA and UK) what is actually put to shareholders for their vote will differ significantly (e.g., the directors/senior executives in the population covered differs between the UK – EDs and NEDs – and USA – CEO, CFO and three most highly paid executive officers, plus outside directors). More detailed disclosure requirements can also apply to certain financial services companies (e.g., the 'banded' pay disclosures for 'high end' staff). The context is that despite the UK executive pay regulatory regime (including the UKCGC<sup>33</sup>/UKSC and financial services special provisions), there remains strong criticism.

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<sup>33</sup> UKCGC (2012) <[www.frc.org.UK/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx](http://www.frc.org.UK/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx)> Accessed 5<sup>th</sup> June 2014. (Note: although the UKCGC does not have legal force, breach of 'comply or explain' could well amount to an infringement of the Listing Rules, with various sanctions attached <<https://fsahandbook.info/FSA/html/handbook/LR/918>> Accessed 5<sup>th</sup> June 2014).

**2.2.1. Review: 1979 – 1992**

ED remuneration packages in 1979 were characterised by long notice periods (three years' salary plus benefits was the norm, compared now to one year's basic salary and benefits), modest STI and LTI opportunity, but 'gold-plated' DB pension arrangements (delivering two-thirds of final salary, after 20 years' service). The remuneration package focused on executive security, with relatively little variable pay linked to performance. This is hardly surprising, tax rates were high so it made sense to major on tax-approved pension arrangements. Today, the variable pay components of the package make up the majority of its value and DB pension provision for new recruits is rare.

In the mid-nineteen eighties, institutional shareholders addressed the dramatic growth in LTI provision following the 1984 enactment of tax-favoured Inland Revenue approved share option schemes. Such arrangements are put to shareholders for approval – with strict limits on potential dilution, and guidelines on the size of LTI awards expressed as a multiple of salary (valued at the date of grant). The relevant guidelines were initially simple (for example, performance conditions governing the exercise of share options were not introduced until 1986).

RCs were still a nascent feature in UK companies and the disclosure of remuneration packages was skeletal (ie by anonymous 'bands', rather than on an individual director basis). There was a level of informality and lack of structure around the determination and disclosure of board/executive pay that seems extraordinary today. However, this was not to last. The Conservative government's privatisation of utilities, coupled with strong stock market performance in the late 1980s/early 1990s, led to a furore over 'windfall gains' arising from tax-favoured executive share options. Worse than this though was the increasing lack of investor confidence in the honesty and accountability of listed companies, due to the sudden failure of Coloroll and Polly Peck. This led to the establishment of the Cadbury Committee (which then had to contend with BCCI and Maxwell).

### 2.2.2. Review: 1992 – 2003

Cadbury's Code of Best Practice, which introduced the 'comply or explain' regime, set the scene for board accountability to shareholders on pay matters – with recommendations on EDs' contracts not exceeding three years, disclosure of directors' total emoluments (including pensions and LTIs) and pay being determined by RCs 'made up wholly or mainly of non-executive directors.'<sup>34</sup> This is modern executive pay in recognisable form – incorporated originally (1992) into the Combined Code and now its successor the UKCGC.

Companies established RCs and appointed remuneration consultants to provide pay data and advise on the design and introduction of STIs and LTIs. In 2009 remuneration consultants worked with Walker to produce the VC.<sup>35</sup> Much has been written about the supposedly malign, Svengali-like influence of remuneration consultants – with alleged 'ratcheting up' of pay levels caused by inappropriate pay benchmarking and promoting incentive schemes designed to 'reward for failure'. Warren Buffett in particular has criticised remuneration consultants in the US.<sup>36</sup>

As pointed out in the VC though: '(...) it is important to clarify the role that executive remuneration consultants fulfil. Their role is to provide advice and information which they believe to be appropriate and in the best interests of the company (...) the role of consultants is not to make decisions'.<sup>37</sup> In other words, remuneration consultants provide information and advice to RCs (and

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<sup>34</sup> The Cadbury Report, note 19, Code of Best Practice, paragraph 3.3.

<sup>35</sup> Remuneration Consultants Group 'Voluntary Code of Conduct in Relation to Executive Remuneration Consulting in the United Kingdom' (2014)  
<<https://www.remunerationconsultantsgroup/assets/Docs/RCG%20Code%20of%20Conduct>> Accessed 20<sup>th</sup> June 2014.

<sup>36</sup> Warren Buffett cited in 'Director & Executive Remuneration Key Issues, Perceptions & Risks: White Paper' Based on 26<sup>th</sup> February 2013 Panel Debate <[www.geniusmethods.com](http://www.geniusmethods.com)> Accessed 20<sup>th</sup> June 2014.

<sup>37</sup> VC, note 35, 2 - 3.

in doing so have duties of transparency, integrity, objectivity, competence, due care and confidentiality), but the RC itself is responsible for determining executive pay for EDs.

Another focus in Cadbury was on institutional shareholders: 'given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance'.<sup>38</sup> The latest UKCGC reinforces this.<sup>39</sup> Institutional shareholder guidelines still exercise a strong influence, but the incentive arrangements operated by institutional shareholders for their own management and key staff may reflect rewards for exactly the same 'short-termism' for which they criticise their investee companies (see Lord Myners's observations regarding the way incentives drive the actions of fund managers: 'It is clear that the government must be involved, at the very least encouraging a cultural shift away from short-term to long-term based performance pay').<sup>40</sup>

The Greenbury Report (1995) focused solely on directors' remuneration. The Code of Best Practice addressed compliance on a 'comply or explain' basis, with specific pay disclosure and policy requirements. The Cadbury disclosure recommendations were actually implemented: 'the report should contain full details of all elements in the remuneration package of each individual director by name'.<sup>41</sup> Additionally, '[R]emuneration committees should consist exclusively of non-executive directors'.<sup>42</sup>

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<sup>38</sup> The Cadbury Report, note 19, paragraph 6.10.

<sup>39</sup> UKCGC, note 33, 5 (Note: FRC Consultation Paper on Executive Pay, 13<sup>th</sup> October 2013 and Consultation Paper on UKCGC, 24<sup>th</sup> April 2014).

<sup>40</sup> House of Commons Business, Innovation and Skills Committee 'The Kay Review of UK Equity Markets and Long-term Decision Making: Government Response to the Committee's Third Report of Session 2013-14' (2013) HC 762 paragraph 62, 28  
<<https://www.publications.Parliament.UK/pa/cm201314/cmselect/cmbis/603/603.pdf>> Accessed 12<sup>th</sup> June 2014.

<sup>41</sup> The Greenbury Report, note 20, 15.

<sup>42</sup> The Greenbury Report, note 20, 14.

Although the RC would produce an annual report for shareholders, this would not be put to vote. It was not until 2002 that there was an annual advisory vote on the DRR. Greenbury favoured the replacement of option schemes by performance shares - with three-year comparative TSR governing the vesting of awards, as opposed to vesting being reliant just on continued service and absolute business performance (e.g., EPS growth over inflation, with a stipulated performance hurdle/range).

The Hampel Report (1998) stated : ‘the emphasis on accountability has tended to obscure a board’s first responsibility – to enhance the prosperity of the business over time’<sup>43</sup>. Hampel focused on practical issues (e.g. abhorring ‘box ticking’): ‘(...) it is dangerous to encourage the belief that rules and regulations about structure will deliver success. Accountability by contrast does require appropriate rules and regulations, in which disclosure is the most important element’.<sup>44</sup> It recommended a strengthening of the Cadbury ‘comply or explain’ regime.

The Labour Government introduced an annual advisory vote on the DRR (2002), the dotcom stock market crash in 2001 having focused minds again on ‘rewards for failure’ and the belief that boards needed to be made more accountable. The UK ‘say-on-pay’ legislation required the RC to include details in the DRR of remuneration policy for the current and previous financial years (and figures of each director’s pay), introduced via The Directors’ Report Remuneration Regulations 2002 SI 2002/1986.

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<sup>43</sup> The Hampel Report, note 21, 17.

<sup>44</sup> The Hampel Report, note 43.

As indicated by Gregory-Smith, the UK effect of say-on-pay was modest - even after the GFC.<sup>45</sup>

Sudhakar Balachandran's research of UK companies following the introduction of the advisory vote found: 'these tests confirm the increase in sensitivity of CEO cash and (more weakly) total compensation to negative operating performance after the new rule, but not the increase in sensitivity of CEO total compensation to negative stock performance'.<sup>46</sup>

The period 1992 – 2003 closes with the 2003 Higgs Report on the effectiveness of NEDs. Higgs refers to 'a background of corporate turbulence'.<sup>47</sup> NEDs were centre stage – with recommendations on their role and duties, remuneration, time commitment, training, plus a summary of the RC's principal duties. He makes the point – echoed by Main subsequently – that 'expectations of non-executive directors have risen as increased business complexity has made it more difficult for shareholders effectively to hold management to account'.<sup>48</sup> However, Main additionally stresses that it is the work RCs now need to do over and above ensuring business probity that may reveal the potential shortcomings of NEDs' performance.

### **2.2.3. Review: 2003 – 2014**

Following the introduction of the DRR/say-on-pay regulation (2002), and the Higgs Review (2003), there was the introduction of the relevant Companies Act 2006 provisions (notably section 420 (1) stipulating disclosure provisions for quoted companies - prescribed in The Large and Medium-sized companies and groups (Accounts and Reports) Regulations 2008 S1 2008/410).

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<sup>45</sup> Gregory-Smith, note 11.

<sup>46</sup> Sudhakar Balachandran, Fabrizio Ferri and David Maber 'Solving the Executive Compensation Problem Through Shareholder Votes? Evidence from the UK' (2007) Harvard Business School Working Paper <[http://www7.gsb.columbia.edu/ciber/sites/default/files/balchandranCIBER\\_Grant\\_Paper\\_UK\\_Voting.pdf](http://www7.gsb.columbia.edu/ciber/sites/default/files/balchandranCIBER_Grant_Paper_UK_Voting.pdf)> Accessed 12th August 2014.

