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2013 AGM Season Report

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Executive summary

This is the first of what will become an annual report from the NAPF looking back at the AGM season in advance of updating its Corporate Governance Policy & Voting Guidelines for the subsequent year.

The NAPF represents some 1,300 pension schemes from all parts of the UK economy. These pension schemes hold assets of some £900 billion, constituting a significant percentage of investment in UK companies. The NAPF, representing the interests of our pension fund members has been involved in developing governance standards for over 25 years. We believe high standards of corporate governance lead to better run companies, creating better outcomes for pension funds and their end beneficiaries.

At the start of 2013, the NAPF, on behalf of its members, wrote to the chairmen of most of the FTSE 350 index constituents to outline our views on remuneration ahead of the AGM season. We suggested that shareholders would express their dissatisfaction at those companies where there is continued poor practice and that directors who bear responsibility for that policy are likely to meet opposition to their re-election.

The positive news after a volatile 2012 AGM season is that this year's season has passed off with far fewer shareholder rebellions, in the FTSE 100 at least. However, today alongside some positive examples, we highlight the small number of companies where shareholders have felt compelled to express their dissatisfaction for a second successive year. While not passing judgement, we do expect these companies to reflect on their shareholders' concerns and introduce appropriate changes next year.

We are also beginning to see encouraging signs that investors are directing their attention towards other issues which have perhaps not received the focus they deserved in the past. Not least amongst these issues is that of the audit, a vital shareholder protection.

The NAPF will continue to monitor developments and the application of its Corporate Governance Policy, seeking improvements from both companies and investors in the best interests of our pension fund members.

2013 - a quiet but effective year

Last year's "Shareholder Spring" saw a small number of high profile shareholder rebellions at blue chip companies causing headlines and provoking change. This year's AGM season, however, has been much quieter, in the FTSE 100 at least. That the 2013 AGM season has attracted less attention than in 2012 is no bad thing, as we believe it is due to many companies learning the lessons of 2012: it has been a year of quiet diplomacy.

There are two likely main reasons for this – the incoming reforms to remuneration from this October and a desire to avoid the reputational damage suffered last year.

It is true that companies have been engaging more and earlier with shareholders. In addition, companies on the whole have been more cautious about introducing anything new or contentious, conscious that the reforms on the horizon present an opportunity to have a more fundamental rethink next year.

While 2013 was encouraging, only time will tell if it was the calm before the storm. With the new remuneration disclosure regulations due to come into effect at the start of next month the 2014 AGM season promises to be a testing one for companies and their shareholders alike.

A few domestic disputes

Despite the fact that 2013 saw a low profile AGM season, the actual number of defeated resolutions is much higher than in 2012 and only one of these resolutions, at Afren, was related to remuneration. The majority of these uprisings have occurred at a few companies, each of which have their own domestic issues to resolve.

- At **Easyjet plc**, Sir Stelios Haji-Ioannou, the airline's founder and largest shareholder – with his family he owns 37% of the shares – has continued his long-running feud with the airline's board.
- The merger of **Glencore** and **Xstrata** took a fresh turn at the inaugural AGM when all the former Xstrata directors were voted out, with over 80% of votes opposing the re-election of the Chairman, Sir John Bond.
- Then at **Eurasian Natural Resources Corporation (ENRC**), shareholders voted against proposals to allow the board to buy back company shares. This was amid concerns the share price would be influenced as a consortium including the firm's three billionaire founders sought to take the firm private following a year of high profile problems, not least an SFO investigation.

Remuneration

2013 statistics to date (September) indicate that shareholder turnout continues to increase as more shareholders take on their governance responsibilities. However, votes against directors remain insignificant and the average vote in favour of remuneration reports continues to be in excess of 90% - reflective this year of the early and largely constructive engagement of companies.

Amongst the FTSE 100 the percentage dissent is down from last year. ISS, the largest proxy advisory service, has identified serious issues in far fewer FTSE 100 companies, recommending a vote against (or an abstain) in just five companies so far in 2013 compared with fourteen in 2012.

It is those outside the FTSE 100 that have received higher levels of dissent this year, as the increased expectations of good practice from investors are being translated further down the market cap range. This is most striking when comparing the percentage of companies receiving significant (20%+) votes against their remuneration reports in the FTSE 100 and FTSE 250 – in the FTSE 100 this was just 3% whereas in the FTSE 250 this figure was 11%. These figures are a reminder that whilst the headlines last year largely emanated from companies in the FTSE 100, mid-cap and smaller companies cannot assume that they are below the radar. With the new reforms coming into force, this presents a big challenge to them.

