

**Executive Remuneration: Discussion Paper.  
Response form**

Please send your response by: 25 Nov 2011

About You	
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I am responding on behalf of (please tick)	
	<b>Quoted company</b>
	<b>Other company</b>
<b>[TICK]</b>	<b>Investor or investment manager</b>
	<b>Business representative organisation</b>
	<b>Investor representative organisation</b>
	<b>Non governmental organisation (NGO)</b>
	<b>Trade Union</b>
	<b>Lawyer or accountant</b>
	<b>Other (e.g. consultant or private individual)</b>

## About this submission

This submission represents the joint views of the Church of England Ethical Investment Advisory Group (EIAG)<sup>1</sup> and the Church of England national investing bodies.<sup>2</sup> The submission should be regarded as an asset owner response.

## Introductory comments

The EIAG and national investing bodies welcome the BIS review of executive remuneration. The national investing bodies vote their shares in-house rather than delegating this responsibility to external fund managers and draw on the advice of the EIAG in doing so. The EIAG and national investing bodies have long taken seriously their responsibility as shareholders to examine executive remuneration arrangements at investee companies. They actively vote and engage on the issue.

The EIAG and the national investing bodies support competitive salaries for senior executives, commensurate to the heavy responsibilities involved. They also support variable remuneration which genuinely rewards the successful growth of the business and aligns the interests of executives, shareholders and wider society. Successful businesses, mindful of their shareholders and all their stakeholders, make a huge contribution to society. High performing executive directors play an essential role in successful businesses.

The EIAG and national investing bodies do, however, have concerns about the present functioning of executive remuneration in the UK. This concern is grounded in our support for the highest standards of corporate governance in the interests of shareholders. It is also informed by our theological view of what makes for a good society.

The EIAG is concerned about excessive remuneration, including in particular variable remuneration (both short-term bonuses and long-term incentive plans). On the EIAG's advice, national investing body voting is principally determined by the relationship between fixed and variable remuneration. The EIAG's view is that remuneration schemes with potential variable remuneration in excess of 300% of fixed remuneration may drive excessive

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<sup>1</sup> The Church of England Ethical Investment Advisory Group (EIAG) makes recommendations on ethical investment policy to the Church of England's national investing bodies. The EIAG and its Secretariat also conduct engagement and proxy voting activities on behalf of the national investing bodies. Seven of the voting members of the EIAG are nominated by the national investing bodies, the General Synod, the Archbishops' Council and the Council for Mission and Public Affairs. The remaining three voting members are co-opted for their experience of investment and business. Further information can be found at [www.churchofengland.org/about-us/structure/eiag](http://www.churchofengland.org/about-us/structure/eiag).

<sup>2</sup> There are three Church of England national investing bodies: the Church Commissioners for England, the Church of England Pensions Board and the CBF Church of England Funds. They have combined assets in the order of £8bn.

returns to executives and usually merit an abstention on a remuneration report; and that potential variable remuneration in excess of 400% of fixed remuneration usually merits a vote against a remuneration report. The three national investing bodies support only about a quarter of UK remuneration reports<sup>3</sup>.

The EIAG recognises that its metric is crude – especially when fixed remuneration is deliberately set low – and so discretion is exercised where appropriate. We also recognise that the drivers of growing executive remuneration are complex. We are currently undertaking a review of our approach to executive remuneration and will publish our thinking in due course.

In the meantime, the EIAG has not considered as a group all of the ideas for improving executive remuneration covered in this consultation and is not therefore in a position to comment across the piece, particularly on some of the more novel ideas floated.

Responses to individual questions follow. Running through our submission is our view that active and effective shareholder oversight and approval is essential if there is to be proper supervision of executive remuneration at listed companies. Our key request is that executive remuneration be made subject to a binding shareholder vote.

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<sup>3</sup> Further information on national investing body voting on executive remuneration can be provided on request. The corporate governance policy which is followed can be found at: [www.churchofengland.org/media/1289056/corporate%20governance%202010.pdf](http://www.churchofengland.org/media/1289056/corporate%20governance%202010.pdf).