<sup>47</sup> The Higgs Review, note 22, 3.

<sup>48</sup> The Higgs Review, note 47.

Martin Conyon's research investigated UK voting in the period 2002 – 2007, to assess the effect of the mandatory non-binding vote.<sup>49</sup> It found a vote against/abstention rate of less than 10% against the DRR – notwithstanding that shareholders were more likely to vote against DRR resolutions than non-pay ones (particularly voting against LTIs and STIs). The overall conclusion was 'limited evidence that on average say-on-pay materially alters the subsequent level and design of CEO compensation.'<sup>50</sup> This is hardly surprising given that the research of Keith Hallock (and others) has shown that 'one of the variables most highly correlated with executive compensation is the size of the company'.<sup>51</sup> This holds for assets/number of employees and market value.<sup>52</sup>

Main makes the point however that the expectations on RCs have risen: 'from simply being a guarantor of the probity of the pay process to one of performing a key principal-agent role in the strategic human resource management of the company'.<sup>53</sup> He adds: 'it can clearly be seen that step-by-step the remuneration committee has been increasingly asked to take responsibility for ensuring that the executive reward structure is aligned with the overall business strategy of the company'.<sup>54</sup>

With the introduction of the advisory vote RCs came under annual pressure 'to keep in view both the previously-awarded incentive schemes and the current design of incentive schemes'.<sup>55</sup>

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<sup>49</sup> Martin Conyon and Graham Sadler 'Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the United Kingdom' (2010) *Corporate Governance: An International Review* 18 (4) 262-312.

<sup>50</sup> Conyon, note 49, 262.

<sup>51</sup> Kevin Hallock 'The Relationship Between Company Size and CEO Pay' (2011) *Workspan* <<http://www.ilr.cornell.edu/ICS/InsightsAndConvenings/upload/02-11-Research-for-the-real-world.pdf>> Accessed 19<sup>th</sup> June 2014.

<sup>52</sup> Xavier Gabaix, Augustin Landier and Julien Sauvagnat, note 17.

<sup>53</sup> Main, note 2,2.

<sup>54</sup> Main, note 1,9.

<sup>55</sup> Main, note 2,6.



In other words, RCs have become part of the strategic human resource management process within companies. Part of avoiding 'rewards for failure' is RCs structuring and 'calibrating' pay to the long-term performance and sustainability of the business.

Main's concerns over RC performance ('remuneration committees feel constrained in their choice by an institutional isomorphism of remuneration design, particularly with regard to LTIs; they commonly fail to allocate the time or resource to calibrate or confirm the effective operation of the chosen remuneration plan and many of their actions are dominated by a perceived need to be able to justify any high pay outcomes in communications with shareholders and institutional investors'<sup>56</sup>), focus on whether the way in which RCs go about their role 'limits the extent to which they are able to live up to the high expectations placed upon them in terms of effecting an alignment of executive interests with the critical success factors of corporate strategy'.<sup>57</sup>

As if all this was not challenging enough, along came the GFC. James Barty<sup>58</sup> details four examples of 'rewards for failure' prior to the onset, during or after the GFC; namely, Royal Bank of Scotland Group,<sup>59</sup> Thomas Cook,<sup>60</sup> Punch Taverns<sup>61</sup> and Cable & Wireless.<sup>62</sup>

The Walker Review (2009) made detailed recommendations on the governance of risk, plus the design of remuneration arrangements. It makes the point (amply echoed in the subsequent Salz

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<sup>56</sup> Main, note 53.

<sup>57</sup> Main, note 2,26.

<sup>58</sup> James Barty and Ben Jones 'Executive Compensation Rewards for Success not Failure' (2012) Policy Exchange < <http://www.policyexchange.org.uk/images/publications/executive%20compensation.pdf> > Accessed 20<sup>th</sup> June 2014.

<sup>59</sup> Barty, note 58, 41.

<sup>60</sup> Barty, note 58, 45.

<sup>61</sup> Barty, note 58, 49.

<sup>62</sup> Barty, note 58, 51.

Review of Barclays<sup>63</sup>) that: ‘board conformity with laid down procedures will not alone provide better corporate governance (...) the behaviour changes that may be needed are unlikely to be fortified by regulatory fiat, which in any event risks provoking unintended consequences’. Walker referred to the need for ‘behaviour improvement’.<sup>64</sup>

Walker considered the UK unitary board structure and the UKCGC remain fit for purpose, but with the addition of FSA (FCA) bank/financial sector-specific measures (for example, the FCA Remuneration Code and the SYSC High Level Standards part of the FCA Handbook).<sup>65</sup> There have also been EU initiatives regarding banking pay (e.g. CRD IV), imposing limits on STIs (expressed in terms of multiples of basic salary – one times basic salary unless shareholder approval is obtained, whereupon the limit is two times basic salary), the effect of which has been to instigate the substitution of part of STI opportunity with ‘annual allowances’ (which do not reflect current performance). Significant basic salary rises (as compensation for lower STI opportunity) have also increased the ‘overhead’ available for STIs. The bizarre outcome of basic salary increases and the payment of ‘annual allowances’ has been that banks’ fixed compensation costs have increased dramatically.

The new UK legislation<sup>66</sup> has been criticised by Damien Knight - on grounds including that the ‘single pay figure’ disclosed should be expressed both as ‘remuneration awarded’ and ‘remuneration

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<sup>63</sup> The Salz Review (Barclays PLC, April 2013).

<sup>64</sup> The Walker Review, note 23, 10.

<sup>65</sup> The Walker Review, note 23, 11.

<sup>66</sup> Enterprise and Regulatory Reform Act 2013 and The Large and Medium-sized Companies and Group (Accounts and Reports) (Amendment) Regulations 2013, 2013 No. 1981.

realised', as opposed to just the latter.<sup>67</sup> Knight's view is that whereas the latter is a better measure for assessing whether company performance justifies total remuneration, the former is better for assessing changes in policy. Barty considers the UK legislation's approach of triggering a binding vote on policy the following year if a company loses its annual advisory one is 'overly convoluted', preferring instead the Australian 'two strikes' basis. He also considers that including LTIs in 'the single figure' confuses the differing time periods over which these are earned.<sup>68</sup> In any event, the UK's new legislation of a binding 'policy' vote (supplementing an advisory 'implementation' one) is likely to be adopted by the EU in an update of the SRD.<sup>69</sup>

### **2.3. REMUNERATION COMMITTEES' DETERMINATION OF EXECUTIVE PAY**

Cadbury recommended: 'boards should appoint non-executive directors and chaired by a non-executive director, to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice if necessary'.<sup>70</sup>

Greenbury proposed RCs should consist exclusively of NEDs<sup>71</sup> and RCs should make a report each year to the shareholders on behalf of the board. Pay levels should be no higher than necessary to 'attract motivate and retain' the managerial talent required.<sup>72</sup> Hampel rightly stated: 'Greenbury

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<sup>67</sup> Damien Knight 'UK Executive Pay Reform – The Albatross Has Landed!' (2013) <<https://blog.manifest.co.uk/2013/07/6197.html>> Accessed 27<sup>th</sup> May 2014.

<sup>68</sup> Barty, note 58,35.

<sup>69</sup> TW 'European Commission Proposes Rules on Say on Pay and Disclosure for EU Companies' (2014) <<https://www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2014/E>> Accessed 4<sup>th</sup> June 2014.

<sup>70</sup> The Cadbury Report, note 19, paragraph 4.42.

<sup>71</sup> The Greenbury Report, note 20, 4.

<sup>72</sup> The Greenbury Report, note 20, 16.

was not about controlling board remuneration, nor can that ever be done in a free market economy. But it is already clear that Greenbury's primary aim – full disclosure – is being achieved.'<sup>73</sup>

Hampel found 'general acceptance that non-executive directors should have both a strategic and monitoring function'.<sup>74</sup> In Main's eyes though, RC members have strategic, monitoring and functional roles – the latter being their integral role in the company's strategic human resource management (i.e., being key players in the design and management of all elements of the executive remuneration package). It is this aspect of the RCs' role that causes concern to Main (and similar themes can be picked up in Higgs).

#### **2.4. EXECUTIVE PAY DISCLOSURE REGIME**

Disclosure is only part of the story, just as important is what actually goes into the relevant tables. For example, LTIs can be valued at grant/award or vesting/exercise date – and methods vary from a simple calculation of by how much shares are 'in the money' to sophisticated variants of the Black-Scholes valuation methodology (using binomial lattice and Montecarlo techniques). Greenbury disclosure of remuneration was fairly straightforward though; for basic salary and STI it was the amounts paid in, or in respect of, the relevant financial period, whereas the grant and exercise/vesting of LTIs was simply tabled and pensions were disclosed on a narrative basis.

In the early 2000s, accounting for share incentives was introduced (IFRS 1992). This meant that a 'cost' figure for LTIs was reflected in the profit and loss account. Such valuations used Black-Scholes type methodology, and at the same time many RCs started using present economic value techniques for pay benchmarking and determining LTI award/grant levels.

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<sup>73</sup> The Hampel Report, note 21, 19.

<sup>74</sup> The Hampel Report, note 73.

Knight's criticisms mentioned earlier are relevant.<sup>75</sup> To make proper comparisons over time the disclosure of both LTIs 'awarded' and 'realised' is needed (plus a share price growth table in the policy scenario charts).<sup>76</sup> RCs often determine grant/award levels in light of the relative 'severity' of the performance conditions attached to vesting/exercisability – so the legislation, in explicitly ignoring the upfront impact of performance conditions, rather turns the clock back on about 15 years of sophisticated work that enabled RCs to assess LTI grant/award levels.