2012 saw household names such as Aviva, AstraZeneca, Barclays and WPP face significant rebellions by their shareholders. In the 12 months since, these firms, along with many others who received warnings from their shareholder base, have listened and learned; subsequently dissent in 2013 was low or at least much lower. At Aviva, only 11% voted against the remuneration report this year, at AstraZeneca this was 6%, at Barclays it was just 5%. At WPP it remained high at nearly 20% but this still reflected a significant reduction – we briefly look at WPP again later in the report.

The negatives - not all companies have learnt the lessons of 2012

While many companies reflected upon the significant dissent they received in 2012, not all appear to have done so to the satisfaction of many of their shareholders.

We have looked at those companies which received more than 20% dissent last year (constituting votes against and abstentions) on a remuneration related resolution and monitored how many received more than 15% dissent this year on their remuneration report. Of the 42 companies in the FTSE 100 and FTSE 250 at which investors expressed significant concerns last year, 9 also received a further reprimand this year.

Company	2012 resolution	2012 dissent	2013 dissent	Possible issues of concern
Afren	Rem Report.	30.3%	81.4%	Directors received special bonuses for 2012
A.G. Barr	Rem Report.	23.6%	18.3%	Sig. unexplained salary increases; lack of retrospective disclosure.
Babcock	Deferred Bonus Matching Plan.	43.4%	16.4%	Sig. above inflation salary increases.
Easyjet	Rem Report.	44.3%	44.8%	N/A
Hansteen Holdings	Rem Report.	35.2%	20.3%	Uncapped LTIP; quantum increase; disclosure.
Inmarsat	Rem Report.	40.9%	38.3%	"Exceptional" awards.
Investec	Rem Report.	27.9%	16.5%	Uncapped annual bonuses. Quantum.
WS Atkins	Long-Term Growth Unit Plan.	20.1%	16.8%	LTIP structure.
WPP	Rem Report.	59.8%	26.5%	Quantum.

**Easyjet’s figures are distorted due to the role of a single large shareholder*

Afren

- **The Executive Directors were awarded exceptional bonuses for 2012 in respect of the Okoro field extension this followed similar 'exceptional' payments made in 2011. Such retrospective rewards, where targets are not set in advance and clearly signalled to shareholders, are not looked upon favourably by investors. Instead any benefits from the Okoro field extension should have been recognised in pay-outs under the normal bonus scheme and over the longer-term, in the outcome of share awards, making it unnecessary to implement special arrangements.**
- **Encouragingly the Chairman of the Remuneration Committee did acknowledge within the Report & Accounts that the Committee is to bring future exceptional performance bonuses within the ambit of the standard bonus plan, and to make such awards subject to predetermined performance conditions.**

Inmarsat

- **The Executive Chairman, Andrew Sukawaty, received a performance share award in 2012 at the 'exceptional' level; this was repeated in 2013, despite objections being raised last year. This follows a similar pattern of special one-off plans being made for Mr Sukawaty (in 2007 and 2009) which continues to pose significant concern to investors.**

WPP

- **WPP's board did hold extensive negotiations with shareholders following the 2012 AGM. The subsequent proposals thus reflect the feedback received and included a significant reduction to Sir Martin Sorrell's remuneration package.**
- **However, quantum remained a concern for many shareholders. The new Share Plan still has a maximum award limit set at 975% of basic salary, giving the CEO an award with a face value of £11.2 million (down from £18.5m in 2012).**
- **Significant concerns also remain around succession planning.**

Increasing accountability

Afren is the only company so far to have its remuneration report voted down by its shareholders. In fact the Afren remuneration report was not just defeated but was voted against by nearly three quarters of the firm's shareholders. This embarrassment is greater still when one considers that Afren also lost the vote on its remuneration report back in 2011 and only just had it passed in 2010.

In its 2012 Remuneration Report the committee chairman Toby Hayward stated: "The necessary transition from remuneration design and reporting more suited to our earlier listing on AIM, has given rise to some shareholder concerns, which we have been addressing over the past two years and we are continuing to address… we realise we still have some way to go to meet shareholders' expectations."

