PENSIONS AND LIFETIME SAVINGS ASSOCIATION

October 2016

AGM SEASON REPORT 2016

PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

INTRODUCTION

The Pensions and Lifetime Savings Association is the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes with over 20 million members and £1tn in assets, and over 400 supporting businesses. They make us the leading voice for pensions and lifetime savings in Westminster, Whitehall and Brussels

EXECUTIVE SUMMARY

The PLSA's 2016 AGM report focuses on the issue of executive remuneration, lending some concrete data to the lively debate currently taking place on this issue. The report includes an analysis of remuneration-related votes at company AGMs, as well as the results of a PLSA survey examining the views of pension fund investors on executive pay.

The key findings contained in the report are as follows:

AGM voting

Overall dissent on remuneration-related votes did not change dramatically in 2016. Average dissent on remuneration reports and those remuneration policies that were put to a vote was slightly under 8 per cent across the FTSE 350. This is a similar level to 2015 and 2014. For the FTSE 100, average dissent was just under 11 per cent. For the FTSE 250, the figure was almost 7 per cent. Again, this difference is similar to previous years. Fifteen FTSE 100 Companies and twenty seven FTSE 250 companies recorded significant levels of dissent on remuneration-related votes. In 2015, the figures were fifteen and thirty five respectively.

While these figures suggest that the notion of a 'second shareholder spring' in 2016 was mis-placed, the averages hide a number of prominent shareholder revolts at high profile companies. Two remuneration-related resolutions were defeated across the FTSE 100 in 2016 and five more attracted dissent totalling over 40 per cent. In 2015, one vote was defeated and only two attracted dissent of over 40 per cent. However, across the FTSE 250, the number of resolutions attracting over 40 per cent dissent fell from eleven to five.

Of the five FTSE 100 companies with the highest level of dissent on a remuneration-related vote in 2016 (BP, Smith & Nephew, Shire, Babcock and Anglo-American), none were prepared to acknowledge that they had got their approach to remuneration wrong in their subsequent statements addressing the votes. This suggests that there is some room for improvement in terms of how responses to high levels of dissent are disclosed and detailed. Despite this, there were no significant votes against the re-election of Remuneration Committee Chairs as Directors at companies experiencing significant dissent over a remuneration-related vote.

Looking at recurrent remuneration-related issues, there were nine companies across the FTSE 350 where a vote on remuneration attracted significant dissent in 2015, and over 15 per cent dissent in 2016. Six of these companies (DS Smith, Experian, Man Group, SVG Capital, Tullet Prebon and WPP) also recorded dissent of over 15 per cent in 2014.

PLSA member survey

Findings from the PLSA survey suggest that asset owners are concerned by the size of executive pay packages, not just their structure. 87 per cent of respondents said they felt that executive pay was too high. Of those, 63 per cent said it was generally too high, while 37 per cent said it was too high in cases of poor performance. 85 per cent of respondents said they were concerned by pay gaps between executives and their workforce. 48 per cent were very concerned and 37 per cent were quite concerned.

The survey found concerns regarding the capacity of asset managers to fulfil their stewardship responsibilities. 42 per cent of respondents said they were satisfied with their asset manager's approach to executive pay, with 5 per cent very satisfied and 37 per cent moderately satisfied. 35 per cent were not satisfied, with 25 per cent not very satisfied and 10 per cent not at all satisfied.

60 per cent felt that pay levels in the asset management sector prevented asset managers from holding companies to account over pay, while 20 per cent did not.

Conclusions

From these results, we have identified four key conclusions:

1) Boards must do more to address shareholder concerns over CEO pay. Stakeholder anger over pay has become an annual event, without practice changing significantly.
2) Asset managers must also do more to hold boards to account, and recognise the concerns of stakeholders, particularly asset owners.
3) The excessive value of pay packages is as much as an issue for stakeholders, including pension funds, as their structure, and reductions need to occur.
4) The PLSA will update our corporate governance policy and voting guidelines in line with these findings.