In regards to pensions, the new legislation applies a multiple of 20 to value annual DB accruals – the same one as used for LTA purposes. Again, this is a simplification that undervalues the cost/benefit of DB pension arrangements compared to DC ones (a corresponding annuity multiple, depending on assumptions selected, might perhaps be 30).

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<sup>75</sup> Knight, note 67.

<sup>76</sup> Knight, note 67.

## CHAPTER 3

### 3. COMPARATIVE PERSPECTIVE

#### 3.1. Key features of the comparative exercise

The approach adopted in this paper regarding selection of particular aspects of executive pay for comparison purposes is that used by Calvin Jackson in WW's 2009 Study<sup>77</sup> and the subsequent articles in Benefits & Compensation International magazine<sup>78</sup>; namely, the governance of executive pay – RCs/say-on-pay/disclosure of executive pay/STI and LTI design. The present paper covers USA, EU, Germany, France and Japan. These territories (the EU being regarded as a single territory due to EU-specific legislation covering member states) comprise the World Bank's ranking of the largest territories by GDP size (excluding China).<sup>79</sup>

All the territories have RCs in operation and, to a greater or lesser extent, have say-on-pay regimes with NEDs comprising a majority (or at least a minority in Japan). 'Comply or explain' is strong in all but the USA and Japan. Accordingly, the comparative exercise shows sophisticated executive pay regulation in the territories concerned (save for Japan where the position is still rather nascent).

#### 3.2. USA

Bailey Morris-Eck points out: '[T]he US did not take the UK path of non-binding 'comply or explain' codes, nor is it likely to given its vastly more complex regulatory structure and a host of diverse players who have different cultures and agendas'.<sup>80</sup> Yet she asserts Cadbury had a big impact on

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<sup>77</sup> Calvin Jackson and Katy Bennett 'Executive Pay Practices Around the World' (2009) WW.

<sup>78</sup> Calvin Jackson and Katy Bennett 'Executive Pay Practices Globally – Is Convergence on the Way?' Parts 1+2 (2009) Benefits & Compensation International, 39 (2) ,(3) 3-9 , 3-8.

<sup>79</sup> The World Bank GDP Ranking (2012) <<https://data.worldbank.org/data-catalog/GDPPranking-...>> Accessed 24<sup>th</sup> June 2014.

<sup>80</sup> Bailey Morris-Eck 'Increasing Interaction' in 'Comply & Explain 20<sup>th</sup> Anniversary of the UK Corporate Governance Code' (FRC, 2012), 33 <<https://www.frc.org.uk/our-work/Publications/Corporate-governance/Comply-or-explain>> Accessed 24<sup>th</sup> June 2014.

subsequent initiatives by US exchanges ‘to put corporate governance on the map for listed companies’.<sup>81</sup> She argues that this has resulted in shareholders being better organised and more focused on ‘achieving constructive dialogue with companies that will minimize excess and result in enhanced long-term shareholder value’.<sup>82</sup> One can see, in the US, a beneficial flow from Enron/WorldCom days, through the SOX provisions (particularly, CEO and CFO ‘certification’ of accounts) to say-on-pay being introduced. Indeed, as Morris-Eck states: ‘it would be a mistake to regard the US as a vast corporate governance wasteland over the past twenty years of real if uneven process’. She views DFA’s say-on-pay as being a ‘game-changer’.

The US was the first country to operate prevalently Compensation Committees (the US title for RCs). As reported by TW: ‘the vast majority of companies continue to receive good marks from shareholders regarding their pay programs’.<sup>83</sup> Ira Kay states: ‘though opportunities remain for companies to improve their pay programs, most should view SoP results as a general endorsement of the current executive pay model’.<sup>84</sup>

Interestingly, the introduction of the US say-on-pay provisions is leading to more homogeneity of remuneration package design. This follows the UK experience. There is less scope for customization and innovation to fit a particular company’s circumstances. Again, the US has followed the UK trend away from share options to performance shares and, ironically, the US is

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<sup>81</sup> Morris-Eck, note 80, 33.

<sup>82</sup> Morris-Eck, note 80, 34.

<sup>83</sup> Robert Newbury, Jessica Yu and Jim Kroll ‘Shareholder Engagement: A Key Component of Improved Say-on-Pay Outcomes in 2014’ (*Towers Watson*, 12<sup>th</sup> March 2014) <<http://www.towers.watson.com/en/Insights/Newsletters/Global/executive-pay-matters/2014/u>> Accessed 4<sup>th</sup> June 2014.

<sup>84</sup> Ira Kay ‘Say on Pay: A Victory for Shareholders and the Executive Pay Model’ (*The Harvard Law School Forum on Corporate Governance and Financial Regulation* 2011) <<http://blogs.law.harvard.edu/corpgov/2011/08/08/say-on-pay-a-victory-for-shareholders>> Accessed 9th June 2014.

focusing more on comparative TSR as a performance measure governing vesting at just the time that UK institutional shareholders are finally allowing more flexibility in performance measure selection.

In summary, the US has RCs, pay disclosure and advisory say-on-pay, but does not operate 'comply or explain'. Todd Lippincott warns: '[T]o support performance and longer-term success the next phase of executive compensation's evolution needs to embrace these concepts of thoughtful customization and differentiation'.<sup>85</sup> It would be ironic if the US (just at the time when Lippincott states 'we know that executive compensation design has not only changed, but has fundamentally improved') opts for standardization in line with institutional shareholder guidelines and adopts performance measures which have been considerably discredited in the UK.

### **3.3. EU**

Mario Becht points out that, with the notable exception of the US, the 'Cadbury Code has been copied, transposed or adopted in every member state of the European Union and in more than 60 other countries elsewhere in the world'.<sup>86</sup> He rehearses the perceived advantages of 'comply or explain' as 'a pragmatic tool that can improve corporate governance without the need for inflexible, burdensome and misguided rules, laws or regulation'.<sup>87</sup> The 'independent director' concept has been adopted around the world (and included in the 1999 and 2004 versions of the OECD Corporate Governance Principles).

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<sup>85</sup> Todd Lippincott and Doug Friske 'The Next Stage In Executive Compensation's Evolution' (*Towers Watson* 17<sup>th</sup> April 2014) <<http://www.towerswatson.com/eu/Insights/Newsletters/Global/executive-pay-matters/2014/T>> Accessed 4th June 2014.

<sup>86</sup> Mario Becht 'Comply or Just Explain' in 'Comply or Explain 20<sup>th</sup> Anniversary Of The UK Corporate Governance Code', note 80, 11–14.

<sup>87</sup> Becht, *ibid*, note 80, 12.



RiskMetrics refers to Cadbury as being the cornerstone of the 'comply or explain' framework in Europe, long before this system was introduced into European law.<sup>88</sup> However, the majority of the Western European states introducing codes of practice in the 1990s did not adopt 'comply or explain'. The second phase followed later (in the 2000s) and saw an internationalisation of the concept. RiskMetrics warns 'corporate governance codes in the EU must therefore be seen in their own specific contexts'.<sup>89</sup> Becht emphasises EU market developments complicated matters further – so 'to solve these cross-jurisdictional problems, the European Commission amended the Fourth Company Law Directive on annual accounts. The Directive formally adopts the 'comply or explain' principle as 'apply or depart and explain' at the European level'.<sup>90</sup> There must be a 'corporate governance statement' in the annual report (referring to the applicable code). He maintains: '[T]he European Union has solved the legal problem of codes incompatibility but in the process, it created a disclosure monster'.<sup>91</sup>

The GFC provided impetus for EU initiatives on executive pay, mainly applicable to financial services. The remuneration aspects of CRD IV and UCITS V exemplify the level of detail with which the EU seeks to regulate executive pay in the sector. More generally than financial services, the 2011 Green Paper on the EU Corporate Governance Framework,<sup>92</sup> built on the EC's 2009 Recommendation<sup>93</sup> - with new guidelines on directors' remuneration, currently remains ongoing. This April the EC

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<sup>88</sup> RiskMetrics 'Study on Monitoring and Enforcement Practices in Corporate Governance in Member States', (23<sup>rd</sup> September 2009) Contract no. ETD/2003/IM/F2/126, 22  
<[http://ec.europa.eu/internal\\_market/company/docs/ecgforum/studies/comply-or-explain](http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain)> Accessed 24<sup>th</sup> June 2014.

<sup>89</sup> RiskMetrics, note 88, 22.

<sup>90</sup> Becht, note 80, 13. (See Council Directive 78/660/EEC as amended by Directive 2006/46/EC).

<sup>91</sup> Becht, note 90.

<sup>92</sup> EU Green Paper 'The EU Corporate Governance Framework' (2011).

<sup>93</sup> EC Recommendation c (2009) 3177 (30<sup>th</sup> April 2009).

published proposals on say-on-pay which largely mirror the recently-introduced UK rules. As pointed out by Tamsin Sridhara: 'the impact of the EC's proposals will vary significantly from country to country in the EU because some, such as France, Germany and the UK have already introduced similar measures in whole or in part'.<sup>94</sup>

### **3.4. Germany**

Germany has both 'comply or explain' and say-on-pay (currently, the Vorst AG non-binding vote regime). The combination of the German Corporate Governance Code and federal laws means that details of executive pay are published in annual reports and are subject to a shareholder advisory vote. There are currently proposals to make the latter a binding vote, but these have stalled. Each year the executive board and supervisory board publish a declaration of conformity with the Code (see for example, Softing AG's 2013 declaration).<sup>95</sup>

So German companies have RCs (the compensation committee of the supervisory board), 'comply or explain', plus say-on-pay. The stalled proposals for a binding say-on-pay vote are likely to come in anyway, as and when the EU amendments to the SRD are enacted. This would bring Germany into line with the current UK position on say-on-pay.

### **3.5. France**

Like Germany and the UK, France operates RCs, has 'comply or explain' provisions and an advisory say-on-pay regime for listed companies choosing to operate the key corporate governance code.