The CBF Church of England Funds are taking part in the pilot phase of the Church Investors Group's (CIG's) UK voting initiative that was developed by the Central Finance Board of the Methodist Church and CCLA in association with PIRC. The CIG voting template also takes into account the quality of disclosure in the remuneration report and contractual termination payments, and can extend to withholding support from non-executive members of a board's remuneration committee.

## Questions

### Role of shareholders

1. Would a binding vote on remuneration improve shareholders' ability to hold companies to account on pay and performance? If so, how could this work in practice?

Yes	No
[TICK]	
Comments	
<p>The EIAG and national investing bodies believe that shareholders have a responsibility to be active owners of the companies in which they invest and companies have a responsibility to be responsive to their shareholders. This applies across the piece, and not just on executive remuneration.</p> <p>While UK companies generally respond well where a significant proportion of shareholders express concern about remuneration, this is not always the case. We believe that making the shareholder vote on remuneration binding would change the dynamic of company discussions with shareholders on remuneration and we support this change.</p> <p>The remuneration report on which the binding vote takes place should make clear the key performance indicators whose achievement the remuneration plan is seeking to incentivise. The shareholder vote should be on remuneration and long-term strategy, and the linkages between the two.</p> <p>We are supportive of the remuneration of directors, and the vote on remuneration, being placed in the context of remuneration in the firm as a whole, including disclosure of pay ratios (such as highest to median) and numbers of staff within different pay bands<sup>4</sup>.</p> <p>Companies and shareholders could use the current advisory vote on remuneration more effectively and both would need to work at making a relationship based on a binding vote effective. It is not enough for</p>	

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<sup>4</sup> The Church Commissioners already disclose staff numbers in different pay bands and will in addition disclose ratios of highest paid to other staff in their 2011 annual report.

**government to create mechanisms to empower company-shareholder relations; companies and shareholders need to use these mechanisms.**

2. Are there any further measures that could be taken to prevent payments for failure?

Yes	No
[TICK]	
Comments	
<p><b>Reward for failure is a major concern for the EIAG and the national investing bodies. We would support a tougher regime under which there would have to be a binding shareholder vote on <i>all</i> compensation payments proposed to be made by companies to executives whose employment is terminated on grounds of unsatisfactory performance.</b></p>	

3. What would be the advantages and disadvantages of requiring companies to include shareholder representatives on nominations committees?

Comments
<p><b>This is not a proposal that we have specifically considered, although, as noted already, we emphasise the need for active shareholder approval of key decisions at investee companies – this includes the appointment of directors.</b></p>

## Role of remuneration committees

4. Would there be benefits of having independent remuneration committee members with a more diverse range of professional backgrounds and what would be the risks and practical implications of any such measures?

Yes	No
Comments	
<p><b>This is not a proposal that we have specifically considered, although we do welcome diversity on both boards in general and on remuneration committees specifically.</b></p> <p><b>It is important that remuneration decisions are not made largely on the basis of consultancy advice narrowly based on what peers are paying. Remuneration committees should acknowledge that executives also have non-financial motivations which need to be taken into account and nurtured. Broad-based membership of remuneration committees ought to be positive in both regards. But whatever the membership of remuneration committees, it is essential that shareholders exercise full oversight of their proposals.</b></p>	

5. Is there a need for stronger guidance on membership of remuneration committees, to prevent conflict of interest issues from arising?

Yes	No
Comments	
<p><b>This is not an issue that we have specifically considered.</b></p>	

6. Would there be benefits of requiring companies to include employee representatives on remunerations committees and what would be the risks and practical implications of any such measures?

Yes	No
Comments	
<b>While we very much support inclusive employee relations, this proposal is not one that we have specifically considered.</b>	

7. What would be the costs and benefits of an employee vote on remuneration proposals?

Comments
<b>Again, this is not an idea that we have specifically considered.</b>

8. Will an increase in transparency over the use of remuneration consultants help to prevent conflict of interest or is there a need for stronger guidance or regulation in this area?

Yes	No
[TICK]	
Comments	
<p><b>The EIAG and national investing bodies support increased disclosure to shareholders of advice received from remuneration consultants. The advice that has been taken into account in reaching remuneration decisions needs to be transparent to shareholders if shareholders are to judge the appropriateness of the decisions and decide whether they merit support. We also support the disclosure of fees paid to remuneration consultations.</b></p>	

## Structure of remuneration

9. Could the link between pay and performance be strengthened by companies choosing more appropriate measures of performance?