Next steps

The PLSA Corporate Governance Policy and Voting Guidelines will be published shortly, incorporating the findings of the AGM report. Specifically, we will look to introduce stronger recommendations into the guidelines on the re-election of remuneration committee chairs, in order to remedy the disconnect between votes against pay practices and those against the individuals responsible for overseeing them. We believe that greater individual accountability may encourage companies to take high levels of shareholder dissent more seriously.

The guidelines will also reflect the message from our members that the increasing size of executive pay packages is problematic in and of itself, not just in respect to company performance or how payments are structured. Once published, the guidelines will be circulated to all leading UK companies. We hope that by strengthening our clear, prominent, evidence-based position on executive pay, the PLSA can help to resolve the ongoing problems on this issue.

INTRODUCTION

The 1,300 pension schemes comprising the membership of the Pensions and Lifetime Savings Association manage assets worth almost £1 trillion. While our members investments are increasingly diversifying across asset classes and expanding their international reach, 68 per cent of Defined Benefit schemes responding to the PLSA annual survey said they continue to invest in UK equities.[1] Defined Contribution schemes responding to the survey suggested that 73 per cent of their assets are invested in equities (both global and UK) during the scheme's 'growth phase.'[2] With the value of DC funds set to increase rapidly as a result of auto-enrolment, the size of these investments is likely to grow.

This amounts to billions of pounds of pension funds' money invested in UK companies and as such, the performance of these companies has considerable bearing on the success of UK pension funds and their capacity to deliver a secure and sufficient income for their members in later life. Studies have repeatedly shown the link between good governance and corporate performance. It is therefore vital that UK companies adopt appropriate governance structures, conduct themselves responsibly and are subject to the necessary levels of scrutiny, in order to deliver the best possible value for investors.

To this end, since 2013 the PLSA has published an annual review of shareholder votes at the Annual General Meetings of FTSE 350 companies, with a particular focus on Directors elections and votes relating to executive remuneration.

We have historically concentrated on these two aspects of corporate governance because they are typically the highest profile votes and offer the most useful insight into quality of governance and stewardship.

This year, however, we are focusing in detail on executive remuneration. There has been intense discussion of this issue in 2016, resulting from:

- a range of analyses of executive remuneration, conducted by think tanks, academics and consultants;
- commentary on the issue from stakeholders across business, politics, the media and elsewhere;
- the keen interest in the subject expressed by PLSA members;
- multiple policy proposals emanating from industry groups; think-tanks and latterly, the Government;
- high profile votes on remuneration at a select number of major UK company AGMs;
- and the large number of companies whose remuneration policy is due for renewal in 2017.

---

[1] PLSA, *PLSA Annual Survey 2015* (2015), p43
[2] Ibid p62

This means that interest in voting results from AGMs will inevitably focus on the votes on remuneration. It also heightens the importance of lending some concrete figures against which the rhetoric of a 'second shareholder spring' and various policy proposals can be contextualised.

Box 1: The Executive pay debate

Executive pay been a subject of considerable controversy for some years. The report of the independent 'High Pay Commission' in 2011 highlighted the extent to which top pay growth had outpaced that experienced by ordinary workers and outlined a series of policy proposals aimed at containing executive pay. This was followed by the so-called 'shareholder spring' in 2012, when a number of companies lost the advisory vote on remuneration at their company AGM, and the 2013 Enterprise and Regulatory Reform Act, empowering shareholders with a triennial binding vote on pay policy to go with the annual advisory vote on pay awards. In the same year the PLSA, in partnership with Hermes Investment Management, the BT Pension scheme, USS Investment Management and RPMI Railpen published our 'principles of executive remuneration' designed to ensure that executive pay awards were proportionate and reflected shareholder interests and the long-term success of the company.

Since then, rising public interest in income inequality; ongoing research on levels of pay and their socio-economic causes and consequences; and controversial pay practices at individual companies have maintained the prominence of the executive pay issue, but in 2016 it has exploded once more. A number of high profile shareholder rebellions at company AGMs have given rise to talk of a 'second shareholder spring.' Research found that average pay levels for FTSE 100 CEOs had passed £5.5 million. The new Prime Minister, Theresa May has put top pay and corporate governance reform at the centre of her policy programme.