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<sup>94</sup> Tamsin Sridhara and Dan Perrett 'European Commission Papers on Say on Pay and Disclosure for EU Companies' (Towers Watson 14th April 2014) <<http://www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2014/E>> Accessed 4th June 2014.

<sup>95</sup> Softing AG (2013) <<https://investor.softing.com/en/corporate-governance/corporate-governance-code>> Accessed 25<sup>th</sup> June 2014.

The AFEP and MEDEF (the two main French business groups) Corporate Governance Code has recently been revised (see Jones Day's July 2013 newsletter<sup>96</sup>) and is applied extensively (as confirmed by the Financial Markets Authority). Listed French companies must comply with the general French company law provisions and may also refer to recommendations in 'a reference governance code' – with any deviation from the code being disclosed to shareholders. Jones Day refers to the AFEP and MEDEF Code as being the 'code of choice' for CAC 40 and other large French companies, with say-on-pay covering directors' compensation packages. The shareholder vote is currently advisory, but in due course France – like Germany and other EU member states - will be covered by binding proposals contained in SRD amendments.

### 3.6 Japan

Japan operates RCs and discloses directors' pay (albeit on an aggregate basis for all directors). Japan also has a binding shareholder vote to approve changes in director compensation amount and compensation policy. But Sodali criticises Japan's position: 'corporate governance standards for Japanese companies are underdeveloped and lag far behind global best practice (...) comply or explain in a code cannot work effectively in the absence of corporate governance principles against which non-compliance can be evaluated.'<sup>97</sup>

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<sup>96</sup> 'AFEP and MEDEF Revising Corporate Governance Code for Listed Companies: Say-on-Pay Comes to France' (Jones Day LLP July 2013) <<http://www.jonesday.com/afep-and-medef-revise-corporate-governance-code-for-listed-companies>> Accessed 25th June 2014.

<sup>97</sup> 'Japanese Version of Stewardship Code' (Sodali February 2014) <[http://www.sodali.com/static/allegati/Sodali\\_Comment\\_of\\_Japanese\\_Stewardship\\_Code.pdf](http://www.sodali.com/static/allegati/Sodali_Comment_of_Japanese_Stewardship_Code.pdf)> Accessed 25th June 2014.

Candidate Number: 140993

This is embarrassing in that, as pointed out by O'Melveney & Myers, Prime Minister Abe had 'touted corporate governance reform as key to revitalizing the country's economy'.<sup>98</sup>

It is not as if the Japanese themselves lack insight into these corporate governance challenges (particularly the continuing paucity of independent directors). The Japanese Association of Corporate Directors' guidelines detail some of the improvements made since the 2007 revision, but state that 'a majority of investors are concerned about executive compensation systems of Japanese companies and pointed out the insufficiency of disclosure items regarding their executive compensation'.<sup>99</sup>

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<sup>98</sup> O'Melveney & Myers LLP 'Abenomics – Dynamic Change in Corporate Governance in Japan' (*O'Melveney & Myers Newsletter* 23 June 2014), <<http://www.omm.com/abenomics---dynamic-change-in-corporate-governance-in-japan/>> Accessed 25th June 2014.

<sup>99</sup> Japan Association of Corporate Directors 'Guidelines on Executive Compensation 2013 and Requests for Revision of Regulations and Tax Systems 2013 Guidelines on Executive Compensation 3<sup>rd</sup> Edition' (April 2013) <[http://www.jacd.jp/en/resources/130412\\_guidelines\\_on\\_executive\\_compensation2013.htm](http://www.jacd.jp/en/resources/130412_guidelines_on_executive_compensation2013.htm)> Accessed 25<sup>th</sup> June 2013.

## CHAPTER 4

### 4. FINDINGS AND DISCUSSION

#### 4.1. Introduction to findings on UK regulatory regime applicable to executive pay

BIS commented in 2011: '[T]he general disconnect between pay and long-term performance suggests that there is something dysfunctional about the market in executive pay or a failure in corporate governance arrangements', noting: '[A]lthough concerns about executive pay are not new, the recent financial crisis has made shareholders, the public and Government more acutely aware of the issue and more critical of perverse incentives or excessive levels of reward'.<sup>100</sup>

Greenbury viewed accountability, transparency and performance as being the three key tenets.<sup>101</sup> On accountability, a RC of independent directors should determine EDs' pay, and transparency effected by disclosing full information to shareholders in due course. There is now far more accountability and transparency in UK executive pay determination and disclosure. All UK listed companies have RCs comprised of independent NEDs, and the combination of advisory vote on implementation of remuneration policy and binding vote in respect of the policy itself gives shareholders greatly enhanced information and also the opportunity to vote on pay.

There remains most controversy over pay levels and 'rewards for failure'. BIS states in respect of the former, that: 'the median total remuneration of FTSE 100 CEOs has risen from an average of £1m to £4.2m for the period 1998 – 2000. Growing company size, international competition for talent, benchmarking practices and the changing structure of pay are just some of the reasons cited for this

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<sup>100</sup> BIS 'Executive Remuneration Discussion Paper' (2011) Department of Business, Innovation and Skills <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf)> Accessed 12th August 2014.

<sup>101</sup> The Greenbury Report, note 20, 11.

trend'.<sup>102</sup> Regarding pay-for-performance, BIS states that: 'over the last decade the link between pay and performance has been hard to discern. CEO pay has risen faster than the increase in the FTSE 100 index, retail prices or average remuneration levels across all employees for the same period'.<sup>103</sup>

The responses to the BIS Consultation Paper were published in January 2012.<sup>104</sup> Two-thirds of responses maintained that: 'the link between pay and performance could be strengthened by moving away from TSR (because it is used on a comparative basis) and EPS (because it is perceived to be easy to manipulate) as measures of performance'.<sup>105</sup> There was two-fifths support for extending LTI periods beyond the current three-year norm, whereas a similar proportion felt that the company should determine the period and just over one-third thought that vesting periods need not be as long as three years.<sup>106</sup>

Over one-half of those who responded to the BIS Consultation agreed that simpler models of remuneration – such as 'career shares' (where directors hold shares in normal circumstances until they leave service and even beyond) – would align the interests of directors with shareholders.<sup>107</sup> There was little support for a binding vote on remuneration policy and just 'a small proportion

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<sup>102</sup> BIS, note 100.

<sup>103</sup> BIS, note 100.

<sup>104</sup> BIS 'Executive Remuneration Discussion Paper: Summary of Responses' (2012) Department for Business, Innovation and Skills  
<[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31381/12-564-executive-remuneration-discussion-paper-summary-responses.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31381/12-564-executive-remuneration-discussion-paper-summary-responses.pdf)> Accessed 12th August 2014.

<sup>105</sup> BIS, note 104, 12.

<sup>106</sup> BIS, note 105.

<sup>107</sup> BIS, note 104, 13.

suggested that RCs should publish a single figure for each directors' annual remuneration' (which has now become law).<sup>108</sup>

A not dissimilar situation occurred in 2011 in an EU context, where only a small minority agreed that the remuneration policy and remuneration report should be put to a binding vote by shareholders.<sup>109</sup> Of course, the EU now proposes – following the UK – that both advisory and binding votes should be held.<sup>110</sup>

#### **4.2. Findings: Remuneration committees' determination of executive pay**

Main's two 2007 papers<sup>111, 112</sup> can be summarised thus: (i) RCs have moved 'from simply being a guarantor of probity to playing a key principal-agent role in the strategic human resource management of the company',<sup>113</sup> (ii) the way RCs conduct their business is causing them difficulties in living up to these high expectations, and (iii) RC practice 'cannot be understood from an agency theory perspective alone but benefits from recognition of the inertia, social embeddedness and path-dependence encountered as remuneration committees seek legitimacy under the prevailing regulatory, normative and cognitive influences that condition their actions'.<sup>114</sup>

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<sup>108</sup> BIS, note 107.

<sup>109</sup> 'Executive Compensation Market Watch' (*Towers Watson Executive Compensation Market Watch*, December 2011) <<https://www.towerswatson.com/en-GB/Insights/Newletters/Europe/executive-compensation>> Accessed 6<sup>th</sup> June 2014.

<sup>110</sup> EU Green Paper 'The EU Corporate Governance Framework', note 92.

<sup>111</sup> Main, note 2.

<sup>112</sup> Main, note 1.

<sup>113</sup> Main, note 2, 2.

<sup>114</sup> Main, note 1, 6–7.

Main considers that 'remuneration committees feel constrained in their choice by an institutional isomorphism of remuneration design, particularly with regard to LTIs'.<sup>115</sup> Other concerns were whether RCs devoted sufficient time or resources to their duties (for LTI design, 'calibration' of LTIs and reviewing past operation) and 'the perceived need to justify high pay outcomes to shareholders and institutional investors'.<sup>116</sup> In relation to the latter, Main in his review of the literature refers, in relation to RCs' behaviour, to: 'the driving motivation is not directly to maximise shareholder value but (...) to reach for a degree of 'legitimacy''.<sup>117</sup>

This has important results, for example: 'performance criteria are chosen less because of their linkage with the key success factors of corporate strategy and more because of their common acceptance and use within the sector'.<sup>118</sup> Main believes his work adds to that suggesting 'that the dominant paradigm of agency theory may not be capable on its own of fully explaining the observed remuneration arrangements for a company's top executives. The arguments presented here suggests developing theory so as to set agency theory within a neo-institutional framework'.<sup>119</sup>

Main questioned whether RCs were able to meet such high expectations. In 2011 there was a further Main/TW Study of how RCs operate.<sup>120</sup> The key findings were that (i) RC members had mixed views on the extent to which pay drives behaviour, (ii) technical knowledge of pay is not a prerequisite for sitting on a RC, and (iii) what has been earned from executive pay in prior years was

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<sup>115</sup> Main, note 2, 2.

<sup>116</sup> Main, note 115.

<sup>117</sup> Main, note 1, 5.

<sup>118</sup> Main, note 1, 6.