Yes	No
[TICK]	
Comments	
<p><b>Our policy on remuneration, the link between pay and performance, and appropriate measures of performance<sup>5</sup> is that:</b></p> <ul style="list-style-type: none"> <li>• <b>packages should be sufficient to recruit, retain and motivate without excess</b></li> <li>• <b>there should be full disclosure of remuneration schemes, including the maximum potential value of awards, and the performance criteria attached</b></li> <li>• <b>schemes should reward superior performance</b></li> <li>• <b>performance targets should be stretching and comprise two performance criteria</b></li> <li>• <b>awards under individual schemes should not usually exceed 100% of salary</b></li> <li>• <b>a multiplicity of incentive schemes may result in potentially excessive awards</b></li> <li>• <b>transaction bonuses and the re-pricing of options should be resisted</b></li> <li>• <b>one-off awards should be disclosed and justified</b></li> <li>• <b>discretionary share options should not be offered at a discount</b></li> <li>• <b>ideally performance periods should be 5 years, and not less than 3</b></li> </ul>	

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<sup>5</sup> This policy was enumerated in, and has been applied since, 2005, with a revision in 2010, primarily to allow for a move from domestic to global voting. It is currently under review.

years

- **bonus schemes should allow for claw back if it transpires that awards have been made for actions that have undermined the long-term success of the business.**

**We are concerned that share price-related metrics are over-used and can be poor proxies for the contribution of executives to the long term success of a business.**

**We generally favour:**

- **no award being made if any one of the baseline performance targets is not achieved;**
- **at least one metric being assessed relative to a peer group;**
- **awards being made on the basis of non-financial as well as financial metrics.**

10. Should companies be encouraged to defer a larger proportion of pay over more than three years?

Yes	No
[TICK]	
Comments	
<b>See answer to Q9 above; our view is that ideally performance periods should be five years.</b>	

11. Should companies be encouraged to reduce the frequency with which long-term incentive plans and other elements of remuneration are reviewed? What would be the benefits and challenges of doing this?

Yes	No
	[TICK]
Comments	
<p><b>Flexibility to amend deficient remuneration schemes is important but must always be exercised in consultation with shareholders and the reasons for change fully disclosed. The vote on the remuneration report is the appropriate occasion for shareholders collectively to express their view on the change. Changes must not leave multiple schemes running at the same time leading to confusion among executives about what they are expected and being incentivised to achieve.</b></p>	

12. Would radically simpler models of remuneration which rely on a directors' level of share ownership to incentivise them to boost share value, more effectively align directors with the interests of shareholders?

Yes	No
Comments	
<p><b>Remuneration committees should certainly consider as part of their duties whether a simple remuneration scheme might work as effectively as or more effectively than a complicated one. Complexity needs to be justified. Remuneration reports must be capable of being readily absorbed and analysed if shareholders are to exercise the</b></p>	

**effective oversight that is essential for good corporate governance.**

**The EIAG and national investing bodies are certainly supportive of a significant proportion of remuneration being in shares.**

13. Are there other ways in which remuneration - including bonuses, LTIPs, share options and pensions – could be simplified?

Yes	No
Comments	
<b>We have no further comments.</b>	

14. Should all UK quoted companies be required to put in place claw-back mechanisms?

Yes	No
<b>[TICK]</b>	
Comments	
<b>See answer to Q9 above; our view is that bonus schemes should allow for claw-back if it transpires that awards have been made for actions that have undermined the long-term success of the business and harmed shareholders.</b>	

## Promoting good practice

15. What is the best way of coordinating research on executive pay, highlighting emerging practice and maintaining a focus on the provision of accurate information on these issues?

Comments
<p><b>There may be merit in the establishment of an independent body to co-ordinate research and promote good practice given the current lack of definitive research on what does and does not work in executive remuneration. Such a body could help focus company, shareholder, consultancy and public debate.</b></p>

Church of England Ethical Investment Advisory Group and national investing bodies

25 November 2011