In addition to May's forthcoming consultation on whether to introduce worker representation on company boards and a binding vote on pay awards, the Business Innovation and Skills Select Committee is also investigating corporate governance and executive pay practices, while the Conservative MP Chris Philp has published proposals to introduce a 'shareholder committee' with authority over executive pay.

In 2017, many companies will also be due to put their pay policy to a tri-annual vote (following the introduction of the binding vote in 2013, many of the first such votes took place in 2014). As such, both companies and shareholders will have to consider what types of policy they will support. A working group convened by the Investment Association has already produced a series of proposals, outlining support for a more diverse range of payment structures, including annual guaranteed share awards with a minimum holding period as an alternative to existing incentive payments.

While the composition of boards and Directors skills, competences, experience, independence and diversity are obviously of critical importance to quality of governance, top pay is also a useful proxy for the quality of oversight and decision-making more generally. The size and structure of a pay package is a key indicator of strategy, managerial accountability and the ultimate interests that the company is serving – how pay is used to align Directors' interests with those of the company and its stakeholders over the long-term.

This relates to the quality of shareholder engagement – and the AGM report is intended as an assessment of the investment stewardship carried out by asset managers and other intermediaries on behalf of our members, as well as corporate conduct.

82 per cent of DB schemes responding to the PLSA annual survey and all DC schemes responding said that they outsourced investment activities to specialist fund/asset managers.[3] Therefore, these managers have a responsibility to PLSA members to take their concerns seriously and act as responsible stewards of their assets. The extent to which they are prepared to curb excessive executive pay is a good benchmark in this respect.

While heightened shareholder dissent at company AGMs is not a sign of success - low levels of dissent can result from successful engagement and constructive dialogue between investors and company boards prior to AGMs –shareholder vetoes are only meaningful instruments of corporate governance if they are used.

In the current context, high levels of a dissent could be seen as a sign of greater shareholder engagement. Average pay for a FTSE 100 CEO leapt by 10 per cent in 2015 to £5.5 million and the subject of top pay continues to exercise politicians, regulators, commentators and stakeholders from across the business community. [4] As such, there is some basis for thinking that responsible stewardship ought to necessitate active opposition to current pay practices at company AGMs.

[3] Ibid p and p53-54
[4] High Pay Centre, *10% pay rise? That'll do nicely* (2016) via http://highpaycentre.org/pubs/10-pay-rise-thatll-do-nicely (accessed September 15 2016)

METHODOLOGY

For this research, the PLSA examined AGM results for FTSE 350 companies between 1 September 2015 and 31 August 2016. This is the period we have taken for '2016' with corresponding dates, for 2015, 2014 and so on. We have classified companies as being in the FTSE 100 or FTSE 250 if they were classified as part of the index on the date of their AGM during this period.

All data was provided by Manifest, the proxy voting agency. The PLSA is very grateful for their support of this report.

FINDINGS

Overall picture

Despite the high profile votes at a number of individual companies, across the FTSE 350, levels of dissent on remuneration issues were little changed from previous years. Average dissent on both remuneration reports and those remuneration policies that were put to a vote in 2016 was slightly under 8 per cent. This is a similar level to 2015 and 2014.

For the FTSE 100, the figure of just under 11 per cent dissent on remuneration reports was higher than the average across the FTSE 250 (as was the case in 2015).

Table 1: Overall dissent on remuneration votes

	FTSE 100	FTSE 250	FTSE 350		
	2016			**2015**	**2014**
Remuneration policy	9.94%	6.74%	**7.71%**	**7.90%**	**8.90%**
Remuneration Report	10.69%	6.97%	**7.95%**	**6.90%**	**7.90%**

Companies with ‘significant dissent

These low levels of average dissent hide a number of outliers where votes were much closer.