<sup>119</sup> Main, note 1, 34.

<sup>120</sup> Main 'What Makes Remuneration Committees Effective?' (*Towers Watson* 2011) <[www.towerswatson.com](http://www.towerswatson.com)> Accessed 8th August 2014.



not seen as being of much relevance in decision-making. There is a checklist of 'key success factors for RCs', with particular stress, as in 2007, on the crucial role of RC Chair.<sup>121</sup>

Main's findings are similar to Higgs's regarding NEDs generally. Sufficient time must be allocated for pre-reading reports, for the RC meeting itself and to hold regular meetings without any company management being present. Main makes the point and RC: 'membership was seen as requiring general skills rather than any particular skill in human resources.'<sup>122</sup>

Main considers that, in respect of RCs' strategic human resource management tasks, they are running ever faster simply to stand still. For company management similar considerations apply. As Barty states: '[T]he comparison of share price performance with pay has often ignored the fact that global equity markets have struggled because of falling valuations rather than falling profits. The FTSE 100 has seen valuations compress by around three-quarters since 1999, with the price earnings ratio falling from 40 to around 10 today'.<sup>123</sup> Again, as pointed out by Barty: 'over the same period [1998 – 2010] FTSE 100 profits had risen by more than 250% and had further risen to over 300% by the end of 2011 (just about enough to offset the de-rating of the equity market)'.<sup>124</sup> Barty considers that although 'there has been some ratcheting up of executive pay, it is not as dramatically out of proportion as some have argued'.<sup>125</sup>

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<sup>121</sup> Main, note 120, 4.

<sup>122</sup> Main, note 1, 17.

<sup>123</sup> Barty, note 58, 15.

<sup>124</sup> Barty, note 123.

<sup>125</sup> Barty, note 58, 14.

Barty's findings are particularly important in that the UK debate over executive pay levels and pay for performance (and 'rewards for failure') focus very much on comparing executive pay against that of employees or selected equity indices. He demolishes the former with a well-made 'data timing dependency' point in respect of the HPC's 'poorly informed analysis'<sup>126</sup> and in respect of the latter he stresses that executive pay should be compared against profits, not equity indices.<sup>127</sup> He also stresses the link between pay levels and company size.

Barty states: 'if a CEO is successful they should be paid accordingly. The fatal flaw in the system is that executives do not suffer a loss if they fail – there remain rewards for failure' and 'this is a key issue of the principal agent problem. If you are an owner/entrepreneur and the company you own fails you bear the loss. Currently, if you are an executive and you fail the shareholders bear almost all the loss'.<sup>128</sup> This echoes the thrust of Gerald Garvey's and Todd Milbourn's views.<sup>129</sup> Barty comments that: 'while salaries have slightly doubled since 1998, bonuses have more than quadrupled and LTI payments are up tenfold' (the figures for STI payments though have broadly tracked EPS growth).<sup>130</sup>

The reason for stressing Barty's findings is that, as pointed out by Main on LTIs, RCs feel constrained by the institutional shareholder guidelines' focus on comparative TSR performance. Having said this, more recent versions of the ABI guidelines refer to absolute operating performance measures being acceptable, provided these are ones shareholders would see as reflecting the long-term performance

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<sup>126</sup> Barty, note 125.

<sup>127</sup> Barty, note 58, 14.

<sup>128</sup> Barty, note 58, 17.

<sup>129</sup> Gerald Garvey and Todd Milbourn 'Assymmetric Benchmarking in Compensation: Executives are Paid for Good Luck but not Penalised for Bad' (2006) *Journal of Financial Economics* 82 (1) 197 -226.

<sup>130</sup> Barty, note 128.

of the company (this has led over time to 'bifurcated' or 'trifurcated' LTI metrics being adopted, part comparative TSR and part absolute business performance).<sup>131</sup>

This paper's finding regarding RCs' determination of executive pay is that the regulation that started with Cadbury has been beneficial, but RCs' task has grown ever harder. Barty's view is that this requires 'increased professionalisation of the non-executive director role.'<sup>132</sup>

#### **4.3. Findings: Regime for disclosure of UK executive pay**

The term 'disclosure' is really a short cut for describing both the publication of directors' pay packages (each director, by package component and overall) and also say-on-pay provisions. The UK initially had simply the former (introduced post-Greenbury), the latter was introduced by the DRR advisory vote (in 2002). The binding vote on remuneration policy (plus the 'single pay figure') was recently added. So we can see movement from the pre-Cadbury 'banded emoluments' figure, to now where the level of disclosure is extremely high. It is too simplistic to argue however that because the level of directors' pay has increased massively since disclosure that this is responsible for the increase (RCs have always had access to remuneration consultants' pay survey data).

This paper has already covered Knight's and Barty's criticisms of the most recent say-on-pay developments. No doubt some disclosure compromises were necessary to produce a single figure enabling cross-company comparisons to be easily made, but it should have been possible to formulate more real life/accurate valuation methodologies.

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<sup>131</sup> ABI 'Principles of Executive Remuneration', note 25, 10-11.

<sup>132</sup> Barty, note 58, 20.

Over the past 35 years the UK disclosure regime has improved dramatically for the better, but it remains work in progress. Both in the UK and EU, the respective say-on-pay consultation exercises (2011) revealed a far from overwhelming demand for more legislation – but the UK has now moved to the combined advisory/binding vote process and it looks as if the EU will do the same. This makes it all the more important that no opportunity is lost to make the actual disclosure format adopted as helpful as possible.

#### **4.4. Findings: Institutional shareholders**

Main's points regarding institutional shareholders are important.<sup>133</sup> Apart from distinguishing the UK from the US (this is changing though in recent years, with the growing importance of ISS voting recommendations to US institutional shareholders regarding say-on-pay issues), it underlines that UK institutional shareholder guidelines have been an important factor in shaping executive pay since the 1980s.

The ABI has been most active (however some commentators maintain that RREV/ISS now takes pole position, due to ISS' US link),<sup>134</sup> with publications in 2012<sup>135</sup> and 2013.<sup>136</sup> The FRC's UKSC<sup>137</sup> and its publications on 'comply or explain'<sup>138</sup> provide much detail on UK practice and requirements

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<sup>133</sup> Main, note 1, 8.

<sup>134</sup> New Bridge Street 2013 'RREV & NAPF UK Remuneration Guidance 2012' ([www.newbridgestreet.com](http://www.newbridgestreet.com)).

<sup>135</sup> ABI 'Comply or Explain Investor Expectations and Current Practices' (2012).

<sup>136</sup> ABI 'Improving Corporate Governance and Shareholder Engagement' (2013) <<https://www.abi.org.uk/insurance-and-savings/Topics-and-issues/Investment-and-...>> Accessed 9<sup>th</sup> June 2014.

<sup>137</sup> UKSC, note 33.

<sup>138</sup> FRC 'What Constitutes an Explanation under Comply or Explain' (2012) < <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/What-constitutes-an-explanation-under-comply-or-ex.pdf>> Accessed 10<sup>th</sup> June 2014.

for institutional shareholders, as does the Government's Response to the Kay Review.<sup>139</sup> The ABI's 2013 publication states: 'the reciprocal of the accountability of the board to shareholders is the responsibility of shareholders to be proactive in the discharge of their stewardship responsibilities'.<sup>140</sup>

The UKSC<sup>141</sup> applies on a 'comply or explain' basis, setting out the principles of effective stewardship by investors. In practice though there are many difficulties/conflicts involved, as covered in Simon Wong's 2010 paper<sup>142</sup>. He states: '[A]s the dominant owners of listed companies in many developed markets, institutional shareholders have been under increasing pressure to act as responsible shareholders'.<sup>143</sup> He believes: 'stewardship is not in their genetic makeup'.<sup>144</sup> Wong notes: 'inappropriate performance metrics and financial arrangements that promote trading and short-term returns', 'executive portfolio diversification that makes monitoring difficult', a 'lengthening share ownership chain that weakens an "owner mindset"', 'a misguided interpretation of fiduciary duty that accords excessive deference to quantifiable data at the expense of qualitative factors' and a 'flawed business model and governance approach of passive funds'.<sup>145</sup>

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<sup>139</sup> BIS 'Ensuring Equity Markets Support Long-Term Growth The Government Response to the Kay Review' (November 2012) BIS, 2012.

<sup>140</sup> ABI, note 136.

<sup>141</sup> UKSC, note 33, 4.

<sup>142</sup> Simon Wong 'Why Stewardship is Proving Elusive for Institutional Investors' (2010) <<https://ssrn.com/abstract=1635662>> Accessed 24<sup>th</sup> June 2014.

<sup>143</sup> Wong, note 142, 406.

<sup>144</sup> Wong, note 143.

<sup>145</sup> Wong, note 143.

There are dangers in asset managers rewarding themselves for delivering short-term results and comparative, rather than absolute, performance generates rewards. Another issue is where asset managers are rewarded for bringing in new funds: 'rather than expanding existing assets through superior investment performance'.<sup>146</sup> Wong considers: 'the starting point is to lengthen the performance review time period and reduce emphasis on relative returns'.<sup>147</sup> He cites a US value asset manager: 'five-to-ten year basis, since a market cycle is at least that long'.<sup>148</sup>

Joseph Bachelder refers to 'quarterly capitalism'. He questions the effectiveness of the 'oversight' institutional shareholders can provide regarding executive pay in investee companies (as compared to the board of directors). Bachelder notes: '[U]nfortunately, TSR has become a dominant measure in the thinking of institutional shareholders, and their proxy advisors, regarding executive pay. To a significant extent, a stock market metric has been substituted for the numerous and often complex considerations (...) necessary to evaluate executive pay programmes at investee companies'.<sup>149</sup>

Tom Powdrill makes the point: '[R]egrettably, however, there are no signs that the UK 's institutional shareholders are likely to champion a shift away from performance-related reward any time soon. In general they remain implicitly wedded to a view of executive motivation where incentives can be designed to elicit the right behaviour'.<sup>150</sup> He refers to 'the new big idea in the investment community is 'career shares' whereby executives are required to hold at least some share awards

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<sup>146</sup> Wong, note 142, 407.