Clearly Afren still has a long way to go to meet its shareholders' expectations. With the remuneration policy binding vote on the horizon it will need to redouble its efforts not just to communicate more

clearly – they have made efforts in this regard – but to align more effectively their remuneration policies with shareholder interests.

Interestingly, despite Mr Hayward only taking over the chairmanship of the Afren Remuneration Committee in June 2012, investors also expressed their dissatisfaction with his performance, with over a quarter voting against his re-election.

The NAPF emphasised in its Corporate Governance Policy & Voting Guidelines last year that it encourages investors to utilise more the full tools at their disposal – these include the re-election of directors, adoption of the annual report and accounts, adoption of the remuneration report and appointment of the auditors. In addition, the Remuneration Principles we issued for discussion earlier this year (with Hermes EOS, RPMI Railpen and USS) stress that remuneration committees should be given more space to formulate policies appropriate to their business and to utilise their judgement. However, shareholders should also in turn hold remuneration committee chairs more accountable for their decisions and judgements.

The vote against Mr Hayward alongside that against Stephen Davidson of Inmarsat (up to 10.4% from 6%) and Perry Crosthwaite of Melrose (up to 7.4% from 1.8%) may be indications of investors escalating their votes where they do not feel they are being listened to. Contrast this with the significantly decreased negative vote against Jeffrey Rosen's re-election at WPP. Many investors remained dissatisfied at the awards being made to WPP CEO Martin Sorrell, but many accepted that the Remuneration Committee had made strenuous efforts to engage with shareholders and had subsequently made significant changes.

There were positives too

It is encouraging to see that most companies are making efforts to improve the disclosure of their remuneration practices and to ensure their policies are driving appropriate performance. Given that each company is unique and as such faces different challenges and opportunities, we are keen to see companies think about their current practices in the manner most appropriate to their own situation.

We like some of the innovative and new approaches introduced this year, such as those at Tullow Oil, Aviva and Quintain Estates. We encourage more companies to assess whether their current remuneration practices are optimal in terms of incentivising management and aligning rewards to long-term success and returns to shareholders. Additionally, we encourage investors to give companies the space to do just this.

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Tullow Oil

- Tullow Oil proposed a radical overhaul of pay for 2013 onwards. The new package seeks to reconcile the very long-term nature of the oil industry, recognising that discovery to production often exceeds a decade.
- They acknowledged that incentives work best when they are relatively short-term, while alignment with investors and an appropriate risk culture are best achieved through material long-term share ownership.
- The new policy consists of just two main elements fixed pay (base salary, benefits and pension provision) and an incentive plan whereby, subject to the achievement of a balanced scorecard, shares are awarded (plus a small amount of cash – 1/6th of the total maximum award) and then deferred for up to five years.

Aviva

- Following a significant negative vote last year, the Aviva Remuneration Committee ensured that it consulted widely to make changes both to the packages awarded and to its policy for future decisions.
- Changes included introducing 'underpin' metrics to 2012 bonuses to ensure bonus outcomes are better aligned with the creation of shareholder value. Consideration of these metrics resulted in no bonuses being awarded for 2012.
- Additionally, any buyouts on the hire of senior executives will in future be on a strict 'like for like' basis.

Quintain Estates

- Quintain Estates decided to replace its existing annual bonus arrangement and long-term incentive plan with a new form of incentive plan which measures performance over a single performance period with clearly disclosed operational KPI's which is then deferred for a period of up to five years
- While the factor which governs the size of the grant is annual performance and disclosure is only retrospective, the requirement to retain shares for five years after the grant and the level of retrospective detail given, coupled with the provision for forfeiture of awards related to previous years, aligns interests with the long-term and promotes on-going performance.

Increased focus on the audit

It is also worth briefly reflecting on the increasing focus being given to other AGM resolutions, such as those relating to the statutory audit.

The audit is a vital shareholder protection but related resolutions have in the past too often been treated as routine and the audit process, quality and auditor's independence rarely challenged – not least because the disclosures provided offer so little insight. This past year has seen increasing attention on this important governance function, with the UK Competition Commission's market review edging towards its final recommendations and the European Commission's proposals continuing to progress and companies are responding.