Taking 20 per cent as our definition of ‘significant’ dissent, there were fifteen FTSE 100 companies and twenty seven FTSE 250 companies that fell into this category.[5] For 2015, the corresponding figures were fifteen companies in the FTSE 100 and thirty five in the FTSE 250.

Table 2: FTSE 100 companies with ‘significant’ dissent

Company	Resolution	Dissent
BP plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	60.86%

[5] The Corporate Governance Code requires companies to issue a statement on how they intend to respond to ‘significant’ shareholder dissent at AGMs. Guidance from the GC100 and Investor Group advises that companies should take 20 per cent as a general definition of ‘significant’ (though they also note that there may be circumstances in which a higher or lower definition may apply).

Smith & Nephew plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	56.90%
Shire plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2015	50.63%
Babcock International Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 March 2016	48.43%
Anglo American plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	47.77%
CRH plc	To approve, by way of an advisory vote, the remuneration policy	42.31%
Paddy Power Betfair plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2015	40.27%
Aberdeen Asset Management plc	To approve the report on the implementation of the remuneration policy for the year ended 30 September 2015	35.94%
WPP plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2015	33.45%
Ashtead Group plc	To approve the report on the implementation of the remuneration policy for the year ended 30 April 2015	31.89%
Dixons Carphone plc	To approve the report on the implementation of the remuneration policy for the year ended 2 May 2015	31.58%
GlaxoSmithKline plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	31.50%
Reckitt Benckiser Group plc	To approve the remuneration policy	28.21%
Bunzl plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	26.28%

Standard Life plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	24.38%
Reckitt Benckiser Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	20.39%

Table 3: FTSE 250 Companies with 'significant' dissent

Company	Resolution	Dissent
Weir Group plc	To approve the remuneration policy	73.53%
Weir Group plc	To approve the amendments to the Long Term Incentive Plan to take account of the proposed Directors' remuneration policy	73.41%
Paysafe Group plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2015	55.78%
Ladbrokes plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	46.10%
Carillion plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	45.85%
Man Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	43.73%
Vectura Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 March 2015	39.16%
SVG Capital plc	To approve the report on the implementation of the remuneration policy for the year ended 31 January 2016	37.64%
Inchcape plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	36.97%

Mediclinic International plc	To approve the retention bonus payable to Ronald Lavater	36.39%
Jupiter Fund Management plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	35.78%
Telecom Plus plc	To approve the amended remuneration policy	34.92%
Telecom Plus plc	To adopt the Long Term Incentive Plan	34.92%
Ophir Energy plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	34.69%
Entertainment One Ltd	To adopt the 2015 Executive Incentive Scheme	34.32%
Restaurant Group plc; The	To approve the report on the implementation of the remuneration policy for the year ended 27 December 2015	33.07%
J D Wetherspoon plc	To approve the report on the implementation of the remuneration policy for the year ended 26 July 2015	32.50%
NMC Health plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	30.76%
RPC Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 March 2016	30.19%
Hansteen Holdings plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	29.53%
Thomas Cook Group plc	To approve the report on the implementation of the remuneration policy for the year ended 30 September 2015	26.52%
Regus plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2015	25.69%
Clarkson plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	23.18%

Elementis plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	21.92%
Go-Ahead Group plc; The	To adopt the 2015 Long Term Incentive Plan	20.80%
Go-Ahead Group plc; The	To approve the remuneration policy	20.77%
Countrywide plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2015	20.74%

Though the similar number of companies experiencing significant dissent in 2015 and 2016 suggests similar levels of conflict/engagement, this is slightly mis-leading. In 2015, only one resolution was defeated and one more attracted dissent levels of over 40 per cent across the FTSE 100. In 2016, two resolutions were defeated and a further five attracted dissent of over 40 per cent. The prospect of a company losing the vote, with all that entails, does seem to have become increasingly plausible in 2016, in the FTSE 100 at least. Across the FTSE 250, the number of votes attracting dissent of over 40 per cent fell from eleven in 2015 to six in 2016.