<sup>147</sup> Wong, note 142, 410.

<sup>148</sup> Wong, note 147.

<sup>149</sup> Joseph Bachelder 'Institutional Shareholders and their Oversight of Executive Compensation' (2012) <<https://www.jebachelder.com/articles/120703htm>> Accessed 9<sup>th</sup> June 2014.

<sup>150</sup> Tom Powdrill 'The Failure of Executive Incentive Schemes' (*Renewal* 2001) <<http://www.renewal.org.uk/articles/the-failure-of-executive-incentive-schemes/>> Accessed 27<sup>th</sup> May 2014.

until retirement (...) this seems to be a non-starter from a motivational point of view, since recipients will put very little value on rewards that lie a long way into the future.’<sup>151</sup>

Although some of Powdrill’s criticisms can be attributed to his strongly-held view that a focus on the structure of executive pay ‘does not address the political problem of growing executive reward’,<sup>152</sup> his point is that institutional shareholders are part of part of the ‘executive pay problem’ – in that they look at the structure of pay, as opposed to whether in his words there are “problems with performance pay”’.<sup>153</sup>

The Kay Review sets out John Kay’s suggested ‘foundation for future developments in public and regulatory policy and market practice in the investment chain’.<sup>154</sup> BIS’s Response refers to Kay’s recommendations on better alignment between pay and long-term performance for company directors and asset managers.<sup>155</sup> BIS’s Recommendation 13 on ‘career shares’ accepts that Kay’s prescription is ‘sensible’ (i.e., that LTIs for EDs should only be provided in the form of ‘career shares’), but it does not favour ‘blanket regulation’.<sup>156</sup>

BIS’s Response notes that ‘a number of institutional shareholders have set out clearly that they expect companies’ remuneration policies to be much simpler and include incentive plans which are

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<sup>151</sup> Powdrill, note 150, 6.

<sup>152</sup> Powdrill, note 150, 2.

<sup>153</sup> Powdrill, note 152.

<sup>154</sup> ‘The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report’ (2012) <<https://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-Kay-review-of-equity-markets-final-report.pdf>> Accessed 6<sup>th</sup> June 2014.

<sup>155</sup> BIS, note 139.

<sup>156</sup> BIS, note 139, 14.

genuinely long-term in nature<sup>157</sup> – referring to Hermes’s 2012 discussion paper on proposed reforms to UK executive remuneration. The government takes the same view regarding asset managers’ remuneration (Recommendation 16): ‘asset management firms should similarly structure managers’ remuneration so as to align the interests of asset managers with the interests and timescales of their clients’<sup>158</sup>. They propose that pay should not be linked to short-term performance of the investment fund or asset management firm but rather a ‘long-term performance incentive should be provided in the form of an investment in the fund (either directly or via the firm) to be held at least until the manager is no longer responsible for that fund’.<sup>159</sup> One can see here that Kay, Lord Myners (in his 2013 comments to the House of Commons BIS Committee<sup>160</sup>) and the government are making broadly similar points.

Institutional shareholder remuneration guidelines for investee companies still feature comparative TSR performance (it could be argued that this metric, and the particular way it is generally employed in an LTI context, mean that it is best used only as an ‘underpin’ to absolute business performance measures) and seek to avoid ‘rewards for failure’, rather than incentivising strong and sustained absolute performance. So in a way company management and institutional investors are in the same boat – the former are subject to mandatory IMS (quarterly reporting) and the latter to short-term fund performance considerations. It may be that the EU will, in due course, remove the quarterly reporting requirement from the Transparency Directive.

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<sup>157</sup> BIS, note 139, 30.

<sup>158</sup> BIS, note 139, 31.

<sup>159</sup> BIS, note 158.

<sup>160</sup> House of Commons Business, Innovation and Skills Committee, note 40.



#### **4.5. Psychology of performance-related pay**

Powdrill considers 'human motivation is more complicated than mainstream corporate governance, and its emphasis on incentive schemes assumes'.<sup>161</sup> He asserts that 'repeated attempts to redesign incentive schemes have diverted shareholder attention away from the overall scale of rewards. Indeed, until relatively recently some asset managers made it almost a point of principle that their interest in remuneration was limited to the way it was structured' and that 'directors and business lobbyists often seek to defend large overall packages on the basis that much of it is performance-related'.<sup>162</sup> Powdrill contrasts the 'two major camps in the argument over the psychology of incentives are those informed by behaviourism and those who favour what has latterly become known as self-determination theory'.<sup>163</sup>

Powdrill notes '[T]here is one interesting overlap between the two camps. Both believe that rewards may be ineffective if they are seen as controlling. This is significant, since in corporate governance debates incentive schemes are usually explicitly intended to control executive behaviour'.<sup>164</sup> Powdrill's conclusion is that: 'it seems unlikely that performance-related reward will make much of a difference to those who are highly-motivated', citing Kenneth Thomas 'so if you are successful in building high intrinsic motivation, don't expect your pay system to have a major positive effect on performance'.<sup>165</sup>

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<sup>161</sup> Powdrill, note 139, 1.

<sup>162</sup> Powdrill, note 139, 3.

<sup>163</sup> Powdrill, note 139, 4.

<sup>164</sup> Powdrill, note 163.

<sup>165</sup> Powdrill, note 139, 5.

The self-determination literature argues that extrinsic motivation, such as the incentive structures, can ‘crowd out’ intrinsic motivation to do the job well. This is picked up by Chuka Umunna, Labour’s Shadow Business Secretary: (...) ‘the heavy focus on the alignment of high powered incentives risks crowding out other more rounded but equally powerful intrinsic motivations of executives that are just as relevant to the company’s success’.<sup>166</sup>

A detailed examination of ‘the underlying human frailties that are exacerbated by variable pay’ is Dimitros Contraros’s 2012 article.<sup>167</sup> Regarding variable pay, he states: ‘the prevalence of this concept within banking has produced negative consequences. Indeed, the motivation of high levels of remuneration is said to have driven executives to engage in excessive risk taking that has been held to be a contributory risk factor to the rise of the recession.’<sup>168</sup> The scenario is one of executives focusing on short-term profits and simply ignoring long-term performance aspects. Contraros’s view is that the regulatory response to this (i.e., SYSC 19A – promoting a long-term time horizon and appropriate attention to risk-taking) will not work because ‘the underlying factor of high levels of monetary incentives continue to be used’.<sup>169</sup>

Contraros considered the rigid nature of SYSC 19A (including high levels of mandatory deferral in the payment of incentives and malus/clawback arrangements) could result in banks ‘expanding the fixed component of pay to make up for the loss in variable remuneration’.<sup>170</sup> He notes that there is

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<sup>166</sup> Chuka Umunna ‘Labour will Address Executive Pay and Rewards for Future’. Speech to the HPC and IPPR on 12<sup>th</sup> January 2012 <<https://www.labour.org.uk/labour-will-address-executive-pay.2012-01-12>> Accessed 2<sup>nd</sup> July 2014.

<sup>167</sup> Dimitros Contraros ‘Changes In Regulations On Executive Remuneration In UK Banks Have Achieved Little In Remedying the Underlying Human Frailties that are Exacerbated by Executive Pay’ (2012) *International Corporate Rescue*, 9 (3) 209-218.

<sup>168</sup> Contraros, note 167, 209.

<sup>169</sup> Contraros, note 167, 210.

<sup>170</sup> Contraros, note 167, 211.

already evidence this is happening, with strong basic salary increases.<sup>171</sup> Contraros notes the longer-term focus introduced in SYSC 19A, but argues that ‘the regulation addresses only half the problem’.<sup>172</sup> His concern is that ‘the use of variable incentives and performance targets to attract and motivate executives will continue to narrow their focus and fail to acknowledge lateral considerations of ethics, honesty, integrity and risks’.<sup>173</sup>

Certainly, Main’s RC interviewees were ‘quite simply sceptical of the efficiency of the process’ of choosing the pay elements and the strengths of their link to performance, with one stating: ‘[T]his motivation business is “phooey”. People do the best job they can’.<sup>174</sup> Main refers to the tension ‘that exists within the remuneration committee between “Performance” on the one hand (achieving an effective agency theory type pay mechanism, thereby strategically aligning incentives) and “Conformance” on the other’.<sup>175</sup> The latter’s emphasis is on being able to demonstrate on an ex-post basis that the payment outcomes conform to corporate governance guidelines/codes.

#### **4.6. Findings: Remuneration committee advisors/in-house executive compensation HR specialists**

Remuneration consultants tend to work for one of the major employee benefit consulting firms or, alternatively, a Big 4 accounting firm. There is criticism of their activities. Umunna argues that: ‘the role of remuneration consultants must be looked at (...) there are widespread concerns that these consultancies are ratcheting up pay here too’.<sup>176</sup> He identifies ‘[P]art of the problem is that – in

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<sup>171</sup> Contraros, note 167, 212.

<sup>172</sup> Contraros, note 167, 214.

<sup>173</sup> Contraros, note 167, 217.

<sup>174</sup> Main, note 1, 20.

<sup>175</sup> Main, note 1, 21.

<sup>176</sup> Umunna, note 166, 5-6.

their advisory role to remuneration committees – the consultants owe their duty to the Board and not to shareholders. This needs to be looked at, along with the risk of conflict where consultants are advising both executive management and non-executive directors on remuneration’.<sup>177</sup>

Although Umunna does state: ‘I am aware of the voluntary guidelines to prevent remuneration consultants cross-selling services’,<sup>178</sup> he considers binding rules should be put in place to prevent conflicts of interest. He mentions lawyers by way of comparison. Apart from the fact that many of the UK’s leading remuneration consultants are actually professionally qualified as lawyers, accountants or actuaries (and work for firms that have business codes in place, authorised/regulated by the FRC or similar), Umunna disregards the VC’s underlying principle that ‘the role of consultants is not to make decisions’.<sup>179</sup>

If remuneration consultants had a duty to shareholders, this would mean that the RC could not look to their consultants as being ‘their advisors’. Even if it were a ‘dual’ duty (i.e., to the RC and shareholders) this would entail the remuneration consultants having two ‘masters’. The present arrangement is straightforward and the line of accountability to shareholders is explicit and easily understood.