In 2012 across Europe there was a record level of dissent expressed in relation to resolutions for re-election of the auditor, continuing a trend of the past few years. Despite the low level of actual votes cast 'against', the upwards trend is reflective of the extra focus this issue is receiving from investors – and in turn policy makers. Figures so far indicate that votes this year failing to support auditor resolutions have risen again, although they continue to remain very low, at approximately 3.6%.

There were four significant rebellions against audit-related resolutions this year where shareholders signalled their dissatisfaction with consistently high levels of non-audit fees. These were at:

- **Pennon Group plc** - 49% of investors withheld support for the board to set the fees for the external auditor PwC. The company had paid PwC more than double the audit fee for other services, including £880,000 for corporate finance work.
- **Inmarsat plc** - 38% of investors failed to back the remuneration of the auditor. For the fourth year running there were high levels of non-audit fees relative to audit fees - the company's £1.2m audit fees to Deloitte were outstripped by £1.9m for other work, including £1.3m for tax advice.
- **Unite Group** – 42% of investors failed to support the resolution to determine the remuneration of the external auditor KPMG. The company had paid KPMG three times as much for non-audit services as for the statutory audit.
- **Laird plc** – 44% of investors failed to support the resolution to re-appoint the external auditor EY, which has been auditing Laird since 1989. As with the above examples, the non-audit fees have consistently exceeded the statutory audit fee.

Many other companies headed off audit-related disputes by either tendering their longstanding auditor contracts or indicating an intention to do so in the near future. Several large companies announced that they had or were changing their auditor this year, probably prompted by both the evolving debate around the merits of mandatory rotation of auditors, which has been supported by the NAPF, and the recent amendments to the Corporate Governance Code by the FRC. These included:

- **HSBC** – moving the UK's largest audit contract after a 20+ year relationship with KPMG;
- **Unilever** ending a 26 year relationship with PwC;
- **Land Securities** PwC were replaced by EY after 69 year tenure;
- **BG group** PWC replaced EY who had been in place since incorporation in 2000.

The NAPF has been a supporter of calls to introduce mandatory rotation of audit firms and is encouraged to see many companies respond positively to the evolving expectations this year. Looking ahead, we encourage those companies where non-audit fees remain consistently high or where the external auditor has been in place for a lengthy period to follow the path set by others this year and take appropriate steps to ensure that the independence of their audit is safeguarded.

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Plenty of room for better reporting

While this trend is encouraging, the quality of reporting in this area remains an issue. Despite the NAPF's Corporate Governance Policy encouraging firms to inform shareholders in advance of their intention to tender the audit contract, only BG group of the companies above had indicated in advance that a tender process would be undertaken. Indeed, over a third of firms in the FTSE 100 are neither stating the number of years they have been with their current auditor nor the year when the tender last took place.

Some of the firms with the longest audit tenures, such as Barclays, where PwC has been in place since 1896, did give an indication this year that they were conscious of the long tenure and would be considering the merits of a tender this coming year. Others, such as Greggs, where KPMG has been in place since 1964; Ladbrokes, where EY has been in place since 1979; and Marstons, where PwC has been in place since 1963, communicated plans to submit the audit function to tender in the coming year(s).

We encourage other companies where the external auditor has been in place for a lengthy period to follow suit.

NAPF to monitor again in 2014

It is vitally important that companies engage with their shareholders. It is even more important that both listen to and reflect upon the messages they hear. On behalf of our members we will continue to monitor evolving market practice and to highlight those companies which continue to cause concern to shareholders.

Next year we will also begin to benchmark companies against our soon to be finalised Remuneration Principles; we would like to see companies use them in a manner which is most appropriate for their company.

In conclusion

As the 2013 AGM season comes to an end and the 2014 season fast approaches, investors and companies will be pleased that on the whole this year was a much more low-key affair. There was much of good to note, including indications that very longstanding auditor tenures are now finally being tendered and rotated. There was also a significant increase in the quality and quantity of engagement taking place and this was a key reason why last year's headlines were not repeated.

That said, not all companies have chosen to act on the feedback they received from their shareholders. It is important that next year they do so, not least due to the introduction of the binding vote on remuneration policy – the impact of which will be watched intently. We expect that investors will continue to utilise more the tools at their disposal, including voting against the re-election of directors, especially where there are persistent infringements of good practice.

The NAPF will continue to assess how companies are matching up against its corporate governance policy, monitor developments in good practice and seek improvements from both companies and investors in the best interests of our pension fund members.