Five companies across the FTSE 350 experienced significant dissent on their binding vote on remuneration policy, including Weir Group, where the proposed policy was defeated. As the vote must take place at least tri-annually and the relevant legislation was introduced in 2013, many such votes took place for the first time in 2014 and are due to be repeated in 2017. Therefore, the experience of Weir Group in 2016 is an interesting case study for forthcoming votes, particularly in light of the interest in and expectation of pay reform.

Box 2: Case Study - Weir Group

One of the most significant votes of the AGM season occurred at Weir Group, where the proposed pay policy was rejected by 70 per cent of voting shareholders, forcing the company's remuneration committee to re-consider their proposals.

Ironically, Weir's proposals were actually very close to one model proposed by the Investment Association's working group on executive pay. The IA working group called for greater flexibility over pay, with greater diversity of structures, beyond the salary/annual bonus/long-term term incentive payment model used by almost all FTSE 350 companies.

One of the alternative structures suggested in the IA working group's final report – restricted share awards made annually, and vesting after a set period of time (in Weir's there would be a staggered release over 3-5 years from grant). Though Weir did also include a performance share award (a form of LTIP) in their proposed policy, this would be reduced to a maximum value of 75 per cent compared to 250 per cent under the old policy. The net result, was that the maximum potential value of the Chief Executives total deferred pay would fall from 250 per cent of salary to 165 per cent – essentially the company were increasing the certainty of the pay award while reducing its value, as many critics of high CEO pay have argued.

However, the response from investors suggests that there is still significant wariness of moving away from existing conventions.

Recurring issues

There were nine companies across the FTSE 350 where a vote on remuneration attracted significant dissent in 2015, and over 15 per cent dissent in 2016.

Table 4: FTSE 350 companies with recurrent dissent

Company	Resolution	Resolution Category	Dissent 2016	Dissent 2015
Centrica plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2014	Remuneration - Report	16.15%	34.21%
DS Smith plc	To approve the report on the implementation of the remuneration policy for the year ended 30 April 2014	Remuneration - Report	17.66%	41.97%
Experian plc	To adopt the remuneration report for the year ended 31 March 2015	Remuneration - Report	17.93%	35.03%
Ladbrokes plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2014	Remuneration - Report	46.10%	39.91%

Man Group plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2014	Remuneration - Report	43.73%	36.16%
SVG Capital plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2014	Remuneration - Report	37.64%	38.06%
Tullett Prebon plc	To approve the report on the implementation of the remuneration policy for the year ended 31 December 2014	Remuneration - Report	16.28%	43.71%
WM Morrison Supermarkets plc	To approve the report on the implementation of the remuneration policy for the year ended 01 February 2015	Remuneration - Report	19.40%	42.28%
WPP plc	To approve, by way of an advisory vote, the remuneration report for the year ended 31 December 2014	Remuneration - Report	33.45%	22.21%

This is particularly concerning, because it suggests that boards at these companies are not heeding the message from shareholders. Six of these companies (DS Smith, Experian, Man Group, SVG Capital, Tullet Prebon and WPP) also recorded dissent of over 15 per cent in 2014.

The fact that a substantial proportion of the companies who experienced significant levels of dissent in 2015 were unable or unwilling to address shareholder concerns implies that a large minority vote against the remuneration report is sometimes disregarded as long as the motion passes. This would be complacent in the extreme -any company where a substantial minority of shareholders (usually the most engaged shareholders) is unwilling to endorse pay practices needs to reflect on how their approach could change in order to avoid damaging a key stakeholder relationship.

Responding to dissent

The Corporate Governance Code suggests that companies with a significant vote against an AGM resolution should issue a statement outlining their intended response alongside their announcement of the results.

The responses to remuneration votes are not encouraging. Of the five FTSE 100 companies with the highest level of dissent on a remuneration-related vote in 2016 (BP, Smith & Nephew, Shire, Babcock and Anglo-American), none suggested that they had got their approach to remuneration wrong. Indeed, Smith & Nephew and Babcock used the statements to defend their pay practices, rather than express serious intent to address shareholder concerns.