There is potential for conflicts of interest to arise in the situation where the appointed remuneration consultants work for a firm that provides other services to the company concerned, but the way this is best dealt with is via disclosure and various other safeguards. An appointed remuneration committee advisor knows that he/she should not advise executive management without first obtaining permission from the RC Chair.

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<sup>177</sup> Umunna, note 166, 6.

<sup>178</sup> Umunna, note 177.

<sup>179</sup> VC, note 35.

In recent years, FTSE 100 companies have moved towards having an in-house executive compensation specialist working in HR. The Main/TW Study referred to earlier found that '[A] supportive and independently-minded HR function whose role vis-à-vis the RC is clear 'is one of the key success factors in making a remuneration committee successful'.<sup>180</sup> This seems entirely sensible.

An in-house executive compensation specialist may potentially be over-influenced by executive management, and may therefore be tempted to 'manipulate' the independent remuneration consultant's advice. The appointed remuneration consultant will have direct access to the RC Chair if any such concerns manifest themselves. Generally, RC Chairs are keen to have excellent liaison/input between the in-house executive compensation specialist and the appointed remuneration consultants, as this minimises the danger of the latter's advice being delivered in a vacuum/not taking on board legitimate interests of executive management.

#### **4.7. Findings: Benefits-v-obligations of UK regulatory regime**

The UK debate on executive pay tends to conflate regulation with allegedly high pay levels/'rewards for failure'. This is understandable given the sort of 'rewards for failure' reflected in Barty's case studies.<sup>181</sup> As Barty states regarding the Shareholders' Spring of 2012: 'this suggests that shareholders have finally had enough of executives who persist in rewarding themselves for sub-standard performance'.<sup>182</sup> The HPC also majors on the ever-widening pay gap between company

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<sup>180</sup> TW/Main, note 120.

<sup>181</sup> Barty, note 58, 38-54.

<sup>182</sup> Barty, note 58, 7.

boards and that of their workers (it is indicative that the title of the relevant article is: '[E]xecutive pay increases despite attempt at regulation').<sup>183</sup>

The objectives of regulation may include limits on executive pay levels, but few would argue that the purpose of regulation is simply to constrain/cap executive pay. If this were the case, then UK executive pay regulation to date would have been a disaster. Pay levels have indeed soared; however, a more objective view is surely that the regulation of executive pay is about far more than simply attempting to restrain pay levels.

Barty has the correct take on all this. The key concern is 'rewards for failure'. Accordingly, regulation should focus on structuring executive pay in ways that oblige executives to share the downside suffered by shareholders when a business is unsuccessful (and vice versa). Although Powdrill would doubtless argue 'they are focusing on structure again', that would be seen by many commentators as being something of a counsel of perfection.

Greenbury's emphasis was on RCs' duties and accountabilities, together with enhanced disclosure of directors' pay. The pay aspect was limited to the exhortation that pay levels should be no higher than necessary. True, stress was placed in both Greenbury and Hampel on pay-for-performance, but this – plus subsequent codes/regulation/guidelines - is a world away from 'hard-wired' caps on executive pay. The focus instead is on transparency (so shareholders know how much directors are paid and the pay-performance linkage) and accountability. In this context, UK pay regulation over the past 35 years has been very beneficial. It justifies the obligations imposed, but detailed disclosure improvements are still required and the pay-performance linkage needs reform.

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<sup>183</sup> Deborah Hargreaves, HPC, quoted in Hywl Roberts, 'Executive Pay increases Despite Attempt at Regulation' (*HR Magazine* 2<sup>nd</sup> June 2014) < <http://www.hrmagazine.co.uk/hro/news/1144482/executive-pay-increases-despite-attempt-regulation> > Accessed 3rd July 2014.

## CHAPTER 5

### 5.1. Conclusions

UK executive pay regulation over the past 35 years has resulted in a far more transparent and accountable regime. On pay-performance linkage in particular though, much remains to be done regarding 'rewards for failure', the need for a longer-term time horizon and LTI design generally. Commentators may dispute whether regulation alone can remedy the perceived problems. For example, those who consider that executive pay is simply far too high argue that regulation could resolve this (even politicians who are not particularly 'left leaning' take this view sometimes; e.g., the House of Commons Treasury Committee's comment 'it should be the FSA's function to regulate levels of the amounts of pay in the banking sector').<sup>184</sup>

Those whose principal concern is 'rewards for failure', such as Barty, promote the use of deferral and 'clawback' arrangements – proposing that '50% of all variable compensation is deferred for a minimum of five years, with no vesting to be faster than straight line. As a result 150% of average variable compensation would be available for 'clawback' in the case of underperformance'.<sup>185</sup> This approach has more in common with Powdrill's than some might appreciate. Powdrill mentions the PwC/LSE research project into the psychology of incentives: 'most executives surveyed said they were driven by more than money, and many also reported that incentive schemes did not motivate them'.<sup>186</sup> PwC concludes: '[E]xecutives are risk-averse, don't like complexity and discount deferred pay (...) we have had to pay executives more to compensate. If pay better reflected executive

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<sup>184</sup> House of Commons Treasury Committee 'Banking Crisis: Reforming Corporate Governance and Pay in the City' (2009), 22.

<sup>185</sup> Barty, note 58, 55.

<sup>186</sup> Powdrill, note 165.

psychology, maybe it could be lower'.<sup>187</sup> Although Powdrill considers that 'institutions are unlikely to champion a shift away from performance-reward any time soon' – and is likely to be correct in this regard – the TW/Main 2013 Study of institutional shareholders' views does reveal some common ground.<sup>188</sup> On pay-performance linkage institutional shareholders accepted that higher leverage can increase the likelihood of unintended consequences in the working of incentives.

This is relevant to the 'lottery issue' of EDs seeking high LTI opportunity because until fairly recently the institutional shareholder guidelines used effectively to stipulate (due to the 'no vesting below median comparative TSR performance provisions) that there was a 50:50 chance that none of an LTI award will vest. On top of this, the chances of vesting were very timing/data dependent .

The TW/Main Study also showed that institutional shareholders are keen 'to emphasise executive shareholdings over the long-term '(...) including shareholding requirements, deferrals and longer vesting/holding periods for long-term incentives'.<sup>189</sup> What is stressed is not just incentive metrics but also the alignment of remuneration with strategy in terms of time horizon. Key additional points raised by institutional shareholders were simplifying LTIs and reducing pay leverage (with consequentially lower award values).

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<sup>187</sup> Powdrill, note 139, 6.

<sup>188</sup> Katharine Turner 'Executive Compensation: Investors' View on the New Executive Pay Environment in the UK' (*Towers Watson* 2013) <[www.towerswatson.com](http://www.towerswatson.com)> Accessed 5th June 2014.

<sup>189</sup> TW/Main, note 188.



Interestingly, only one of the institutional investors consulted their bondholder/fixed income colleagues. Bondholders tend to remain silent on executive pay issues (this would probably not remain the case if companies were to adopt Alex Edmans's proposal that CEOs should be paid via a combination of debt and equity).<sup>190</sup> The overall conclusion of the TW/Main Study is that '[F]und managers in general view pay increases subordinate to questions about the overall business strategy of investee companies'.<sup>191</sup> Kevin Keasey argues companies' executive pay arrangements have allowed institutional shareholders to keep their distance and minimise monitoring efforts and active engagement'.<sup>192</sup>

Institutional shareholders and RCs have difficult roles to fulfil and the demands upon them grow apace. There are limits too on how closely institutional shareholders can become engaged with their investee companies. Main's research shows what a difficult task RCs face in terms of professionalism, time commitment and review of payment outcomes. The solution to the UK's executive pay debate does not lie primarily in more regulation. This is underlined by Contraros when he states there is a 'need to prevent the negative elements of performance-based remuneration that were just as, if not more, responsible for the financial crisis as the weaknesses in remuneration structures themselves'.<sup>193</sup> This is also echoed by Stephen Haddrill's comment: '[R]emuneration of executives on the Board must also incentivise them to put the company's well-being before their own'.<sup>194</sup> Contraros's reference to 'ethics, honesty, integrity and risks' is important in this context.

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<sup>190</sup> Alex Edmans 'New Thinking on Executive Compensation: Pay CEOs with Debt' (*VOX EU* 13 July 2010) <<http://www.voxeu.org/article/new-thinking-executive-compensation-pay-ceos-debt>> Accessed 3rd June 2014.

<sup>191</sup> TW/Main, note 188.

<sup>192</sup> Kevin Keasey 'Executive Compensation in the UK' (2006) *Journal of Financial Regulation and Compliance*, 14 (3) 235-241.

<sup>193</sup> Contraros, note 167, 218

<sup>194</sup> Stephen Haddrill of FRC, in speech given on 26<sup>th</sup> April 2013 <<https://www.frc.org.uk/news>> Accessed 16<sup>th</sup> July 2014.

In relation to financial services, John Plender states: 'the financial system appears to have become an ethics-free zone' and 'at a personal level bonuses took precedence over virtually everything, including the customer (...)[A]s long as incentives are at odds with ethical requirements, common decency will be a minority pursuit. Scandals are inevitable'.<sup>195</sup> Plender states: 'boards have simply failed to recognise that pay and incentives were encouraging behaviour that was at odds with the claimed values of the organisation'. He argues that there needs to be 'a retreat from the obsession with punishing corporations rather than senior executives'. His concern is that: '[M]odestly refining the carrots and using the wrong sticks is a poor formula for rebuilding the moral capital stock. There has to be a more radical way'.

Anthony Hilton refers to Andrew Smithers's words: '[M]odern incentives have increased the difference between the short-term interests of management and the long-term interests of shareholders (...)[M]odern incentives are thus contrary to the interests of long-term shareholders'.<sup>196</sup> Smithers's view is that managers are obsessed with their STIs. Hilton states: 'the whole idea of engaging with underperforming companies is a mistaken attack on the symptoms of corporate decline, and this prevents there being a proper focus on the root cause of decline, which is to be found in the way top executives are paid'.

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<sup>195</sup> John Plender 'The Crisis Shows Moral Capital in Secular Decline' *Financial Times* (London, 10<sup>th</sup> June 2014).

<sup>196</sup> Anthony Hilton 'Shake Up Executive Pay for a Real Bonus' *Evening Standard* (London, 3<sup>rd</sup> July 2014), 58.

## **5.2. Recommendations**

Social cohesion is threatened by rancorous criticisms of executive pay – with diversion away from the real goal of how best to achieve sustainable economic growth and enhanced prosperity of the population generally, to a Them-v-Us conflict. Further work will be required to formulate robust improvements that secure the buy-in of key parties - but some initial recommendations are set out below.

### **Recommendation 1: Regulation.**

The regulatory provisions which came into force this year should be given time to bed-down. Any review will probably take place anyway, on the first to occur of a change of government, another economic downturn or a series of corporate scandals. In due course, review consideration should be given to implementing Knight's disclosure proposals (particularly on 'realisable value'), plus Barty's (on deferral of variable pay) and also addressing the disclosure valuation issues discussed already in relation to LTIs and pensions. Further global initiatives on regulation and corporate governance codes/remuneration guidelines would also be welcome, but are not covered in this paper.

### **Recommendation 2: Institutional shareholders.**

Kay's Investor Forum should devote efforts to institutional investors' 'short-termism' and their flawed remuneration incentives. Once institutional shareholders have taken on their own challenges, they should be better placed to introduce remuneration guidelines that promote a long-term mind set and rewards for EDs. It is encouraging that since Main's 2007 findings there is now less reliance in UK LTIs on comparative TSR, in favour of using that metric in combination with an

absolute business performance measure(s). Institutional shareholders should also address the situation where a RC can be caught between the Scylla of one set of guidelines and the Charybdis of another (e.g., in respect of a particular LTI design feature).

**Recommendation 3: Remuneration committees.**

Main's research puts paid to any suggestion that, due to the improvements in RC governance/practice post-Cadbury, nothing further needs to be done. RCs undoubtedly important role as directors generally (e.g., on company strategy) needs to be supplemented by greater 'professionalism' in terms of the RC being thoroughly committed, as Main recommends, to 'calibrating the LTI with critical success factors of the company's business strategy' and to 'examining the entire portfolio of unvested and vested – but unexercised - executive reward while considering the composition of the latest year's reward'.<sup>197</sup>

Implementing Main's key recommendations will inevitably require additional RC training (perhaps even introduction of a formal 'ticket' for RC Chairs, at least) and time devoted to reading papers/meetings/communicating with EDs and institutional shareholders. There needs to be greater recognition and appreciation of the value of RC Chairs (who should be highly experienced in both remuneration and business matters). NEDs should be well remunerated for devoting the time needed to fulfil their duties. As Aine Hurley states: '[M]atching the structure and quantum of remuneration to the precise needs of the particular company is one of the most important, if not the most important, roles in the success and/or survival of the business'.<sup>198</sup>

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<sup>197</sup> Main, note 2, 38.

<sup>198</sup> Aine Hurley, Virginia Bottomley and Colin Wall (2008) Odgers Berndtson Newsletter [www.odgersberndtson.co.uk](http://www.odgersberndtson.co.uk).

**Recommendation 4: Remuneration committee advisors/in-house executive compensation HR specialists.**

UK remuneration consultants agree to be bound by the VC, are subject to their respective employing firms' business conduct protocols, and in many cases are additionally bound by codes put in place by their own professional bodies. Therefore, the burden of proving any necessity for additional regulatory controls on remuneration consultants should be on those who make them.

In-house executive compensation HR specialists are, ironically, not only subject to more risk of being 'leant on' by corporate management but are also not bound by the VC (as they do not act as appointed independent advisors to the RC). One way to promote higher professional standards in respect of both remuneration committee advisors and in-house executive compensation specialists would be to establish a professional qualification (on a licence-to-practise basis) for at least the former (many of the latter are recruited from the ranks of the former anyway).

**Recommendation 5: Remuneration packages.**

The structure of UK incentive packages needs reform. EDs regard LTIs as a complete 'lottery' and massively discount the value of LTIs at the time of award. EDs' argument runs that to secure any vesting value they need to remain in service for at least three years in normal circumstances (the Fidelity initiative for a 'five-year hold' is currently trending the period up to five years), plus often a comparative TSR hurdle needs to be attained (with a straight line vesting schedule to upper quartile comparative performance attainment) – so their own company's own performance may well not be the only or key determinant of vesting. LTI opportunity has increased because EDs may seek to 'max out' in the performance cycles, perhaps one cycle in three, where there may be solid

'bounceback' between previous poor performance and current solid performance. This increases the chances of 'rewards for failure' occurring.

EDs also focus on STI opportunity – where a single year performance time horizon gives better 'line of sight'. RCs have collaborated in this process because they feel, as Main found in his research, far more comfortable in setting absolute business performance metrics and 'calibration' to annual business budgets/strategy.<sup>199</sup> This unvirtuous circle is completed by institutional shareholders who, despite articulating a long-term interest, are driven by their own short-term demons (in terms of retaining mandates/confidence of their own investors).

EDs, RCs and institutional shareholders are all thinking too short-term. A starting point would be to accept that the UK's incentive pay regime is somewhat broken – and fixing it will require co-operation between the parties concerned. Barty is correct in arguing that compensation needs to be tied to the long-term performance of companies: 'recently more compensation is being paid out in shares, but the average period over which incentive programmes are assessed is three years, which we believe is too short a time to truly reflect the long-term performance of a company.'<sup>200</sup> He states: '[T]he extension of long-term incentive plans to five years would result in some pay would be exposed to the performance of the company over ten years thereby truly linking pay to the long-term success of the company'.<sup>201</sup> Barty additionally proposes that 50% of all variable pay (STI and LTI) should be deferred for a minimum of five years. The combination of a five-year performance

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<sup>199</sup> Main, note 2, 17.

<sup>200</sup> Barty, note 58, 8.

<sup>201</sup> Barty, note 58, 9.

period, with the deferred portion paid out on a straight line over the next five years, is a sound concept – but needs other LTI design changes as well if it is to work effectively.

Extending the performance period to five years, and ‘leaking out’ deferred payouts over the following five, is an excellent counter to ‘rewards for failure’ (with strong ‘clawback’ provisions), and would only reward genuinely long-term success’. However, it does not avoid the issues raised in EDs’ perception that current UK LTI performance conditions stipulated by institutional shareholders are too comparative and insufficiently geared off absolute company performance. The solution is to build on Barty’s proposals by adding in elements of the PwC/LSE Study referred to by Powdrill.<sup>202</sup> This provides a future paradigm for UK incentives that is a more practical, real-world solution than adopting Powdrill’s ‘purist’ approach.

Barty is not so much concerned about executive pay levels as such, he is worried about ‘rewards for future’ – whereas Powdrill is very much of the view that executive pay is too high and incentives are part of the problem. In this light, Powdrill’s criticism of ‘career shares’ is understandable – and is supported in certain respects by the government’s refusal to give explicit legislative support to Kay’s proposals in this regard<sup>203</sup> (Lord Myners also sees the practical difficulties in the ‘career share’ concept<sup>204</sup>) – but TW/Main’s Study shows that ‘career shares’ have considerable performance characteristics, including limiting ‘rewards for failure’.<sup>205</sup> Barty’s proposals capture the best points of ‘career shares’ without actually going down that route. This is a pragmatic approach – focusing on

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<sup>202</sup> Powdrill, note 150, 5–6.

<sup>203</sup> House of Commons BIS Committee, note 139, 30.

<sup>204</sup> House of Commons BIS Committee, note 139, 28.

<sup>205</sup> Main ‘New Ideas to Reward Sustained Performance’ (Towers Watson 2011) <[www.towerswatson.com](http://www.towerswatson.com)> Accessed 5th June 2014.

the long-term nature of five-year rolling performance periods, whilst avoiding institutional shareholder concerns over the whole concept of 'career shares'.

The key point is that the UK's current executive incentives regime needs to change to being longer-term in focus, whilst mitigating the downsides in LTI participant perception otherwise inherent in this. EDs' natural concern regarding long LTI performance periods is understandable, but can be reduced by using metrics they feel they can influence and which reward them commensurately.

**Recommendation 6: Corporate ethics/behaviour.**

Regulation has its limits. Commentators may argue about where these lie, but the need for sound business ethics and behaviour runs through the whole UK executive pay debate. Responsible capitalism – on which the UK's prosperity depends – demands that all parties, whether board directors generally, RC members (and their external/internal advisors), institutional shareholders and other stakeholders, must pay due regard to the ethical considerations referred to by Contraros and Plender. The difficulties involved in promoting and securing adherence to such behaviour are admittedly large – particularly in a world where competing territories may seek to secure business advantage/regulatory arbitrage - but this makes it all the more essential to rise to the challenge.



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### Table of Contents

|  |       |
|--|-------|
| UK/EU Legislation and Green Papers .....     | (ii)  |
| Reports, Reviews, Codes and Guidelines ..... | (iii) |
| Books .....                                  | (v)   |
| Articles .....                               | (vi)  |
| Online Sources .....                         | (x)   |

Candidate Number: 140993

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