Box 3: Selected quotes from companies RNS Statements

'*We have already spoken to a number of shareholders and have a continuing dialogue. They are seeking changes to our remuneration policy for the future. We will continue that engagement and will bring a revised policy to our next AGM in 2017.*' **(BP)**

'*In spite of the voting outcome, the Remuneration Committee and indeed the Board unanimously believe that in these particular circumstances the Remuneration Committee made the right decision in aligning executive reward to the shareholder experience.*' **(Smith and Nephew)**

'*We have engaged extensively with our major shareholders on the remuneration report and acknowledge the vote today. We remain firmly committed to a constructive and appropriate dialogue to fully understand shareholder views as we compete in a global market place.*' **(Shire)**

'In light of these important factors, the Remuneration Committee believes it was justified in its decision not to reduce the level of shares under award upon retirement for these two executives.' **(Babcock)** [6]

'Setting executive remuneration in a volatile industry such as mining can be challenging and the Remuneration Committee intends to again engage with shareholders in order to refine the policy to ensure that it is both appropriate and motivational' **(Anglo-American)**

While all the companies did promise to engage with shareholders in future, unspecific commitments to future engagement and a reiteration of arguments that ought to have already been made to shareholders (and have clearly proved unconvincing, on the basis of the AGM vote) are not sufficient. The PLSA's Corporate Governance Policy and Voting Guidelines suggest that boards should:

'communicate as soon as reasonably possible following the AGM how it intends to engage with shareholders in order to understand the reasons for dissent. Subsequently the company should explain within the following year's annual report and accounts the steps it has taken, or will be taking, to resolve the concerns.'[7]

Initial statements from some companies do not detail adequately concrete plans to address shareholder concerns. It is hoped that this will be remedied through subsequent engagements and disclosures.

[6] The Babcock statement refers to the ongoing participation of two retiring executive in the company's Long-Term Incentive Plan, continuing to accrue benefits of the plan despite no longer working for the business

[7] PLSA, *Corporate Governance Policy and Voting Guidelines 2015/16* (2015) via http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0556-2016-Corporate-Governance-Policy-and-Voting-Guidelines.pdf (accessed 26 September 2016)

Votes on Remuneration Chairs

The annual re-election of remuneration committee chairs as company directors affords shareholders an opportunity to express their dissatisfaction with remuneration practices more forcefully. If they oppose the company's pay awards or policies, they can vote the individual responsible off the board. This ought to act as a powerful incentive to get remuneration right. However, there is a striking discrepancy between votes against remuneration reports or policy and those against the re-election of remuneration Chairs.

Of the fifteen FTSE100 companies that attracted significant levels of dissent regarding an AGM vote on remuneration, none experienced a significant vote against the re-election of a Remuneration Committee Chair. The highest level of dissent was 16.87 per cent against the re-election of Padraig O'Riordan of Paddy Power Betfair. It was a similar story across the FTSE 250, where the 12.55 per cent dissent against the re-election of Warren Tucker at Thomas Cook was the highest for the Remuneration Committee Chair of any company on the index experiencing significant levels of dissent on a remuneration vote.

This suggests that even where they have reservations about remuneration practices, shareholders are reluctant to use tools other than their AGM votes on remuneration awards and policy.

THE VIEWS OF PENSION FUNDS

Some larger PLSA members invest directly in listed companies; others delegate their investment and stewardship responsibilities to asset managers and other intermediaries, but retain some say over the approach taken to governance and executive pay; others, particularly smaller schemes investing in pooled funds, have little influence over these issues.

The majority, however, have money invested in UK companies, and therefore their perspective on pay practices at those companies should be recognised and respected by both by companies and investment intermediaries alike. To better understand the views of our members, the PLSA undertook a short survey asking whether existing practices and levels of stewardship concerned them.

An overwhelming majority of respondents felt that typical levels of executive pay are too high.

Table 5: Views on levels of executive remuneration

In general, which of the following best reflects your view of current executive pay levels for UK listed companies?	
	%
Too high	87%
About right	7%
Too low	2%
Don't know	5%

We asked a follow-up question to those who felt it was too high, attempting to better understand why they took this view. Tellingly, a smaller but still substantial majority suggested that executive pay was too high across the board, not just in perceived cases of 'rewards for failure.'

Table 6: Why is remuneration too high?

If you had to choose, which of the following statements best reflects your opinion on executive pay levels	
	%
Large pay packages for under-performing executives are particularly inappropriate, but executive pay is disproportionately high across the board	63%
There is nothing wrong with large pay packages for successful executives, but they are too often awarded regardless of performance	37%

In addition to technical concerns about the structure of pay packages, most of our members also believe that pay gaps between executives have become an important issue. This could be because they directly affect individual businesses (for example, by souring intra-company relationships and exacerbating the risk of industrial conflict) or because they create a moral or reputational issue for business as a whole that will eventually have an indirect impact through regulatory action or consumer activism.

Table 6: Views on pay gaps

How concerned, if at all, are you by the extent of the pay gap in listed companies between executives and their wider work force?	
	%
NET CONCERNED	**85%**
Very concerned	48%
Fairly concerned	37%
NET NOT CONCERNED	**13%**
Not very concerned	10%
Not concerned at all	3%
Don't know	2%

A slim majority of our members were satisfied with their asset managers' approach to executive pay, though just 5 per cent were very satisfied. In general, the results imply that asset managers are already holding companies to account over pay, but could do more to reflect pension funds' views. There was also a strong sense that high levels of pay in the asset management industry hinder asset managers' capacity to hold investee companies to account over pay practices. This has been a theme of recent media coverage. Analysis by the Financial Times found that Chief Executives of the largest asset management firms received bonus payments worth on average fifteen times their basic salary as part of their total pay package.[8]

How satisfied, or not, are you with your asset manager's approach to executive pay?	
	%
NET SATISFIED	**42%**
Very satisfied	5%
Fairly satisfied	37%
NET NOT SATISFIED	**35%**
Not very satisfied	25%
Not at all satisfied	10%
Don't know	23%

[8] Financial Times, *Asset managers face pressure over bonuses*, 11 September 2016 via https://www.ft.com/content/89045562-75df-11e6-b60a-de4532d5ea35

To what extent, if at all, do you think pay levels in the asset management sector prevent asset managers ability to scrutinise executive pay?	
	%
NET GREAT OR MODERATE EXTENT	**67%**
To a great extent	22%
To moderate extent	45%
NET SMALL OR NO EXTENT	**20%**
To a small extent	13%
To no extent at all	7%
Don't know	12%

CONCLUSION

The findings form this research invite the following conclusions. These do not apply equally to all companies, investors and other stakeholders involved in the debate around executive pay, but are broadly reflective of current top pay practices and related stewardship activities in the UK in general.

1) **Boards must do more to acknowledge the message on pay**. A significant number of companies experienced significant shareholder dissent over their pay practices, but any hope of them improving in 2017 is discouraged by recent experience. A substantial minority of the companies subjected to significant levels of dissent in 2015 did not do enough to avoid a similar experience this year. This report provides examples of high profile companies who responded to significant levels of dissent in 2016 with an insistence that they did nothing wrong. There is a risk that even when it only achieves a slim majority, a vote on remuneration that passes is seen as a success. The subsequent public acknowledgements of shareholder disapproval are treated as procedural matters. This is negligent. It is not sustainable for a company to maintain pay practices that are unacceptable to a substantial proportion of their (most engaged) shareholders.

2) **Shareholders must hold companies to account.** The views of PLSA members express clear concerns about pay practices and the extent to which the asset managers who invest their money are holding companies to account. Asset managers should be mindful of the ordinary pension scheme members whose interests they ultimately represent. While the debate about the justification of high pay levels will continue, there is solid evidence that top pay levels have increased at a much greater rate than returns to shareholders or other performance indicators.[9] It is surprising that shareholders have allowed this to happen. The number of companies experiencing significant dissent shows that many shareholders are acting as responsible stewards of their investments. Failure to hold remuneration committee chairs to account, and the small number of cases where controversial pay awards or policies were actually defeated suggests that many are not.

3) **Pay policies must address the size of CEO pay packages, as well as their structure.** Our 2013 principles of executive remuneration, stating that pay policies should be transparent, understandable and aligned with shareholder and company interests over the long-term. These principles remain valid. However, the paper did not comment on the size of executive pay packages – and nor has the latest investment industry proposal published by the Investment Association working group. The issues of the value of CEO pay packages and the huge pay gap between

[9] See for example, Income Data Services, Executive Remuneration in the FTSE 350 – a focus on performance-related pay, 2014, p7

executives and ordinary workers has become of considerable societal interest. Whether or not such high pay levels are justifiable from a business perspective is also subject to considerable debate. Of the eight FTSE 100 companies to pay over £10 million in 2015, four were also amongst those that experienced significant remuneration-related dissent, which is indicative of investor concern regarding the value of pay awards, as well as their structure.[10] The results of the PLSA survey emphasises the strong concerns of UK pension funds in this regard. It now follows that these concerns should be acted upon.

4) **As a key stakeholder in this debate and industry representative, the PLSA needs to reflect the concerns and interests of pension funds.** This report highlight ongoing problems with executive pay practices and clearly demonstrates the concerns of pension funds in relation to the pay levels at the companies they invest in and the stewardship activities of the asset managers that manage those investments. As industry body for UK pension funds, the PLSA plays a role in supporting good practice through resources such as our corporate governance policy and voting guidelines for resolutions at company AGMs and our 'aide de memoir' crib sheet, providing questions that pension funds can ask their prospective asset managers about their stewardship activities when awarding mandates. We intend to update both of these documents to reflect the evidence found in this report.

[10] High Pay Centre, *10% pay rise? That'll do nicely*

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

NEXT STEPS

The PLSA Corporate Governance Code and Voting Guidelines are reviewed annually. The 2016/17 iteration will be published shortly, incorporating the findings of the AGM report. The guidelines have since 2013 reflected in detail how our 'principles of executive remuneration' might be applied in practice. However, the principles do not directly address the issue of the size of executive pay packages in absolute terms, rather than in relation to performance. In line with the findings of our member survey and more qualitative discussions with PLSA members, our revised guidelines will emphasise the fact that our members consider current pay packages – in general – to be too high and the imperative to address this issue, in addition to any problems with structure and link to long-term performance.

We will also look to introduce stronger recommendations into the guidelines on the re-election of remuneration committee chairs, in order to remedy the disconnect between votes against pay practices and those against the individuals responsible for overseeing them. This increased accountability can encourage those individuals to ensure their companies are more responsive to shareholder dissent.

Once published, the guidelines will be circulated to all leading UK companies, as well as other key stakeholders from across the corporate governance world. By strengthening our clear, prominent, evidence-based position on executive pay, the PLSA can help to resolve the on-going problems identified in this report.

The PLSA will also continue to provide resources for our members on an ongoing basis via our 'Stewardship Central' website helping them to ensure that the companies in which pension savers' money is invested adopt responsible pay practices. We are particularly keen to support the asset management industry in holding companies to account over executive pay and currently host Stewardship Disclosure Frameworks, providing our members with a concise insight into different asset managers' approach to stewardship, and our 'aide de memoir' crib sheet, providing questions that pension funds can ask their prospective asset managers about their stewardship activities when awarding mandates. We constantly assess and review these resources and consider how they can be improved and promoted.

As ever, we welcome advice and partnership in this work, and invite any interested stakeholders to contact Luke Hildyard, Policy Lead for Stewardship and Corporate Governance via luke.hildyard@plsa.co.uk.